

1                               BEFORE THE WASHINGTON UTILITIES AND  
   TRANSPORTATION COMMISSION  
 2   WASHINGTON UTILITIES AND            )  
   TRANSPORTATION COMMISSION,        )  
 3    )  
                           Complainant,    )  
 4    )Docket No. TO 011472  
                           vs.                )Volume 30  
 5    )Pages 3517 - 3783  
   OLYMPIC PIPELINE COMPANY, INC.,)  
 6    )  
                           Respondent.     )

7  
 8                    A hearing in the above matter was held on June  
 9   28, 2002, at 9:30 a.m., at 1300 South Evergreen Park  
 10   Drive Southwest, Room 206, Olympia, Washington, before  
 11   Administrative Law Judge ROBERT WALLIS, CHAIRWOMAN  
 12   MARILYN SHOWALTER, COMMISSIONER RICHARD HEMSTAD, and  
 13   COMMISSIONER PATRICK OSHIE.

14                    The parties were present as follows:

15                    THE WASHINGTON UTILITIES AND TRANSPORTATION  
 16   COMMISSION, by DONALD T. TROTTER, Senior Assistant  
 17   Attorney General, and LISA WATSON, Assistant  
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Deborah L. Cook  
 Court Reporter

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JUDGE WALLIS: Let's be on the record, please, for our Friday, June 28, 2002 session in the matter of Commission Docket TO 0011472.

A couple of procedural matters today. We're going to hear George R. Ganz first, a witness for Olympic, and then we will move to Mr. Means, who is a witness for Tosco.

Their schedules preclude their appearance later in the process, and we are accommodating their appearance today.

The parties have earlier -- those who chose to submit outlines have done so, and we have asked the parties to review those outlines in light of each other's suggestions, and the process so far in the hearing, and we will talk about those on Tuesday morning.

We will set an administrative conference for the discussion about the outline. This is an outline for briefs. Briefs will be simultaneous following the proceeding. And in order to assist the parties in making their best presentation and assist the Commission in understanding and evaluating the presentations, we ask that parties

1 follow the common outline.

2 We will be talking about that, determining  
3 it, and hope, by the end of the proceeding -- and  
4 will, by the end of the proceeding, have the common  
5 outline for people to follow.

6 There was a pending matter from yesterday  
7 before we move on for today's process, that was a  
8 motion in limine by Tesoro, to which Olympic  
9 responded. We had some discussion about that last  
10 night.

11 The Commission deliberated upon it, and  
12 grants Mr. Brena's motion. The Commission rules  
13 that RPC 3.7 is applicable in this situation, and  
14 believes it is a good rule in this situation for the  
15 reasons cited in the parties' arguments.

16 Mr. Beaver's testimony does not fall within  
17 the exception to the rule. It does not relate to  
18 uncontested issues. Other parties do contest the  
19 issues on which the testimony would bear. Olympic  
20 admits the testimony relates to issues that are not  
21 a mere formality as it argues it would suffer  
22 hardship if the testimony was not accepted.

23 Finally, olympic cannot demonstrate that  
24 the likelihood of Mr. Beaver's appearance was not  
25 reasonably foreseeable before trial, as his evidence

1 was prefiled a number of months before he entered an  
2 appearance as counsel in this docket.

3 Olympic may choose to present Mr. Beaver,  
4 and he may choose to appear as a witness. If he  
5 does appear as a witness, first his testimony may  
6 not be withdrawn after he appears as a witness.  
7 Second, if he is asked questions as a witness, he  
8 may not respond as a lawyer. In other words, he  
9 cannot assert attorney-client privilege as to  
10 matters that are within the scope of his testimony.  
11 And three, he may not continue to represent the  
12 company in this proceeding.

13 Do the Commissioners have anything  
14 additional to add? Are there any questions?

15 MR. BEAVER: No.

16 JUDGE WALLIS: All right. At this point we  
17 are going to take up the examination of Mr. Ganz.  
18 And I understand that there is a new face as counsel  
19 table for Olympic. Is that right, Mr. Beaver.

20 MR. BEAVER: Although for me an old face --  
21 Mr. Art Harrigan, to my left, will be presenting the  
22 testimony of Mr. Ganz. Art Harrigan is, and has  
23 been for sometime, Olympic's chief civil defense  
24 attorney. He is a partner of Tim Leyh, who you have  
25 already met, and he is a principal in the law firm



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1 in Danielson Harrigan and Tollefson in Seattle.

2 JUDGE WALLIS: Thank you very much, Mr.  
3 Beaver.

4 Mr. Harrigan, could you state your name and  
5 your business address, and communication access,  
6 telephone, fax numbers, for the record, please, and  
7 we will ask you to speak directly into these  
8 microphones. A good test on whether everyone else  
9 can hear you is whether you can hear yourself  
10 through the speakers as you are speaking.

11 MR. HARRIGAN: Thank you. My name is Art  
12 Harrigan. Address is 999 Third Avenue, Suite 4400,  
13 Seattle, Washington, 98101. Telephone is  
14 (206) 623-1700.

15 JUDGE WALLIS: Thank you very much. At  
16 this time Olympic has called George R. Ganz to the  
17 stand. I'm going to ask Mr. Ganz to stand and raise  
18 your right hand, please.

19  
20 GEORGE R. GANZ,  
21 produced as a witness in behalf of Olympic Pipeline,  
22 having been first duly sworn, was examined and testified  
23 as follows:

24

25 JUDGE WALLIS: In conjunction with

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1 Mr. Ganz' appearance, some exhibits have been  
2 premarked at the administrative conference on June  
3 13 of this year. Those are Exhibits 1101-T through  
4 1105, and consist of his rebuttal testimony and  
5 qualifications, and proposed exhibits on cross  
6 examination.

7 In addition, the company has distributed  
8 this morning, several documents that relate to his  
9 testimony. One is an errata sheet, and there are  
10 two others.

11 Mr. Harrigan, would you help identify  
12 those, and we will assign numbers.

13 MR. HARRIGAN: Yes, Your Honor. First of  
14 all, there is the errata sheet.

15 JUDGE WALLIS: We will mark that as 1106  
16 for identification.

17 (EXHIBIT IDENTIFIED.)

18 MR. HARRIGAN: Then we have the financial  
19 statements of Olympic Pipeline Company with notes of  
20 December 31, 1998, of which exhibit -- cross  
21 examination Exhibit 1103 is a single page. And  
22 we're proposing that exhibit consisting of the  
23 balance of that document.

24 JUDGE WALLIS: That's 1107 for  
25 identification.

1 (EXHIBIT IDENTIFIED.)

2 MR. HARRIGAN: And lastly, we have the  
3 instructions for filing the FERC Form No. 6,  
4 Olympic's filing of Form No. 6 is Cross Examination  
5 Exhibit 1104, and we propose to include the  
6 instructions for filling out that form from the US  
7 Department of Energy.

8 JUDGE WALLIS: And we have marked that as  
9 Exhibit 1108 for identification.

10 (EXHIBIT IDENTIFIED.)

11 MR. BRENA: And there will be some  
12 objections with regard to the incorporation and use  
13 of these exhibits.

14 JUDGE WALLIS: Very well.

15 JUDGE WALLIS: Mr. Harrigan, you may  
16 proceed.

17 MR. HARRIGAN: Thank you, Your Honor.

18 JUDGE WALLIS: And I will ask you to bring  
19 that microphone up close. It's much easier to hear.

20

21 DIRECT EXAMINATION

22

23 BY MR. HARRIGAN:

24 Q Mr. Ganz, would you please state your full  
25 name?

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1 A My name is George R. Ganz.

2 Q What is your present position?

3 A I am a principal with Regulatory Economics  
4 Group, LLC.

5 Q Are you testifying today on behalf of  
6 Olympic Pipeline Company?

7 A Yes, I am.

8 Q Did you prepare Exhibits 1101-T and 1102 in  
9 connection with your testimony?

10 A Yes, I did.

11 Q And they are your testimony, and your  
12 qualifications, correct?

13 A That's correct.

14 Q Do you have any additions or corrections to  
15 make to your testimony?

16 A The corrections to my testimony are on the  
17 errata list that was just marked as Exhibit  
18 No. 1106.

19 Q And do you also intend to introduce  
20 Exhibits 1107 and 1108 that I just described?

21 A I believe so, yes.

22 Q With those corrections, additions, and  
23 additional exhibits, do you adopt the testimony and  
24 the exhibits as your own?

25 A Yes, I do.

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1                   MR. HARRIGAN: Okay. This witness is ready  
2 for cross examination.

3                   JUDGE WALLIS: Will you be moving the  
4 exhibits at this time?

5                   MR. HARRIGAN: Your Honor, that's entirely  
6 up to the way you want to proceed. I could do them  
7 after Mr. Ganz testifies about them, but I could  
8 move them at this time, if that's appropriate.

9                   JUDGE WALLIS: Please proceed.

10                  MR. BRENA: If I could speak briefly, I  
11 have objections to the use of these documents in  
12 this hearing. So I want to make clear that no party  
13 could have prepared their cross examination relative  
14 to those documents that have just been handed to us.  
15 And so I am going to move to strike any reference by  
16 this witness to any of these documents as we move  
17 forward, unless we address the issues of these now  
18 because I have no choice in the matter.

19                   I don't want these documents to be  
20 informally admitted because the witness takes  
21 opportunity to refer to them as we move forward.

22                  JUDGE WALLIS: Very well. Why don't we  
23 deal with that now.

24                  MR. HARRIGAN: Would you like me to  
25 respond, Your Honor?

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1 JUDGE WALLIS: Yes.

2 MR. HARRIGAN: First of all, 1107, as I  
3 mentioned, consists of Olympic's financial  
4 statements as of December 31, 1998. The Cross  
5 Examination Exhibit 1103 consists of one page of  
6 that document, a single page of the notes to those  
7 financial statements. This document contains the  
8 balance of the notes, the letter consisting of the  
9 report of the independent public accountant, and the  
10 financial statements themselves.

11 The primary purpose for introducing this  
12 exhibit is to include the balance of the notes to  
13 the financial statements, not just the single page,  
14 that was proposed as a cross examination exhibit.

15 For completeness, we have included the  
16 entire document. As I say, however, our purpose is  
17 not to put in the numbers, but to make sure the  
18 notes themselves are complete.

19 With respect to 1108, one of the cross  
20 examination exhibits, Exhibit 1104, is the FERC Form  
21 No. 6 submitted by Olympic Pipeline Company, which  
22 is this document right here, FERC form No. 6. And  
23 it is the year of report December 31, 2001. And we  
24 simply propose to introduce FERC Form No. 6  
25 instructions for completing the form.



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1 Mr. Harrigan?

2 MR. HARRIGAN: Not at this time, Your  
3 Honor.

4 JUDGE WALLIS: Very well.

5 MR. TROTTER: Thank you, Your Honor.

6

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CROSS EXAMINATION

8

9 BY MR. TROTTER:

10 Q Good morning, Mr. Ganz.

11 A Good morning.

12 Q You are not a CPA, are you?

13 A I am not a CPA. I have passed the CPA exam  
14 and studied accounting, but I am not a CPA.

15 Q Turn to page 4 of your testimony, Exhibit  
16 1101-T?

17 A Okay.

18 Q And on lines 11 through 16, is the purpose  
19 of this testimony to assert your opinion that when  
20 this Commission adopted the FERC Form 6 as its  
21 annual report for oil pipeline companies, that it  
22 adopted the FERC USoA?

23 A Yes. I think it's reasonable to assert  
24 that, based on the fact that the Form 6 has been  
25 adopted, and no other guidance on accounting has



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1       been promulgated.

2                   MR. TROTTER:  Your Honor, could we go off  
3       the record for a second?

4                   JUDGE WALLIS:  Yes.

5                               (Discussion off the record.)

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

7           Q     BY MR. TROTTER:  You note on lines 17 to 19  
8       that the Commission has adopted, expressly adopted  
9       the Uniform System of Accounts of FERC for gas and  
10      electric utilities.  Do you see that?

11           A     Yes.

12           Q     But the Commission, in its rule for gas  
13      utilities, did not use the same language that it  
14      used for the gas and electric utilities.  The rule  
15      for oil pipelines is not worded the same in terms of  
16      adopting the USoA as the Commission used for gas and  
17      electric utilities, correct?

18           A     That's correct.

19           Q     Did you examine the Rule Making Orders of  
20      the Commission when it adopted FERC Form 6 for oil  
21      pipeline annual reports?

22           A     I don't know if I have seen the Rule Making  
23      Order.  I looked at the portion of the  
24      Administrative Code that I have cited on line 12 of  
25      page 4.

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1           Q    Turn to page 5, lines 6 through 8 where you  
2           state, quote, "The accounting requirements of the  
3           USoA are consistent with generally accepted  
4           accounting principles, GAAP. In many respects, key  
5           differences exist," unquote. Do you see that?

6           A    Yes.

7           Q    Is the accounting for equity investments  
8           one of those key differences?

9           A    Yes, that is one.

10          Q    Would you agree that Olympic has no equity  
11          investments, and therefore, this difference is not  
12          relative to Olympic's books of account at this time?

13          A    I don't know if I can say one way or the  
14          other. I don't believe there's any reported in the  
15          Form 6, but I am not familiar enough with their  
16          history to say this never would have been relevant  
17          to them.

18          Q    My question was relevant at this time?

19          A    At this time, looking at documents, I would  
20          agree at this time it would not appear relevant. I  
21          don't know if there are any impacts that may appear  
22          today for things that may have been relevant in the  
23          past. But I note in their Form 6, they currently do  
24          not reflect any amounts that would be reported under  
25          the equity method.

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1 Q You just didn't investigate that for past  
2 periods, is that right, one way or the other?

3 A That's correct.

4 Q Is allocation of purchase price of the firm  
5 another key difference?

6 A There are specific provisions for recording  
7 the purchase of a portion of a system that is held  
8 as an undivided interest. Is that the portion you  
9 are referring to, or are you referring generically  
10 to any purchase?

11 Q Generic.

12 A The portion that I am aware of has to do  
13 with undivided joint interest investments, and how  
14 those would be recorded.

15 Q I am focusing on that. Are there  
16 differences between USoA and GAAP on in that area?

17 A I believe there are, yes.

18 Q There have been no such purchases involving  
19 Olympic, have there, so that distinction is not  
20 relevant here?

21 A None that I am aware of.

22 Q I would like to refer you to Exhibit 1104,  
23 which is Olympic's FERC Form 6 for the year 2001.  
24 Do you have that?

25 A Yes.

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1           Q    Turn to page 110 the comparative balance  
2   sheet statement.  And for the lines that Olympic has  
3   filled out on this sheet, can you identify any that  
4   use an accounting method required by FERC that is  
5   different from GAAP?

6           A    There are none that I am aware of.  But not  
7   knowing all of the backup for these amounts, I don't  
8   know if there's something there that I am just not  
9   aware of.  I did not investigate how these numbers  
10  came to be on here.  I relied on the fact that they  
11  filed these documents, but I haven't looked behind  
12  the numbers.

13          Q    Turn to page 111.  Same question, is there  
14  any entry on this page that would use an accounting  
15  method required by FERC which is different from  
16  GAAP?

17          A    (Looking at document.)  Yes.

18          Q    What is that?

19          A    The items on line 31, for account 31,  
20  accrued depreciation.

21          Q    And could you explain the difference  
22  between USoA and GAAP?

23          A    The difference that I have in mind relates  
24  to the recording of a transaction in which assets  
25  are sold.  At the time that an asset is sold under

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1 the USoA -- and I just discuss this in my  
2 testimony -- the asset transaction for the sale is  
3 recorded as a retirement, and any proceeds or  
4 salvage, gain or loss, is applied to the accumulated  
5 depreciation balance under the USoA.

6 Under GAAP, that would be recorded on the  
7 income statement.

8 Q Are you sure about your answer?

9 A I am fairly sure, yes.

10 Q Turn to page 113. Can you identify any  
11 entries on this page that would use an accounting  
12 method required by FERC that is different than GAAP?

13 A I think there are a few entries on this  
14 page that could potentially use a different method.  
15 I don't know if there is a different method that has  
16 been applied. But based on my understanding of how  
17 the FERC requires the accounting to be done, there  
18 certainly could be differences.

19 Q And do you know about them?

20 A I know of the nature of the differences in  
21 the accounting requirements. But whether these  
22 balances would reflect any of those differences, I  
23 don't know. I will say that the retained earnings  
24 number, for the same reason that the accumulated  
25 depreciation number would be different, I believe

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1 the retained earnings number would also bear a  
2 corresponding difference.

3 Q And finally, page 114, any difference in  
4 accounting requirements in the USoA that would be  
5 different from GAAP?

6 A On the surface, looking at the numbers,  
7 there's none that I can point you to. But there may  
8 be some underlying differences in how the numbers  
9 are compiled. Again, I haven't looked behind these  
10 numbers, nor was my testimony addressing  
11 specifically Olympic's numbers.

12 Q Turn to Exhibit 1103, which is an excerpt  
13 from the 1998 audited financial statement of  
14 Olympic. And looking at note 1, it states in the  
15 last sentence of the first paragraph, quote, "The  
16 accounting policies followed in preparation of these  
17 financial statements generally conform to those  
18 required by the FERC and are not materially  
19 different from generally accepted accounting  
20 principles," unquote. Do you see that?

21 A Yes, I see that.

22 Q Is that a correct statement, to the best of  
23 your knowledge?

24 A Having not prepared these financial  
25 statements, I am not sure I can tell you if it's

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1 correct or incorrect. But I can accept what it says  
2 here. But what it says here is the accounting  
3 policies are not material -- excuse me, are not  
4 materially different. It doesn't say that any  
5 individual number is identical under both policies.

6 Q But what it is saying is if they are not  
7 identical, the difference is not material?

8 A No. It says the accounting policies are  
9 not materially different. It doesn't say anything  
10 about the numbers.

11 Q So you could have an immaterial difference  
12 in an accounting policy, and a material difference  
13 in a number?

14 A I believe this references the accounting  
15 policy taken as a whole. It doesn't speak to any  
16 individual accounting policy. That's how I  
17 interpret it.

18 Q What is the value of this statement if, in  
19 fact, there would be a material difference in the  
20 amounts recorded due to differences in policy  
21 between FERC, USoA, and GAAP?

22 A I am not sure I can tell you what the value  
23 of the statement is. As I said, I didn't prepare  
24 these financial statements. I understand that they  
25 disclose significant accounting policies. It

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1 fulfills that requirement.

2 Q So in your opinion, a person reading that  
3 sentence should not understand that the financial  
4 results reported in the report are not immaterially  
5 different as between GAAP and FERC USoA. That would  
6 be a wrong inference to infer from this sentence?

7 A I don't think I can tell you one way or the  
8 other. I think it's significant that what this does  
9 say is, first, we conform to the FERC accounting  
10 requirements. And as a whole, they are not  
11 materially different. But it doesn't say they are  
12 the same, nor does it say, first and foremost we  
13 conform to GAAP.

14 Q Well, it doesn't say that it conforms to  
15 FERC. It says it generally conforms to those  
16 required by FERC, doesn't it?

17 A Those are the words. Yes.

18 Q Is it true, to your knowledge?

19 A I don't know of any reason to doubt it.  
20 They are subject to the FERC regulation, and the  
21 FERC accounting requirements.

22 Q But it doesn't say they conform to FERC  
23 requirements. It says, generally conform, doesn't  
24 it?

25 A As I said, those are the words. But I



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1       didn't prepare this document, so I can't tell you  
2       how that may or may not qualify what they are trying  
3       to communicate here.

4             Q     Well, you are an accountant, aren't you?

5             A     I have an accounting background. I don't  
6       do accounting for a living. I deal with accounting  
7       issues.

8             Q     As a person dealing in accounting issues,  
9       reading that sentence, you do not understand that to  
10      mean that the results in the financial statement to  
11      which this is attached, this Exhibit 1107, are not  
12      materially different had they been prepared  
13      consistent with GAAP versus USoA?

14            A     One might come to that conclusion, but I  
15      don't think that's what this statement says. I  
16      think this statement says the accounting policies,  
17      as a whole, generally are not materially different.  
18      But they have been following the FERC accounting  
19      guidelines.

20            Q     Well, let me ask again -- well, do you  
21      think this sentence is misleading?

22            A     I don't believe so.

23            Q     Do you think it's reasonable to interpret  
24      this sentence to mean that the financial results  
25      reported in the report would not be materially

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1 different had they been reported under the FERC USoA  
2 versus had they been reported under GAAP?

3 A I don't think this speaks to the results.  
4 I think this speaks to the accounting policies.

5 Q Accounting policies generate the results,  
6 don't they?

7 A The accounting policies would definitely  
8 play a role in how the results are depicted in the  
9 financial statements. But, again, I think this  
10 talks about the policies as a whole. It doesn't  
11 talk about any specific number.

12 Q Are the accounting policies of the USoA  
13 reflected in the Code of Federal Regulations that  
14 sets forth the USoA? In other words --

15 A That would be the primary source that I  
16 would look to, yes.

17 Q The regulations are the policies, aren't  
18 they?

19 A The regulations are the frame work for the  
20 policies. They include some specific direction as  
21 to how certain matters should be recorded, and they  
22 also prescribe a chart of accounts and provide  
23 definitions and instructions for using that chart of  
24 accounts.

25 They don't limit the policies at that level

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1 to specifics that can't be applied at a lower level  
2 of detail. There's more detail that can be applied  
3 by the company, but that is not specifically  
4 prescribed.

5 Q Let's turn to page 5 of your testimony,  
6 lines 9 through 14. You refer to FERC Order 620,  
7 where FERC updated the USoA to be more consistent  
8 with GAAP, but denied an oil pipeline industry  
9 initiative to shift to GAAP financial statements; is  
10 that correct?

11 A Yes.

12 Q Am I correct that the purpose of that rule  
13 making was to better meet current and future  
14 regulatory requirements and industry needs? That's  
15 one purpose. The other was to update USoA  
16 requirements to be more consistent with current  
17 generally accepted accounting principles? Do you  
18 understand that to be a purpose of the rule making?

19 A Those are two of the three that are  
20 identified on the face of the order.

21 Q And would you accept that the order stated,  
22 quote, "As stated in the Notice of Proposed Rule  
23 Making, this final rule updates the USoA regulations  
24 to reflect statements of financial accounting  
25 standards," unquote.

3544

1           A    Could you refer me to where you are looking  
2   at for that statement?

3           MR. TROTTER:   May I approach the witness?

4           JUDGE WALLIS:   Yes.

5           THE WITNESS:   (Reading document.)   That is  
6   what it says here.   It -- again, becoming more  
7   consistent with GAAP, and reflecting statements of  
8   financial accounting standards, I think helps with  
9   consistency with GAAP.

10           But I don't think this became entirely  
11   consistent with GAAP.   I don't know which statements  
12   of financial accounting standards this is  
13   specifically referring to, but I know there are some  
14   that are not currently being used by the FERC.

15           So I know that this was a statement in the  
16   order, but I don't think that you can look at this  
17   statement and say that all of the statements of  
18   financial accounting standards are applicable and  
19   may be applied by oil pipeline companies.

20           Q    Turn to page 7 of your testimony, and you  
21   are referring to Mr. Kermode's testimony here where  
22   he sets forth three criteria for application of FASB  
23   71.   Are you familiar with your testimony on that  
24   point?

25           A    Yes.

3545

1 Q Do you recall that he identified three  
2 criteria, all of which had to be met?

3 A Yes.

4 Q Do you agree that the first and third  
5 criteria have been met for Olympic, since you focus  
6 only on the second?

7 A (Reading document.) I agree that the first  
8 criterion is met. I think I would need to do some  
9 analysis to know whether or not the third criterion  
10 is met.

11 Q You haven't addressed the third criterion  
12 in your testimony, have you?

13 A No, I have not.

14 Q Let's focus on the second criterion, and  
15 you quote it on lines 4 through 6. Quote, "Rates  
16 are designed to recover the specific enterprise's  
17 costs of providing the regulated services or  
18 products," unquote. Do you see that?

19 A Yes.

20 Q So these refer to how the rates are  
21 actually designed for the firm, correct?

22 A I believe this refers to how the governing  
23 body that is mentioned in the first criterion would  
24 go about setting the rates.

25 Q How they do set the rates, correct, not how

3546

1 they might set the rates?

2 A I don't know if there is a distinction in  
3 my mind, between how they do and how they might --  
4 how the rates are set.

5 Q Let's focus on how the rates are set.  
6 Okay?

7 A Okay.

8 Q And on line 19, you state, "The required  
9 linkage between costs and rates is relevant only  
10 under the fourth rate filing approach." Do you see  
11 that?

12 A Yes.

13 Q So if Olympic's rates are set using the  
14 fourth rate filing approach, then the second  
15 criterion is satisfied. Is that what you mean to  
16 say here?

17 A What I mean to say here, and I am talking  
18 about the broader context of the discussion on this  
19 page, and in the context of why FASB 71 generally  
20 does not apply for oil pipelines regulated by FERC.  
21 There are four different approaches, and only one of  
22 the rate filing approaches would qualify as  
23 establishing a linkage between costs and rates.

24 But the rate filing approach that does  
25 qualify under that is not the default approach, and

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1 no pipeline is entitled to use that every time they  
2 go in to file rates.

3 When indexing -- every year when the index  
4 is issued, oil pipelines file index rates. If the  
5 index is reduced, the FERC goes out and pursues rate  
6 filings to see that all oil pipelines reduce their  
7 rates in compliance with the index. And that is  
8 something that they pursue, absent the company  
9 voluntarily coming in to do a rate filing.

10 So even if a pipeline had cost of service  
11 rates filed, if the index went down -- and it has  
12 done so at least as often as it has increased -- the  
13 FERC is going to be coming in looking for cost  
14 decreases. That is not a cost rate filing.

15 One time setting rates on the cost of  
16 service basis is, I don't think a strong enough  
17 event to qualify a company for treatment under FASB  
18 71.

19 Q The FERC adopted its indexes methodology in  
20 Order 651, did they not?

21 A Order 561.

22 Q And the FERC said in that order, quote,  
23 "The indexing method selected by the Commission in  
24 this final rule is cost based," unquote. Doesn't it  
25 say that?

3548

1           A    I don't have the order in front of me, but  
2   they said a lot of things in Order 561.  They said a  
3   lot of things in subsequent orders, and related  
4   orders.  They also -- give me just a moment.  In  
5   Order 561 there's a footnote that says, "Indexes  
6   foster efficiencies by severing the linkage under  
7   tradition cost of the service rate making between a  
8   pipeline's rate changes and changes in its current  
9   operating and investment costs."

10                 That right there says we're not tying rates  
11   to these specific enterprise's costs.

12                 CHAIRWOMAN SHOWALTER:  What footnote is  
13   that?

14                 THE WITNESS:  Footnote 37 in Order 561.

15           Q    BY MR. TROTTER:  Has Olympic ever filed a  
16   rate before this Commission that, in your opinion,  
17   was not cost of service rate?

18           A    I have not reviewed the filings before this  
19   Commission.

20           Q    Has Olympic ever filed at FERC a rate that  
21   was not designed to recover the specific  
22   enterprise's costs of providing the regulated  
23   services or products?

24           A    I have also have not reviewed the filings  
25   at FERC.  But as I mentioned before, there have



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1       been, I think, three years when the index has gone  
2       down. And if Olympic did not go in and file index  
3       rate reductions, the FERC would have come and asked  
4       them to.

5             Q     Do you know whether they did or not?

6             A     No. I know they did for other pipeline  
7       companies. I don't know if Olympic specifically  
8       did.

9             Q     If the rates that a firm files in a state  
10       jurisdiction are cost of service rates, in other  
11       words, the state does not permit indexes, but  
12       another jurisdiction does, does the firm need to  
13       comply with FASB 71 at the state level, in your  
14       opinion?

15            A     Could you tell me what you mean by, comply  
16       with FASB 71 at the state level?

17            Q     For purposes of -- financial reporting  
18       purposes?

19            A     I am still not clear on what you mean. The  
20       requirement, as I understand that this Commission  
21       has made part of the regulations, is to file Form 6  
22       here. Form 6 is a total company document. There is  
23       no breakdown of just the operations within the state  
24       here.

25                    So I don't think it's -- from a practical

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1       standpoint, it's possible for them to partially  
2       comply with FASB 71 for just operations within this  
3       state.

4           Q     But if a firm complied with FASB 71, would  
5       they be in violation of the USoA?

6           A     I don't think that you could comply with  
7       FASB 71 and conform with the USoA.

8           Q     Would you turn to page 12 of your  
9       testimony?

10          A     (Complies.)

11          Q     The issue of line lowering costs.  And it's  
12       your testimony that line lowering is an expense  
13       item, not a capital item; is that correct?

14          A     I am discussing a specific line lowering  
15       cost for this specific event.  And I believe this  
16       one does qualify as expense.

17          Q     And with respect to this specific event, is  
18       this specific event a line lowering that resulted  
19       from the result of pipeline being exposed as a  
20       result of storm water run-off?

21          A     That's my understanding.

22          Q     Let's assume that the same activity, the  
23       identical activity is performed on another section  
24       of the line, but it was done in response to mandate  
25       of a regulatory agency, and not a storm water

3551

1 run-off. Would that change your opinion on whether  
2 it is a capital item or expense item?

3 A I don't think I would have enough  
4 information with just that assumption to know.

5 Q What else would you need to know?

6 A I need to know more about what the specific  
7 activity entails.

8 Q But the activity is identical. The  
9 identical length of pipe is lowered in an identical  
10 fashion using the same equipment moving the same  
11 types of earth in the same way as the run-off  
12 location. The activity is in all respects  
13 identical, but the context is, instead of a storm  
14 water run-off context, it's a government mandate  
15 context or compliance -- well, I will stop there.

16 A I don't know. I haven't looked at that  
17 situation. I looked at the one Mr. Kermode had  
18 commented on.

19 Q You do agree that there is a benefit of  
20 lowering the line that extends over one year,  
21 correct?

22 A I will say there may be a benefit of that  
23 nature. But I don't look at this as an improvement.  
24 This is a repair. This restores the line to  
25 service. It doesn't put it into a better condition

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1 than it was in before the storm water run-off  
2 exposed it.

3 Q You don't think line lowering puts it in a  
4 better condition than it was before, in terms of,  
5 perhaps, having less of an incline on the pipeline  
6 to permit better transmission of the product, more  
7 efficient transmission of the product?

8 A When do you mean when you say "before"?  
9 Before the line lowering, or before the storm water  
10 run-off?

11 Q Before the line lowering.

12 A Before the line lowering, the line is in  
13 need of repair to be able to operate in the  
14 condition that it was in prior to being exposed.  
15 This is a repair. This is not an improvement.

16 Q If by lowering the line as a result of the  
17 storm water run-off, the efficiency of the line is  
18 improved because it has less of an incline, for  
19 example, so it doesn't have to push as hard, isn't  
20 that an improvement in the facility?

21 A If that is, it may be a consequence or an  
22 outcome of doing the line lowering. But I think  
23 that's incidental to the main purpose for which the  
24 line lowering is being done in the first place; to  
25 repair the line.

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1           Q    How do you know that?  How do you know that  
2   the water run-off was a cause of going to address a  
3   situation, and a decision was made in the overall  
4   context that it would be an efficient activity to  
5   lower the line at that point for efficiency purposes  
6   as well?

7           A    I am not sure I understand your question.

8           Q    Did you investigate the reason why, in that  
9   circumstance, the line was lowered?

10          A    Yes.  And my understanding is it was  
11   lowered because it became exposed due to the storm  
12   water run-off.

13          Q    And do you know whether a decision was made  
14   regarding the extent of lowering the line, that it  
15   would be cost effective at the time they were  
16   lowering the line to lower it to a degree that would  
17   also improve the efficiency of the line?  Did you  
18   investigate that?

19          A    No, I didn't.  But I would say if they did  
20   do something along those lines, it would be  
21   incidental to the fact that they had to lower the  
22   line to put the line back into it proper operating  
23   condition.

24          Q    Wouldn't the incidental nature depend on  
25   the magnitude of line lowering required by storm

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1 run-off, versus line lowering that might have been  
2 occasioned by being able to lower the line  
3 efficiently at that time?

4 A It may. But, again, the need for this  
5 activity to happen was to repair the line. If there  
6 was some improvement that happened, there are other  
7 accounting requirements that might come in to play  
8 to determine whether or not there was -- any of the  
9 costs that should be capitalized. But for line  
10 lowering, as a general activity, it's a repair to  
11 the line.

12 Q There are times when repair costs are  
13 capitalized, aren't there?

14 A There are times. Generally that would  
15 involve whether there's a replacement that improves  
16 the line, versus simply a repair.

17 Q Do you agree with FASB Statement of  
18 Financial Accounting Concept, No. 6 that states,  
19 Assets that yield their benefits over several  
20 periods -- "For assets sets that yield their assets  
21 over several periods, expenses should be allocated  
22 to the periods they benefit."

23 A Well, I haven't reviewed that specific  
24 statement recently. But I think when you are  
25 looking at an asset that you are constructing or

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1 improving, that's what that statement would apply  
2 to.

3 Q Do you agree that regulatory theory  
4 requires that expenses that affect more than one  
5 period should be allocated over those periods so  
6 that rate payers only pay the costs associated with  
7 their usage?

8 A I would agree that that is sometimes the  
9 major consideration.

10 Q Beginning on page 14 of your testimony, you  
11 discuss AFUDC, and your discussion continues over  
12 several pages. AFUDC is the accounting for the  
13 carrying cost of plant under construction; is that  
14 correct?

15 A Yes, I would agree with that.

16 Q And it's your testimony that it would be  
17 improper for Olympic to record AFUDC on its books  
18 and records; is that correct?

19 A Yes.

20 Q The Uniform System of Accounts does not  
21 prohibit AFUDC from being accrued, does it?

22 A It doesn't explicitly prohibit it. But I  
23 would say in the gas and electric Uniform System of  
24 Accounts, there are specific provisions for AFUDC  
25 with very detailed instructions. There is no

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1 parallel instruction for oil pipelines.

2 And the FERC has acknowledged that AFUDC,  
3 the equity portion of AFUDC is not recorded on oil  
4 pipelines' balance sheets.

5 Q Well, some oil pipelines, in fact, record  
6 AFUDC, do they not?

7 A I am not aware of any oil pipelines under  
8 the FERC jurisdiction that would record AFUDC on  
9 their balance sheet.

10 Q Are you sure about that?

11 A I am sure.

12 Q Have you reviewed other pipelines that are  
13 managed by BP Pipelines?

14 A I may have in the course of my career.  
15 Do you have some specifically --

16 Q I guess, is it your testimony that no  
17 company operated by BP Pipelines records AFUDC on  
18 its books?

19 A I will say no oil pipelines regulated by  
20 the FERC record AFUDC on their balance sheet when  
21 they are recording their financial information under  
22 the Uniform System of Accounting in the Form No. 6.

23 Q Turn to page 20 of your testimony. And you  
24 indicate in the top two lines that the USoA provides  
25 specifically for oil pipelines to capitalize



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1 interest during construction. Do you see that?

2 A Yes.

3 Q In fact, Olympic does not capitalize  
4 interest during construction, does it?

5 A I don't know. I haven't reviewed that  
6 portion of the capitalization policy.

7 Q You go on to say that the debt portion of  
8 AFUDC is similar conceptually to interest during  
9 construction. Do you see that?

10 A Yes.

11 Q In fact, Olympic does not capitalize the  
12 debt portion of AFUDC, does it?

13 A As I said, I haven't reviewed that portion  
14 of the capitalization policy, so I can't tell you.

15 Q Are you familiar with any FERC orders or  
16 points that expanded the definition of cost of  
17 construction to include AFUDC?

18 A I am aware that FERC has described AFUDC as  
19 a cost of construction. That was not an accounting  
20 order, and I don't think it would be within a  
21 reasonable interpretation of the USoA to expand that  
22 definition to extend to the accounting regulations.

23 Q So at the bottom of line 19 when you are  
24 referring to opinion 351, "FERC affirmed its intent  
25 to allow oil pipelines to recognize AFUDC as a

3558

1 component of construction costs." It's your  
2 testimony that that is only for rate making  
3 purposes?

4 A Yes.

5 Q On page 28 of your testimony, you are  
6 addressing Staff's proposal to use the test period  
7 of year ended December 31st, 2001. Do you see that?

8 A Yes.

9 Q Are you aware that the company is proposing  
10 to change the test period to year-end September 30,  
11 2002, using actual results -- generally speaking,  
12 using actual results through April 2002, budgeted  
13 results for May and June 2002, and estimates for  
14 July through September 2002?

15 A I think we might be getting into some  
16 terminology and semantics here. The base year that  
17 was reflected in Mr. Collins' calculations is  
18 consistent with what I understand this Commission  
19 describes as a test period. And I believe that  
20 period, as reflected by Olympic, was October 2000  
21 through September 2001.

22 Q And do you understand that the results of  
23 operations that they are now relying on is based on  
24 actual results from September 30, 2002 through April  
25 2002, budgets for May and June of 2002, and

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1 estimates for July through September 2002?

2 A I understand it's been described that way.

3 I am not sure that I have focused on it closely  
4 enough to know if I agree with that characterization  
5 of it. But I listened to Mr. Collins' testimony,  
6 and I heard the questions and the answers.

7 Q Is it your testimony that the company has  
8 provided compelling reasons to file its rebuttal  
9 case the way it has?

10 MR. HARRIGAN: Objection; vague. I don't  
11 know what "filed the rebuttal case the way it has"  
12 means.

13 MR. TROTTER: Filed the rebuttal case in  
14 the manner I described, the budgets -- actual, plus  
15 budgets, plus estimates.

16 JUDGE WALLIS: The witness may respond.

17 THE WITNESS: I don't believe I have  
18 commented on that in my testimony. My discussion  
19 here is talking about the test period as this  
20 Commission uses the term. This is the historical  
21 period October 2000 to September 2001.

22 Q BY MR. TROTTER: You understand that the  
23 pipeline was virtually shut down until the  
24 mid-summer of 2001?

25 A I understand that they have been operating

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1 at reduced pressure, and have not been operating  
2 over the past several years, even at the level that  
3 they are operating today.

4 Q Well, let's be more precise. They only  
5 returned to 80 percent pressure in July 2001, is  
6 that correct, or mid-summer of 2001?

7 A I would agree generally with that time  
8 frame, but I don't know specifically.

9 Q Do you have any opinion as to whether  
10 results of operations during the time of substantial  
11 shutdown, prior to the 80 percent pressure  
12 resumption are representative of ongoing operations  
13 for Olympic?

14 A I don't have specific knowledge of it. But  
15 I would imagine that that would not be  
16 representative of what would be considered today, or  
17 even as of December when the direct case was filed,  
18 what was contemplated as normal operations for the  
19 foreseeable future.

20 Q In your opinion, is six months of actual  
21 operations under 80 percent pressure better than  
22 three months of actual operations under 80 percent  
23 pressure?

24 A Better for what purpose?

25 Q For determining what normal operations are

3561

1 for that 80 percent pressure condition?

2 A Well, I think the more time that you have  
3 actual results operating as the system will be when  
4 the rates are in effect, that would be better.

5 I think Olympic's rebuttal case, as you  
6 say, using actuals for an additional four months, by  
7 the same token, should provide even better basis for  
8 having some operating results that would be more  
9 likely to provide representative levels of  
10 operations going forward.

11 Q And my question is simply, you have  
12 criticized the Staff for doing what you are now  
13 commending the company for?

14 MR. HARRIGAN: Objection; we're well beyond  
15 the scope of the witness' direct testimony, and I  
16 have not objected to that. But it's obvious that  
17 saying he's criticizing the Staff when he didn't  
18 submit anything on this issue in his direct  
19 testimony is an incorrect statement.

20 MR. TROTTER: He criticizes the Staff  
21 directly. He says he does not believe Staff has  
22 presented a compelling reason to project the test  
23 period Olympic has reflected. And he's just  
24 acknowledged that the company was -- it was  
25 appropriate for the company to file even more recent

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1 data.

2 So I am suggesting the criticism in his  
3 testimony is inappropriate.

4 JUDGE WALLIS: The objection is overruled.

5 MR. TROTTER: I will move on.

6 Q BY MR. TROTTER: Turn to page 8 of your  
7 testimony. And you are talking about the sale of  
8 the Sea-Tac terminal. And on line 13 you indicate  
9 that Mr. Twitchell asserted that Olympic's  
10 adjustment for the sale does not reflect correct  
11 accounting, and based on his assertion, recommended  
12 different rate base adjustments for this  
13 transaction. Do you see that?

14 A Yes.

15 Q Are you aware that Ms. Hammer, in her  
16 rebuttal testimony, agreed with Mr. Twitchell and  
17 adjusted the data she provided Mr. Collins to use  
18 the dollar amount booked to the plant account from  
19 3,645,000 to \$6,814,365?

20 A I have reviewed Ms. Hammer's testimony. I  
21 don't remember that discussion specifically, but my  
22 recollection is that she did not agree with the  
23 dollar amount that Mr. Twitchell had used, that  
24 there may have been some discrepancies in the  
25 facilities that he had included versus what they

3563

1 actually sold.

2 But I understand that the numbers have been  
3 updated from what was included in the direct case,  
4 which were estimates at the time because the sale  
5 was not final.

6 Q And the numbers she gave Mr. Collins for  
7 the adjustment, \$6,814,365 is the same number  
8 Mr. Twitchell uses; is that correct?

9 A My recollection is that there was some  
10 small difference between the numbers, but it was  
11 generally about 6.8 million dollars. As I said,  
12 it's been a while since I reviewed Ms. Hammer's  
13 testimony. Perhaps there is no discrepancy.

14 Q Does it refresh your recollection to learn  
15 that there was a \$10 difference between the figures?

16 A I don't know if I ever knew the specific  
17 dollar amount. I think I say in my testimony that  
18 the values don't appear to be materially different.

19 Q On line 19, in referring to trended  
20 original cost methodology, you state that you do not  
21 believe there is anything about that methodology  
22 that implies the need for Olympic to obtain an  
23 accounting order from the Commission. Do you see  
24 that?

25 A I am sorry. What page.

3564

1 Q 22, lines 19 through 21?

2 A (Reading document.) Yes, I see that.

3 Q In making that statement, did you review  
4 any of this Commission's orders on when an  
5 accounting order is required for a public service  
6 company under its jurisdiction?

7 A No, I did not. I was relying on my  
8 understanding of the trended original cost  
9 methodology, and how the FERC applies it.

10 Q And when you use the term "Commission" on  
11 line 21, are you referring to FERC or the WUTC?

12 A I am referring to this Commission.

13 Q Did you review Ms. Omohundro's deposition  
14 testimony regarding deferred accounting petitions?

15 A No, I did not.

16 Q On page 23, lines 5 through 13, you  
17 indicate that Mr. Twitchell stated that Olympic does  
18 not record the starting rate base on its books. Do  
19 you see that?

20 A Yes.

21 Q He's correct, isn't he?

22 A Yes.

23 Q He also stated that Olympic had not  
24 provided testimony to support that the SRB write-up  
25 is an appropriate adjustment for rate making under



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1       either the FERC or WUTC methodologies. Was he  
2       correct in that statement?

3             A    I --

4             Q    And he's referring to the direct case,  
5       obviously.

6             A    I don't know if I would agree with that  
7       entirely. I understand that Mr. Collins includes  
8       some discussion of the starting rate base, but I am  
9       not sure if it's a matter of degrees as to whether  
10      you would consider that to be sufficient to state  
11      why it is appropriate, versus it's a part of the  
12      FERC methodology.

13            Q    Turn to page 29 of your testimony, starting  
14      at line 17. You are talking about the Bayview  
15      facility, and you indicate on line 21, "Staff does  
16      not include the balance of accumulated deferred  
17      income taxes associated with Bayview in its  
18      adjustment PF 2." Do you see that?

19            A    Yes.

20            Q    Can you explain why Olympic will have to  
21      pay these taxes, since the Staff is recommending  
22      that the Bayview facility remain on the books, and  
23      AFUDC charged to the balance?

24            A    I am sorry. I don't understand your  
25      question.

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1           Q    Is it your testimony that because of  
2           Staff's treatment, that Olympic will actually pay  
3           the taxes that had been deferred related to Bayview?

4           A    I haven't said anything with respect to  
5           whether or how much taxes will be paid.

6           Q    Do you have an opinion, or is that within  
7           the scope of your testimony?

8           A    No. I am discussing the treatment as it  
9           adjusts the rate base when Staff has removed the  
10          plant facilities, but left the deferred taxes as a  
11          reduction from the rate base that remains.

12          Q    Do you have any opinion on whether  
13          Olympic's investment in Bayview terminal was  
14          prudent?

15               MR. HARRIGAN:  Objection; goes beyond the  
16          scope of direct.

17          Q    BY MR. TROTTER:  If that's the case, I will  
18          accept that.  You are not testifying to that issue?

19          A    No, I am not.

20          Q    And do you have an opinion on what it would  
21          have cost Olympic to build Bayview if its uses were  
22          limited to those to which it is currently put?

23               MR. HARRIGAN:  Same objection.

24               JUDGE WALLIS:  The witness may respond  
25          whether he has an opinion.

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1                   THE WITNESS: I have no opinion on  
2 construction costs for Bayview.

3           Q    BY MR. TROTTER: On page 30, lines 14  
4 through 17, you are referring to the proforma  
5 interest adjustment. Do you see that?

6           A    Yes.

7           Q    And you state, Mr. Twitchell -- at line 15,  
8 "Mr. Twitchell took the balance of net carrier  
9 property of Bayview associated with the Bayview  
10 facility and added the costs back into rate base  
11 before he applied the weighted cost of debt."  
12 Do you see that?

13          A    Yes.

14          Q    Now, when you say he added it back into  
15 rate base, do you actually mean he placed it in the  
16 balance upon which the interest rate was applied for  
17 purposes of the adjustment? Is that a more precise  
18 way of saying it?

19          A    Well, that's a different way of saying it.

20          Q    I am saying the same thing?

21          A    I think if you did the math, you would come  
22 up with the same answer as what I am describing.

23          Q    Are you aware that the WUTC consistently  
24 includes CWIP in the calculations of proforma  
25 interest expense, even when CWIP is not included in

3568

1 rate base?

2 A No, I am not aware of specifically how that  
3 is done.

4 Q You didn't study those orders that held for  
5 that treatment?

6 A No, I did not. But it sounded to me from  
7 my review of, oh, I think some discussion in  
8 Mr. Twitchell's testimony that spoke to something  
9 like that, that it has to do with some specific  
10 treatment that wasn't standard. That there were  
11 some special conditions applied. That was what I  
12 understood from it.

13 Q And Staff has recommended that AFUDC be  
14 charged on the Bayview investment; is that correct?

15 A I believe that's correct. And I note that  
16 it seems to me there's a bit of a double dip there,  
17 because if you are earning AFUDC, but also taking  
18 the debt portion of that and including it as the  
19 interest expense for the tax calculations, you are  
20 reflecting it in two places.

21 Q To the extent you are correct, that same  
22 consideration would apply with CWIP not included in  
23 rate base; is that correct? And also included in  
24 the proforma debt calculations?

25 A I suppose it would, if that is consistent

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1 with what Mr. Twitchell has done here.

2 Q Now, Olympic's investments in CWIP and the  
3 Bayview facilities have been built with -- have been  
4 built with debt, and to the extent that there was  
5 any equity, equity funds, correct?

6 A I am sorry. Would you ask that again?

7 Q Olympic's investments in CWIP and the  
8 Bayview facilities have been built with debt, with  
9 funds provided by debt. And to the extent Olympic  
10 had equity, any equity funds, correct?

11 A I am not certain what the source of the  
12 funds were.

13 MR. TROTTER: Those are all of my  
14 questions, Your Honor. I would move admission of my  
15 Exhibits 1103, 1104 -- yes, I do need to address  
16 1105, but I will ask the question first.

17 Q BY MR. TROTTER: Mr. Ganz, 1105 is the  
18 portion of the code of Federal Regulations that is  
19 the Uniform System of Accounts; is that correct?

20 A Yes, this is what I refer to as the USoA.

21 Q And you refer to that in your testimony?

22 A Yes.

23 MR. TROTTER: Your Honor, I would move the  
24 admission of Exhibit 1103, 1104 and 1105.

25 JUDGE WALLIS: Is there objection?

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1                   MR. HARRIGAN: No, objection except for  
2 1103, since it forms a part of 1107, which is the  
3 complete exhibit, and which has been admitted. I  
4 don't believe it's necessary to add a duplicative  
5 page at this point.

6                   MR. TROTTER: Either way.

7                   JUDGE WALLIS: Because the record does  
8 refer to 1103, I think that extent of duplication  
9 will not unduly burden us. We'll be able to follow  
10 it, and consequently, we will receive 1103 through  
11 1105.

12   (EXHIBIT ADMITTED)

13                   JUDGE WALLIS: Let's take a 10 minute break  
14 at this point, please.

15   (Brief recess.)

16                   JUDGE WALLIS: Let's be back on the record,  
17 please.

18                   Mr. Brena, do you want me to mark these for  
19 the record?

20                   MR. BRENA: Yes, please, Your Honor.

21                   JUDGE WALLIS: I am marking as Exhibit 1109  
22 for identification, a document that is described as  
23 an excerpt from Opinion No. 435 of the Federal  
24 Energy Regulatory Commission, dated January 13,  
25 1999.

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1

(EXHIBIT IDENTIFIED.)

2

JUDGE WALLIS: Marking as Exhibit 1110 for  
identification a document that is identified as an  
excerpt from an initial decision issued September  
25, 1997 in a matter designated as SFPPLP.

6

(EXHIBIT IDENTIFIED.)

7

JUDGE WALLIS: Mr. Brena.

8

MR. BRENA: Thank you, Your Honor.

9

10

CROSS EXAMINATION

11

12

BY MR. BRENA:

13

Q Good morning, Mr. Ganz.

14

A Good morning.

15

Q I want to chat with you a little bit about  
financial reporting, regulatory accounting, and rate  
making. Okay?

16

17

A Okay.

18

Q You are aware that financial accounting for  
reporting purposes and regulatory accounting for  
reporting purposes are different in certain regards?

19

20

21

A Yes.

22

Q You are also aware, are you not, that  
regulatory accounting for reporting purposes  
deviates from rate making?

23

24

25

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1           A    It may.

2           Q    Are you aware of the cases, or line of  
3 cases -- and if I could quote a metaphor from one of  
4 them that you might recognize -- that the accounting  
5 tail should not wag the rate making dog?

6           A    I am not sure I am familiar with that  
7 phrase or the context, but I understand what you are  
8 referring to.

9           Q    Are you aware of the line of cases that  
10 stand for the proposition that regardless of what is  
11 proper for regulatory accounting reporting purposes  
12 under the Uniform System of Accounts, that does not  
13 control proper rate making treatment?

14          A    I am not aware of a line of cases that  
15 stand for that.

16          Q    You are not aware of that authority?

17          A    I don't disagree with that idea, but I am  
18 not aware of specific cases that stand for that  
19 proposition.

20          Q    Have you ever reviewed a case that stands  
21 for that proposition?

22          A    None come to mind.

23          Q    But you are aware of the principles  
24 underlying the cases?

25          A    Again, without knowing the cases, I am not



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1       sure I can be in agreement or disagreement with the  
2       principles underlying them. I don't disagree that  
3       the accounting doesn't, in all events, control the  
4       rate making treatment of costs.

5           Q    Okay. Thank you. Are you familiar with  
6       how BP Pipelines maintains its accounts?

7           A    Not in specific. I understand that Olympic  
8       Pipeline conforms with the Uniform System of  
9       Accounts, and BP does their accounting. But beyond  
10      that, I am not sure I can tell you.

11          Q    It's your testimony that BP -- do you know  
12      whether or not BP maintenance of its books and  
13      records complies or does not comply with the Uniform  
14      System of Accounts?

15          A    I have not investigated specifically how  
16      they maintain their books and records in the  
17      accounting procedures. But I am aware that they  
18      prepared the Form 6, that was marked as Exhibit  
19      1104. And on the second page of that exhibit  
20      there's a signature of one of the officers  
21      certifying the correctness of it.

22          Q    Certifying the correctness of the FERC 6  
23      filing; not their books and accounts, correct?

24          A    That's correct.

25          Q    Are you aware of any such certification

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1 that relates that -- where BP has affirmatively  
2 stated that their books and accounts comply with the  
3 Uniform System of Accounts?

4 MR. HARRIGAN: Objection, or at least  
5 request for clarification. Are we seeking of BP  
6 Pipelines or Olympic Pipelines when we talk about BP  
7 Pipelines' books and records.

8 MR. BRENA: I think, actually, BP Pipelines  
9 doesn't maintain its books and records. It has a  
10 third party do that for them, Exensure (ph.), but I  
11 am speaking about the Uniform -- so I am speaking  
12 about BP Pipelines at this point, and their agents.

13 Q BY MR. BRENA: Do you have my question in  
14 mind?

15 A No, I don't.

16 MR. BRENA: Could I have it read back,  
17 please?

18 (Record read back.)

19 Q BY MR. BRENA: And I would modify that  
20 sentence only with the clarification that I made in  
21 responding to the objection. Are you aware of BP  
22 Pipelines -- whether or not BP Pipelines has ever  
23 affirmatively represented that they maintain their  
24 books and records consistent with the Uniform System  
25 of Accounts?

3575

1           A    I am not aware of anyplace I could point  
2   you to, or any need for them to make such a  
3   representation, either, beyond what they report when  
4   they report in the Form 6.

5           Q    What they report when they report -- okay.  
6   The Uniform System of Accounts requires the accrual  
7   method of accounting to be used, doesn't it?

8           A    I believe that's one of the requirements in  
9   the general instructions.

10          Q    Don't you know?

11          A    I try not to memorize a lot of rules and  
12   regulations if I know where to look them up.

13          Q    You don't know whether or not the Uniform  
14   System of Accounts requires an accrual or cost-based  
15   method of accounting without looking at the  
16   regulation.  Is that your testimony?

17               MR. HARRIGAN:  Objection; the question has  
18   now been changed to accrual or cost method.

19          Q    BY MR. BRENA:  And I will modify -- and  
20   please, I don't want you to check the regulations.

21               Do you know whether or not the Uniform  
22   System of Accounts requires accrual accounting?

23          A    That's my understanding, but I never  
24   understood this to be a memory test.

25          Q    Well, it's not intended to be.  It is your

3576

1 understanding that the Uniform System of Accounts is  
2 based on an accrual principle -- requires accrual  
3 accounting? Is that where we ended up?

4 A As I said in the first place, I believe  
5 that's one of the general instructions.

6 Q And if I can read -- I am just reading, The  
7 system of accounts shall be kept by the accrual  
8 method of accounting. That's in section 1.4 of the  
9 Uniform System of Accounts.

10 Can you tell me whether or not BP Pipelines  
11 maintains their books and records on an accrual  
12 method of accounting?

13 A As I said, I have not looked on how they  
14 maintain the books and records.

15 Q With regard to the line lowering or the  
16 line raising, can you tell me whether or not that  
17 was booked on a cost basis, on an accrual basis, or  
18 some mixed basis?

19 A I have not looked at the specific recording  
20 of the transactions, no.

21 Q Does the Uniform System of Accounts also  
22 require that the books and records be maintained on  
23 a monthly basis -- without checking please?

24 A It's consistent with what I understand.  
25 But, again, if I have to go from memory, this is

3577

1 going to be a lot less specific.

2 Q But that is your understanding?

3 A That's my understanding.

4 Q And I will read, "For accounting periods  
5 each carrier shall keep its books on a monthly basis  
6 so that all transactions as nearly as may be  
7 ascertained may be entered into the account not more  
8 than 60 days after the last day of the period for  
9 which the accounts are stated." And it goes on with  
10 an exception.

11 That's consistent with your understanding?

12 A I believe I even cite a portion of that  
13 text specifically in my testimony.

14 Q Do you know whether or not BP Pipelines  
15 books of accounts that were used in this rate case  
16 are consistent with that requirement?

17 A As I said before, I have not looked  
18 specifically at their books and records, or  
19 recording of any specific transactions.

20 Q You are an expert witness in the Gaviota  
21 case, were you not?

22 A I provided testimony in the Gaviota  
23 Terminal proceedings.

24 Q Your direct case was struck, was it not?

25 A In --



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1 JUDGE WALLIS: Does the witness now have  
2 that document?

3 THE WITNESS: Yes. May I take a moment to  
4 review this document?

5 JUDGE WALLIS: Yes.

6 THE WITNESS: (Reading document.) Okay.

7 Q BY MR. BRENA: In Gaviota, when the initial  
8 filing was made, isn't it true that the base period  
9 was for 1994?

10 A That's what it indicates -- that's what it  
11 indicates in the order. I wouldn't have come up  
12 with that from memory.

13 Q Isn't it true that the test period for the  
14 initial filing was calendar year 1995?

15 A Again, as it says in the order, I don't  
16 think I would have remembered that otherwise.

17 Q The testimony that you provided as a  
18 witness in the direct case, you used a base period  
19 of September 1, 1994 through August 31, 1995,  
20 correct?

21 A I am sorry. Could you state that again?

22 Q The base period which you used in your  
23 initial testimony used a base period of September 1,  
24 1994 through August 31, 1995?

25 A Yes.

3580

1           Q    The test period that you used in that same  
2 testimony began on September 1, 1995 and went  
3 forward to August 31, 1996; is that correct?

4           A    Again, as stated in the order, that's what  
5 it says. I don't know that I would have recalled  
6 that.

7           Q    And isn't it true that the reason your  
8 testimony was struck even in that case was because  
9 you provided testimony which changed the basis and  
10 test year period from the initial filing?

11          A    I believe that's the substance of the  
12 order. The order also discusses that the oil  
13 pipeline regulations that establish what a base year  
14 and test year are had recently been issued, and  
15 there were no specific provisions in the oil  
16 pipeline regulations that described the ruling that  
17 was made here with enough specificity that this  
18 order could be made based on just looking at the  
19 regulations for oil pipelines.

20                    There was an extensive discussion of the  
21 relationship and similarities of the oil pipeline  
22 rules versus the gas pipeline rules, but this was  
23 based on how gas pipeline rules have been applied.  
24 So there was quite a bit of interpretations beyond  
25 that supported the ruling here.



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1                   MR. BRENA: I would ask that that response  
2 after "yes" be struck. I asked him whether or not  
3 that was the basis for the strike. He went on to --  
4 which it is. He went on to explain reasons  
5 unrelated to why the judge struck it.

6                   MR. HARRIGAN: Your Honor, I believe that  
7 the explanation related directly to what was  
8 essentially the legal question that was asked;  
9 namely, what was the basis of this decision.

10                   MR. BRENA: And my question was quite  
11 specific, and it went to what the basis for it being  
12 struck was.

13                   JUDGE WALLIS: We will allow the answer to  
14 stand.

15                   Q BY MR. BRENA: The explanation that you  
16 just offered, those were the explanations that the  
17 judge rejected in striking it; isn't that true?

18                   A I think the judge acknowledged that what  
19 was said was the case, and that is why the testimony  
20 was struck but the case was not dismissed. We were  
21 given an opportunity to revise and refile our direct  
22 case with the instruction that was provided in this  
23 order.

24                   MR. BRENA: I move that that be struck.  
25 Now he went in -- not only to why it was struck, but

3582

1 he went into why it was not dismissed. And that  
2 went well beyond the scope of my question.

3 MR. HARRIGAN: What counsel is attempting  
4 to do here, it seems, is to get the witness to  
5 answer legal questions, and then objecting when the  
6 witness gives the full explanation of what the legal  
7 decision was.

8 JUDGE WALLIS: We don't want to restrict  
9 the witness from explaining an answer. But in the  
10 context of this proceeding, it might be more  
11 effective and efficient to allow the witness to  
12 answer the question and confine his answer to the  
13 question. Then, if you, on redirect, wish to  
14 explore an area with him, you would have that  
15 opportunity.

16 So I am going to ask the witness to limit  
17 your answer to the questions that are asked.

18 THE WITNESS: Okay.

19 MR. BRENA: With regard to the motion to  
20 strike that portion that was nonresponsive to the  
21 question?

22 JUDGE WALLIS: We will allow that to stand.

23 Q BY MR. BRENA: In making his ruling on page  
24 6 of the order, the judge says the words of the  
25 regulations and the logic of the regulatory scheme

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1 support such an outcome.

2 And by that he is referring specifically to  
3 striking your testimony, because the testimony you  
4 provided in your direct case used a different basis  
5 and test period than the initial filing from the  
6 company, correct?

7 A Could you point me to where it is that  
8 these words appear on page 6?

9 Q On page 6, the second full paragraph  
10 beginning, "Therefore, the Producers Group motion to  
11 strike the testimony and exhibits of Gaviota Witness  
12 Ganz is granted. The words of the regulation and  
13 the logic of the regulatory scheme support such an  
14 outcome."

15 A Okay. I have the text, and I don't have  
16 your question in mind.

17 Q I asked if that was the basis for his  
18 ruling, that the words of the regulation and the  
19 logic of the regulatory scheme does not support the  
20 arguments advanced?

21 A Well, again, I think this summarizes he all  
22 of the discussion that precedes it. I am not sure I  
23 would agree that that is a fair statement that  
24 this is the basis of the ruling without  
25 understanding all of the preceding text.

3584

1           Q    I would like to go to the reason that you  
2           gave that this regulatory scheme -- if I understood  
3           it correctly, that this regulatory scheme had not  
4           previously been interpreted. Did I understand that  
5           was part of your explanation?

6           A    I don't know if I was saying it had not  
7           previously been interpreted. But the regulations  
8           for the oil pipelines had recently been modified to  
9           include definitions of base period and test period.  
10          This ruling interprets those in terms of the gas  
11          regulations, not the oil regulations.

12          Q    It would seem incredibly clear after this  
13          decision that a direct case has to follow the same  
14          base and test period as the initial case. Would you  
15          agree?

16               MR. HARRIGAN:  Objection; argumentative.

17               MR. BRENA:  I didn't intend for it to be.

18               JUDGE WALLIS:  The question may stand.

19               THE WITNESS:  I would think that this would  
20          be a decision that a pipeline would need to be  
21          mindful of in preparing their direct case.

22          Q    BY MR. BRENA:  Mr. Collins is a principal  
23          with you?

24          A    Yes, in the same firm.

25          Q    Does the direct case -- does the direct

3585

1 case that was filed with FERC use the same base and  
2 test period in its initial filing as it does in case  
3 2?

4 CHAIRWOMAN SHOWALTER: Mr. Brena, you are  
5 referring now to Olympic Pipelines case?

6 MR. BRENA: Yes.

7 THE WITNESS: I am not terribly familiar  
8 with all the specifics of Mr. Collins' calculations,  
9 but my understanding is that in the direct round,  
10 the testimony that was filed at FERC included one  
11 case that reflected the same base and test period  
12 that was used in the initial filing at FERC, and one  
13 case that reflected updates.

14 Q BY MR. BRENA: And the one that reflected  
15 the filing was your understanding of case 1, and the  
16 one that did not was your understanding of case 2?

17 A I am not sure if I have an understanding of  
18 which was which.

19 Q Isn't it true that the base period in the  
20 initial filing was the year 2000?

21 A I don't know.

22 Q You don't know that?

23 A No.

24 Q Have you reviewed Mr. Collins' testimony?

25 A I reviewed it at some point. But as I

3586

1 said, I haven't reviewed all of his testimony and  
2 exhibits in great detail. And it's been a while  
3 since I reviewed his testimony.

4 Q Are you aware of the reasons that FERC just  
5 rejected Olympic's filing before FERC?

6 A Well, I am not aware that the FERC has  
7 rejected anything. I understand that the  
8 Administrative Law Judge has indicated that a ruling  
9 will be forthcoming. But as far as I know, there  
10 has been no ruling issued, and the Commission itself  
11 has not -- the FERC itself has not had this issue  
12 before it.

13 Q Have you reviewed the transcript of the  
14 Administrative Law Judge's comments?

15 A No, I have not.

16 Q Isn't it true that Olympic in this case  
17 changed the base and test period from the initial  
18 filing to the direct case, and from the direct case  
19 again to the rebuttal case?

20 A When you say "in this case," which --

21 Q In this proceeding.

22 A This proceeding here?

23 Q Yeah. If you know.

24 A Well, my understanding is that in  
25 Washington before this Commission that the rate

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1 filing must be accompanied by the direct testimony.  
2 As I understand that, I think that implies that  
3 their direct case and their rate filing essentially  
4 happened in December.

5 Q Is it your understanding that Olympic  
6 Pipeline filed the case that was unique to this  
7 Commission's regulations and laws, or that it simply  
8 prepared a FERC case and filed it here?

9 A It's my understanding that the case that  
10 was prepared was based on the FERC methodology, and  
11 the same information was filed at the FERC and filed  
12 here.

13 Q Are you aware of any part of the direct  
14 case that refers to this Commission's precedents  
15 at all?

16 A No. But I don't think I have reviewed the  
17 entire direct case.

18 Q In short, your interpretation of a base  
19 period and a test period under the FERC oil pipeline  
20 regulations was the basis for your testimony to be  
21 struck in the Gaviota case; is that true?

22 MR. HARRIGAN: Calls for a legal conclusion  
23 about a multi-page opinion that can't be summarized  
24 in a single sentence.

25 MR. BRENA: I think it can.

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1                   JUDGE WALLIS: We will allow the witness to  
2 explain, to identify his own understanding with the  
3 understanding that he is not a practicing lawyer and  
4 he, of course, is free to --

5                   MR. BRENA: I withdraw the question, Your  
6 Honor.

7                   JUDGE WALLIS: Very well.

8                   Q BY MR. BRENA: You have also put testimony  
9 in with regard to AFUDC calculations, is that  
10 correct, whether or not the Staff had correctly done  
11 those or not?

12                  A In which case?

13                  Q In this case, the Olympic case.

14                  A No, I have not commented on the correctness  
15 or incorrectness of AFUDC calculations.

16                  Q You go through to describe on page 19 of  
17 your testimony, "Please describe the treatment of  
18 AFUDC under the FERC methodology." So at least you  
19 explain the FERC methodology to this Commission with  
20 regard to AFUDC. Is that more fairly stated?

21                  A If by that you mean that I am explaining  
22 the presence or the role of AFUDC within the context  
23 of the FERC methodology, yes.

24                  Q Were you an expert in the SFPP case?

25                  A Which SFPP proceeding are you referring to?



3589

1           Q    The one that resulted in Opinion No. 435 OR  
2   92-8, of which relevant portions of the decision are  
3   marked as Exhibit 1109.

4           A    Yes, I provided testimony in that  
5   proceeding.

6           Q    Part of your testimony went specifically to  
7   your interpretation of AFUDC under the FERC  
8   regulations, did it not?

9           A    No, it did not go to my interpretation. I  
10  provided an AFUDC calculation, but there are no --  
11  there are no specific regulations for oil pipelines  
12  on how to calculate AFUDC to be interpreted.

13          Q    Your calculation that you advanced for  
14  AFUDC was rejected by the FERC, was it not?

15          A    My specific calculation was not accepted.  
16  The approach that I had used at a general level is  
17  what was determined to be used.

18          Q    When I am looking at page 61 of the  
19  decision, "The problem with SFPP's calculations is  
20  SFPP failed to take any steps to tie them directly  
21  to actual expenditures on the South lines, or to  
22  derive the imputed AFUDC directly from the interest  
23  recorded on its books."

24                That is a reference specifically to your  
25  calculation, is it not?

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1           A    That is a reference to my calculation.  I  
2   am not sure that I agree with what is stated here,  
3   but that is what it states.

4           Q    You do agree that that was the opinion of  
5   the Commission?

6           A    No.  This was the opinion of the -- well,  
7   this is Opinion 435.  I guess this is the opinion of  
8   the Commission based on the initial decision.

9           Q    Now, you used a 50 percent calculation, and  
10  didn't build it up month to month based on actual  
11  expenditures; is that correct?

12          A    That's correct.  And that's what I was  
13  saying before, the approach that was ultimately  
14  deemed to be the proper one to use didn't look at  
15  monthly expenditures, either.  The difference was  
16  instead of 50 percent, a factor of about 30 percent  
17  was used.

18          Q    Were there any books or records which  
19  demonstrated what the month-to-month calculations of  
20  AFUDC should have been?

21          A    Are you asking me were there records that  
22  showed what the monthly balances on which a  
23  calculation could be done?  Is that the nature of  
24  your question?

25          Q    Yes.  In the record of the proceeding, was

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1       there month-to-month expenditure information from  
2       which a month-to-month calculation could have been  
3       done?

4             A     There was not entered into the record  
5       information of that sort.  Information that could  
6       have been used to develop that was made available to  
7       the parties, but nobody chose to undertake the  
8       exercise to do it.

9             Q     Are you aware of the AFUDC calculation that  
10       Olympic filed in its initial filing?

11            A     What are you referring to as initial  
12       filing?

13            Q     Well, the initial filing of the rate  
14       increase.  The fact that they used the 50 percent  
15       without a month-to-month calculation?

16            A     I am not aware of what specifically was  
17       used.

18            Q     Are you aware of whether or not there are  
19       books and records supporting a month-to-month  
20       calculation in this proceeding?

21            A     I am not aware specifically.  But, again,  
22       if your question goes to whether there are  
23       calculations or whether there's data of monthly  
24       construction, I don't know one way or the other.  I  
25       don't recall having looked at this rate filing that

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1 was made back in June or July of last year.

2 Q Are you aware that they shifted the AFUDC  
3 calculations from 50 percent to 100 percent from  
4 their filing to their case?

5 A Are you referring to the issue that  
6 Mr. Collins described in his rebuttal testimony?

7 Q Yes.

8 A Yes, I am aware of what that issue entails.  
9 And that issue is completely different from this  
10 discussion and Opinion No. 435.

11 Q Do you or do you not agree that the proper  
12 way to calculate AFUDC would be to have the proper  
13 company records to do a month-by-month calculation  
14 of that number?

15 A I would agree that that is a more  
16 preferable method. But as far as whether that's the  
17 only method, obviously in Opinion 435 that the FERC  
18 issued, they approved a method that does not use the  
19 monthly construction balances.

20 MR. BRENA: Thank you. I have no further  
21 hes questions.

22 JUDGE WALLIS: Do you wish to move the  
23 exhibits.

24 MR. BRENA: I do.

25 JUDGE WALLIS: Is there objection to 1109

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1 and 1110?

2 MR. HARRIGAN: I have one objection, and  
3 that is a reservation, Your Honor, in that we would  
4 like to reserve the right to supplement Exhibit 1110  
5 with the balance of this opinion pursuant to ER 106.

6 But at this point, I don't know whether  
7 we're going to trouble the Commission with that many  
8 pages, because I haven't had a chance to look  
9 at them.

10 MR. BRENA: Without objection, I would  
11 prefer, rather than supplement, it be an independent  
12 exhibit.

13 JUDGE WALLIS: Yes.

14 MR. HARRIGAN: I have to make the same  
15 reservation with 1109, as Mr. Beaver pointed out.

16 JUDGE WALLIS: You may offer the complete  
17 documents.

18 1109 and 1110 are received.

19 (EXHIBIT ADMITTED)

20 JUDGE WALLIS: Mr. Finklea, do you have any  
21 questions of the witness?

22 MR. FINKLEA: Tosco has no questions of the  
23 witness.

24 JUDGE WALLIS: Commissioners.

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## EXAMINATION

2

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BY CHAIRWOMAN SHOWALTER:

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Q Mr. Ganz, you know that your profession has arrived, for better or worse in today's New York Times, as a glossary of accounting terms of the very types we have been talking about, expenses versus capital expenditures, and where appropriate costs should go.

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Obviously I am referring to a much bigger issue than we're dealing with here. But my questions really do revolve around how appropriate judgments are made about how expenses, slash, expenditures should be accounted for, and who is responsible for making those judgments.

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So I want to ask you some questions, I think, partially in the abstract accounting principles and accounting practices, but also, if appropriate, getting to the particulars of this case.

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And maybe you can help me, when a company -- I am talking abstractly now -- decides to assign certain costs or expenses or expenditures -- I have only today learned the distinction between expenses and expenditures in

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1     accounting lingo -- when a company does that, who is  
2     it, in general, who is responsible for that kind of  
3     assignment? Is it, generally speaking, the company  
4     accountant, or the outside accountant? Is that an  
5     accounting function?

6             A     I would think it's an accounting function,  
7     but it would be determined by the accounting  
8     policies that are established by the company. And I  
9     think it could be, depending on the expenditure, a  
10    decision that is made by a controller or treasurer  
11    or a clerk.

12            It really depends on the nature of the  
13    expenditures, and the significance, and whether it  
14    is something that is clearly within the policies and  
15    guidelines, or if it's something where there is some  
16    discretion or decisions that would need to accompany  
17    how a transaction is recorded.

18            Q     So in the first instance, there are bills,  
19    receipts, pieces of paper, that indicate money was  
20    spent, maybe checks issued. And then someone has to  
21    decide what to do with those with respect to the  
22    records of the company; is that correct?

23            A     I am not sure about the sequence or  
24    chronology, but I would think that the way that the  
25    transactions would be recorded could most likely

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1 precede, actually, cutting a check. When invoices  
2 are received, they would need to be reviewed and  
3 approved. And I think at the point they are  
4 approved, that the transaction would essentially  
5 become a transaction. And then the costs would be  
6 recorded.

7 At the point where the company determines  
8 it has a valid charge that it will and must pay, it  
9 records it. And at that point, I would think for  
10 the most part, the costs would be determined as  
11 expense capital, or whatever. And more often than  
12 not, would be classified, based on these policies,  
13 and would be left where they are if they didn't  
14 stand out on any accounting reports or require some  
15 further decision making.

16 Q So assume there's been an initial  
17 assignment of these costs. They have been recorded  
18 in some manner by the company by means of a company  
19 policy, and whatever individuals are responsible for  
20 carrying out that policy.

21 A Okay.

22 Q Now, then, when a regulate the company goes  
23 to present that type of information to the  
24 regulator, do you agree that someone from the  
25 company, or hired by the company, needs to present



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1 that information in a manner that conforms with the  
2 regulatory body's needs to make a decision?

3 A I would agree that the needs of the  
4 regulatory body would likely be served by their  
5 accounting requirements, and that the accounting  
6 data would have to be presented in conformance with  
7 those requirements.

8 Q And is the presentation both a matter of  
9 form, meaning report the right thing in the right  
10 place, but also substance, meaning the amount shown  
11 is the reasonable amount to show in this correct  
12 box; is that correct?

13 A I was with you until you got to the word  
14 "reasonable." In what context do you mean  
15 "reasonable"?

16 Q All right. Let's take an example, like  
17 salaries. I assume that a company pays salaries and  
18 knows how to put in its regular records those  
19 amounts in a box called "salaries." So far am I  
20 correct?

21 A Yes. There's an account for salaries and  
22 wages.

23 Q But then when it comes to this Commission,  
24 isn't it the case that not only do amounts for  
25 salaries need to be in the right box, but someone

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1       somewhere -- and maybe it is the accountant -- needs  
2       to say, and furthermore, that is an appropriate  
3       amount of salaries. In substance it's the right  
4       amount for this Commission to recognize.

5               I am trying to tease out two different  
6       purposes or functions that are necessary in order  
7       for us to make our decision.

8               A    Okay.

9               Q    Do you agree that those are two necessary  
10       functions?

11              A    I would agree that those could be two  
12       functions that this Commission would require, but  
13       not that those are both accounting functions.

14              Q    And that really is getting to my question.  
15       I am just really looking for who is responsible for  
16       making judgements on behalf of the company about A,  
17       where the right box is, the right accounting box,  
18       but also B, the right amount to put into the box.

19              So am I hearing from you that accountants  
20       in general are responsible for making sure that  
21       whatever amount of money is there gets put into the  
22       right box, but not necessarily to evaluate whether  
23       that is the right amount of money?

24              A    Let me say it a little different and maybe  
25       this gets to the same point. Accounting and

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1 financial statements, as I understand, are intended  
2 to represent economic events. And they report what  
3 has happened, for the most part.

4 The costs that would be reported for  
5 salaries and wages would be, I think, for the  
6 majority of the case, what money has been spent for  
7 salaries and wages without regard to any qualitative  
8 analysis of whether it's reasonable, appropriate.  
9 The only, maybe qualitative evaluation would be, is  
10 it correct that we spent this amount?

11 When it comes to looking at that amount in  
12 the context that I think you are referring to, this  
13 Commission would, is that a reasonable amount for  
14 the company to reflect and recover in a cost of  
15 service or revenue requirement presentation used to  
16 design rates. I don't think that's an accounting  
17 function.

18 But I think without having a specific role  
19 or function within the company in mind with a title,  
20 like chief accountant, I believe that management of  
21 the company has an overall objective control over  
22 the nature of the salaries and wages that are paid  
23 to employees, and they would be mindful of what  
24 industry trends are. They likely have salary  
25 surveys, or things like that, to know whether they

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1 are paying people more than the average for the  
2 location that they operate in, the industry that  
3 they are in, things of those sorts.

4 And if management is not fulfilling that  
5 type of oversight function, shareholders of the  
6 company have to be reported to, and they will have  
7 some say so about whether management is fulfilling  
8 their fiduciary duties to operate the company, and  
9 keep costs in check, and make sure they are not out  
10 of line.

11 Q But let's take the example of salaries.  
12 And I don't mean this to apply to this particular  
13 case. I am not addressing the salaries in this  
14 case. I just think it's an easy one to think about  
15 since we all know what salaries are.

16 We have in the past disallowed, or not  
17 recognized, for regulatory purposes, all of the  
18 salary of the CEO for Avista, for example. In that  
19 case we did not question that the board, on behalf  
20 of its shareholders, could hire a CEO at whatever  
21 salary they wanted to. But we were not going to  
22 recognize all of it.

23 And that's the distinction I am trying to  
24 draw; that is, the company itself may not even  
25 request all of the salary that they have decided to

3601

1 provide. They made a judgment. But for regulatory  
2 purposes, isn't it a different question, even from  
3 the company's point of view?

4 A It could be. But I don't know -- I don't  
5 know the details of your decision concerning Avista,  
6 and what the situation is there. But if the company  
7 is, I guess, a large publicly owned company, and  
8 that information is out there in the public record,  
9 available, and there are other standards that can  
10 easily be applied, I suppose that puts a  
11 different -- that suggests a different level of  
12 analysis of what one might consider to be  
13 reasonable.

14 I guess it depends on what types of  
15 considerations that you find to import to evaluating  
16 the reasonableness of it. And I am not familiar  
17 with what those may be, as you have applied them in  
18 other proceedings.

19 Q Let me turn to an example that you do  
20 discuss on page 12 of your testimony, 1101. And  
21 here in the middle of the page, lines 9 to 15, you  
22 are discussing the line lowering project.

23 Again, aren't there two issues here? One  
24 is, is the money spent for this project appropriate  
25 as an expense, or as a capital cost? That's

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1 question one. And then whatever the amount is,  
2 which in this case is \$455,000, is that a reasonable  
3 amount? Aren't those two separate regulatory  
4 questions?

5 A I suppose those could be two separate  
6 questions. I was not addressing that second one.

7 Q Right. And I am just trying to get to what  
8 your domain of expertise is versus anyone else's in  
9 the company. So what you are saying is as far as  
10 your testimony is concerned, you are just telling us  
11 where you think this \$455,000, which amount you are  
12 not questioning, where it should be; is that right?

13 A That's correct.

14 Q So you are making professional judgments  
15 about the categorization of expenses, not the  
16 reasonableness of them. Am I right?

17 A That's correct. I think that would be  
18 a fair way to describe much of what I described in  
19 the testimony. It may not all go to where it should  
20 be recorded. But I don't believe in any place I  
21 have addressed reasonableness of the level of any  
22 expenditures.

23 Q And then when you are making that judgment  
24 about categorization here, you said, I believe you  
25 believe this is appropriately recorded as an expense

1 as opposed to a capital expenditure; is that right?

2 A Yes. I believe that recording it as an  
3 expense is the correct way to do it, based on the  
4 Uniform System of Accounts. And in this case, the  
5 nature of the expenditures.

6 Q All right. And then what information  
7 do you rely on when you are deciding this very  
8 amount, the \$455,000 should be an expense? Do you  
9 make that judgment yourself, or is somebody else in  
10 the company telling you, well, this was maintenance.  
11 This was not a long-term improvement?

12 A There may be limits of both. In a sense, I  
13 asked what was the nature of this activity -- what  
14 was involved in the line lowering. Are we looking  
15 at a line lowering of 10 miles of pipe, or 10 feet  
16 of pipe? Are we replacing pipe, or are we just  
17 lowering it in place?

18 The distinction that I think is relevant  
19 here is not so much a matter of the dollar amount  
20 that is at issue, as it is the nature of the  
21 activity that prompted them to incur the cost. And  
22 the nature of the activity, as I understand the  
23 accounting guidelines, pretty much tells you where  
24 this needs to go on your financial statements.

25 Q But to determine the nature of the

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1 activity, someone had to tell you, I take it, what  
2 the nature was?

3 A Yes. I inquired from the company what this  
4 project was for, and the information that I received  
5 in response to that was that this was a line  
6 lowering that was required because the line became  
7 exposed from storm water run-off.

8 Q And then where did you get your information  
9 from -- from whom?

10 A I don't recall specifically, but my  
11 recollection is that it was information that  
12 originated from somewhere within the BP Pipeline  
13 accounting control group in the Chicago area. I  
14 don't know that they are downtown Chicago, but they  
15 are in Illinois. That was not where I inquired.  
16 That was where my inquiry was responded from.

17 Q Where did you inquire?

18 A Through counsel to try to find out who  
19 would know, and how the information could be  
20 acquired.

21 Q Now, speaking a little more abstractly in  
22 terms of when something is appropriately an expense,  
23 once you determine it is an expense, then do you  
24 take another step and determine whether it is an  
25 annual expense versus an expense that should be



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1 amortized over some period of years?

2 A I did not, and I don't believe that type of  
3 determination is part of preparing an accounting  
4 report like the Form 6. That strikes me as more of  
5 a rate making treatment of costs than an accounting  
6 for the cost type of function.

7 Q So, again, a regulatory expert of some kind  
8 would make that sort of decision; not you, anyway,  
9 as an accountant?

10 A If one were to be preparing a rate making  
11 presentation, that's when the determination would be  
12 made. It would not be made in preparing a Form 6.

13 Q If you have what seems to be a one-time  
14 expense that won't recur again, let's say as in the  
15 case of an earthquake that does something to a  
16 pipeline that has to be repaired, but that repair  
17 doesn't happen to extend its life, do you, as an  
18 accountant, make a judgment as to whether that is  
19 the type of expense that needs to be amortized or  
20 not? Or is your answer the same as the previous  
21 answer, that's not your --

22 A Again, from an accounting perspective,  
23 there are some other conversations that may well  
24 apply to that type of situation. And what I am  
25 thinking of specifically in the carrier property

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1 instructions, there used to be a prescribed unit of  
2 property definition. And I guess, for lack of a  
3 better way of explaining it, units of property are  
4 essentially identified types of property that are  
5 used for tracking what type of facilities, and what  
6 components of the pipeline have been installed.

7           If something is -- let me give you a  
8 concrete example. The previous Uniform System of  
9 Accounts, which was updated just a year and a half  
10 ago, included unit of property definitions that  
11 would include for, I believe, six-inch diameter pipe  
12 or larger, if a section of 1,500 feet or more was  
13 considered a unit of property, if you were going to  
14 do a repair on a trunk line that was six inches or  
15 more in diameter, that was for a section that was  
16 only 10 feet, it was less than a unit of property.

17           And even if you removed a piece and  
18 replaced it, if it was only 10 feet, you expensed  
19 it. If was more than 1,500 feet, you would  
20 capitalize it when it's replaced, whether or not it  
21 reflected an improvement. It met the unit of  
22 property requirement.

23           It's an easier case to make if you are  
24 improving. It's a lot clearer, but in the case of  
25 earthquake damage, as your example was, if it was

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1 necessary to replace a mile of pipe contiguously, I  
2 believe the accounting for that would require you to  
3 retire what was removed, and capitalize what you  
4 installed. And that would have, I think, less to do  
5 with the improvement than it did that it met the  
6 unit of property requirement.

7 Now, currently, there aren't units or  
8 property defined, but pipelines are required to have  
9 a unit of property listing that they will use in  
10 that same manner, so the concept still applies.

11 Q Okay. I think I followed most of that,  
12 except I may have missed something at the beginning  
13 of your answer. You say are required. Required by  
14 what, or where, or what document?

15 A The Uniform System of Accounts requires  
16 companies to maintain a unit of property listing.

17 Q And is the Uniform System of Accounts  
18 specific on points like 10 feet versus one mile, or  
19 is it a more abstract level and some judgment has to  
20 be brought to bear?

21 A In this particular example, until the FERC  
22 decided that they would let oil pipelines establish  
23 units of property for themselves, it was specific to  
24 1,500 feet of pipe that is six inches in diameter or  
25 greater. And there was a longer length. I don't

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1 remember if it was 2,000 or 3,000 feet. It was less  
2 than six inches in diameter.

3 Q But you are using past-tense?

4 A Up until a year and a half ago they were  
5 prescribed, and now they don't tell you what they  
6 should be, but that you maintain units of property  
7 and you use them in accounting for property.

8 Q Back to the example at hand, on the  
9 \$455,000, is there specific -- are there specific  
10 guidelines on that, or are there more general  
11 guidelines, and some professional or employee has to  
12 make a judgment about where this goes?

13 A I think there are some specific guidelines,  
14 and there are interpretations that need to be  
15 applied in some situations. I don't know what  
16 decision process may have been undertaken at the  
17 company, specifically with regard to this.

18 But based on what I have seen, and things  
19 that I have dealt with before in working with oil  
20 pipeline companies, and with what the Uniform System  
21 of Accounts says, and my understanding of accounting  
22 principles, I believe this is fairly clear, a  
23 repair. Which is the treatment would be to expense  
24 it.

25 Q But as you answered previously, you are

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1 basing that judgment on some information that was  
2 provided to you, but you, yourself, didn't review  
3 exactly what the money went for. It was represented  
4 to you in some higher level form?

5 A That's correct. What I was provided with  
6 was the information about what this -- what the  
7 project involved in terms of lowering the line that  
8 became exposed from storm water run-off, and that  
9 this was at, I believe, East Creek, and was not a  
10 particularly long section of the pipe that was  
11 involved.

12 CHAIRWOMAN SHOWALTER: I have no further  
13 questions. Thank you.

14 JUDGE WALLIS: Very well. In light of the  
15 hour and the other activities today, let's take a  
16 break. We will resume at 1:30.

17 (Lunch recess taken.)

18 JUDGE WALLIS: Let's be back on the record,  
19 please, following our noon recess.

20 At the end of this morning's session, we  
21 completed examination from the bench, and counsel  
22 may have questions before we return to redirect.

23 Mr. Brena.

24 MR. BRENA: I am last in line, so I assume  
25 Mr. Trotter or Mr. Finklea.

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(NO RESPONSE.)

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REXCROSS EXAMINATION

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BY MR. BRENA:

6

Q Good afternoon.

7

A Good afternoon.

8

Q I wanted to follow up on Chairwoman

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Showalter's questions with regard to accounting

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conventions. In your questions and answers with

11

her, for example, with regard to the line lowering,

12

did I understand your answer correctly, that for the

13

purposes of the Uniform System of Accounts the line

14

lowering is properly categorized as an expense?

15

A Yes.

16

Q And you were advancing that opinion as a

17

statement on how the definitions within the Uniform

18

System of Accounts should be applied to that event,

19

correct?

20

A I believe that statement is supported by

21

the Uniform System of Accounts, and I will -- I also

22

think it's consistent with GAAP as it happens.

23

Q So the answer to my question would be

24

"yes"?

25

A Yes.

3611

1           Q    Now, in the Uniform System of Accounts --  
2           and I want to ask you some questions about the  
3           difference between the Uniform System of Accounts  
4           and rate making.  Now, is there any such convention  
5           within the Uniform System of Accounts that requires  
6           normalization?

7           A    Not normalization per se, unless you  
8           consider depreciation on a straight-line basis to be  
9           a form of normalization.

10          Q    With the exception of depreciation, is it  
11          fair to say that the Uniform System of Accounts are  
12          not just to normalize level of expenses, but instead  
13          are intended to record what the expenses were for  
14          that period on an accrual basis is?

15          A    For the most part I would agree.  There may  
16          be provisions for how delayed items from one period  
17          to the next may be recorded that might involve  
18          amortizing an adjustment, but that would be more  
19          from an accounting perspective than from a rate  
20          making perspective.

21          Q    Similarly, there's nothing within the  
22          Uniform System of Accounts that requires the removal  
23          of non-recurring costs, correct?

24          A    To the extent that you are describing that  
25          as a rate making adjustment, I would agree.  But

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1 nothing comes to mind that mentions non-recurring  
2 costs and a defined term. Even the Uniform System  
3 of Accounts is reporting your costs, not treating  
4 them for rate making purposes.

5 Q So it's fair to say that under the Uniform  
6 System of Accounts, the entire concept of recurring  
7 or non-recurring costs is a concept that is foreign  
8 to the proper recordation of expenses under the  
9 Uniform System of Accounts?

10 A I think -- I am not sure, entirely foreign.  
11 I don't think it's a guiding principle in the  
12 Uniform System of Accounts. I don't think it  
13 determines how things are reported in, say, the Form  
14 6.

15 Q With regard to -- and I am not speaking  
16 about the Form 6. I am only talking about the  
17 Uniform System of Accounts, whether an expense is  
18 recurring or non-recurring is irrelevant for how you  
19 record it within the Uniform System of Accounts,  
20 isn't it?

21 A There's a category of -- well, accounting  
22 designation for extraordinary items which one might  
23 consider to be consistent with non-recurring costs,  
24 and that is specifically addressed in the Uniform  
25 System of Accounts.



3613

1           Q    Do you consider the definition of  
2           extraordinary cost within the Uniform System of  
3           Accounts to be the same concept as the recurring and  
4           non-recurring costs as it's used in rate making?

5           A    I think there's degrees of definition of  
6           non-recurring that might bring those two in  
7           alignment.  I don't think non-recurring as it's used  
8           in rate making is necessarily identical to an  
9           extraordinary cost and extraordinary item as defined  
10          for accounting purposes.

11          Q    Well, the truth of the matter is you may  
12          have a perfect set of accounts, according to the  
13          Uniform System of Accounts, and none of those have  
14          been put through the rate making filter of  
15          normalization, recurring, non-recurring, whether or  
16          not it's properly expensed over a period of time for  
17          rate making or not.

18                 The fact is there's an entire regulatory  
19          filter that those Uniform System of Accounts has to  
20          go through within the context of a rate proceeding,  
21          correct?

22          A    I am not sure I agree with your analogy  
23          entirely, but I would agree that the treatment of  
24          them for the accounting purposes in the Form 6, or  
25          in conformance with the Uniform System of Accounts

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1 doesn't, in every event, tell you what the proper  
2 treatment is for rate making presentation.

3 Q Well, in this particular case, the FERC  
4 6 -- which, did your firm help prepare?

5 A I did not personally. I don't know. I  
6 believe we may have assisted with preparing some of  
7 the information on page 700, but I was not involved  
8 personally. Beyond page 700, I don't believe we had  
9 any involvement.

10 Q I mean, in the FERC 6 that Olympic just  
11 filed, it's millions of dollars higher than the cost  
12 of service they have proposed in this case as a  
13 result of the Whatcom Creek event; isn't that true?

14 A My understanding is that would be one major  
15 difference in the costs reported between those two  
16 forms of presentation.

17 Q So the Uniform System of Accounts, from a  
18 rate making perspective, is a beginning point, but  
19 not an end point, correct?

20 A It would be a beginning point. I don't  
21 know if it's all encompassing.

22 Q Now, to go to the line lowering example  
23 that the Chairwoman was exploring, it may well be  
24 that the line lowering perfectly fit within the  
25 definition of an expense within the Uniform System

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1 of Accounts, but that doesn't necessarily mean  
2 that's the appropriate treatment for rate making  
3 purposes, does it?

4 A It doesn't mean it is or isn't.

5 Q Doesn't speak to it either way, does it?

6 A Not for the purpose that the Uniform System  
7 of Accounts addresses it, no.

8 MR. BRENA: Thank you. I have no further  
9 questions.

10 JUDGE WALLIS: Mr. Trotter.

11 MR. TROTTER: No questions.

12 JUDGE WALLIS: Redirect?

13 MR. HARRIGAN: Thank you, Your Honor.

14

15 REDIRECT EXAMINATION

16

17 BY MR. HARRIGAN:

18 Q Mr. Ganz, did the Staff criticism of line  
19 lowering treatment on Olympic's books and records  
20 relate to whether it was an expense or capital item,  
21 or to the appropriateness of how it should be  
22 treated in the rate making process?

23 A The issue that I responded to in my  
24 testimony that was raised in Staff's testimony was  
25 whether the cost was appropriately recorded as a

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1 capital cost or operating expense.

2 Q And how was it, in fact, recorded by  
3 Olympic?

4 A Olympic had reflected the cost as an  
5 operating expense.

6 Q And in your opinion, was that the proper  
7 way to report it under the USoA.

8 MR. TROTTER: I object; asked and answered.  
9 It's in the direct.

10 JUDGE WALLIS: The witness may respond.

11 THE WITNESS: My testimony is that that is  
12 the appropriate way to record it.

13 Q BY MR. HARRIGAN: Now, would you please  
14 turn to Exhibit 1107, which is the complete version  
15 of the December 31, 1998 financial statements with  
16 notes.

17 A I have that.

18 Q And you were asked about one of the notes  
19 on cross, which appears -- if you want if you look  
20 at the stamp numbers, it's the stamp No. 6231 at the  
21 bottom.

22 A Yes, I have that.

23 Q And you were asked about whether -- about  
24 the statement that the accounting policies followed  
25 in preparation of these financial statements

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1 generally conform to those required by the FERC, and  
2 are not materially different from Generally Accepted  
3 Accounting Principles. And then you were further  
4 asked about whether that meant there would be no  
5 material differences in the numbers that were  
6 generated in the financial statements based upon  
7 whether they were prepared pursuant to the FERC  
8 requirements or to Generally Accepted Accounting  
9 Principles.

10 I am just directing you to that area of  
11 your questioning. Do you have that in mind?

12 A Yes.

13 Q You mentioned an instance relating to the  
14 disposition of an asset that would be treated  
15 differently under Generally Accepted Accounting  
16 Principles and under the USoA method. Would you  
17 generally describe what those differences are?

18 A The instance I was referring to was the  
19 treatment to record the sale of an asset. And in  
20 general terms, the recording of the sale of an asset  
21 would follow the carrier property instructions for  
22 an asset retirement. The carrier property balance  
23 would be reduced by the original cost of the assets,  
24 and the accrued depreciation balance, also, would be  
25 reduced by the original cost.

1           And the proceeds under the USoA would then  
2 be applied to the accrued depreciation balance.  
3 There would be no income statement effect.

4           Q   And generally speaking, what would be the  
5 effect on the rate base, or how would the effect on  
6 the rate base be determined as a result of that  
7 calculation?

8           A   As a result of that calculation, the  
9 retirement porting of that would not change the rate  
10 base, but the rate base would change depending upon  
11 what the net salvage realized on the asset is.  
12 Assuming it was sold for more than its cost to remove  
13 it from service, it would reduce the rate base.

14          Q   Is one of the accounts that would be  
15 affected by this exercise under the USoA method  
16 accrued depreciation or accumulated depreciation?

17          A   Yes, that is where the proceeds would be  
18 recorded on Account 31.

19          Q   And before we get to the GAAP part, let me  
20 ask you this preliminary question. If you were to  
21 perform -- if you were to calculate the effect of  
22 the same disposition under Generally Accepted  
23 Accounting Principles, would the accrued  
24 depreciation number that -- the accrued depreciation  
25 effect of that be the same number as you would get

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1 using the USoA method?

2 A No, it would not.

3 Q And what is the -- how would this same  
4 transaction be treated under GAAP?

5 A Under GAAP, the carrier property balance  
6 would be reduced by the original cost. The accrued  
7 depreciation balance would be reduced by the amount  
8 of accrued depreciation taken on the asset to date,  
9 and the gain or loss from any proceeds, or cost of  
10 removal related to it, would be put on the income  
11 statement. And ultimately, after taxes are paid, it  
12 would be reflected in retained earnings.

13 Q And turning then to -- turning back a  
14 couple of pages in this exhibit to the balance  
15 sheet, which is at page with the stamp ending 228 on  
16 it. If you look down toward the bottom of that page  
17 under the general heading that there's a line item  
18 for retained earnings?

19 A Yes.

20 Q And is that an item that is a line item  
21 that would be the same, regardless of whether you  
22 treated this asset disposition under GAAP or USoA,  
23 or could it be different?

24 A My expectation would be it would be  
25 different.

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1           Q    And depending on the asset and the size of  
2   the company, could that difference between the GAAP  
3   approach and the USoA approach be material?

4           A    Depending on the size of the company, or  
5   the nature of the asset, or the sales price, that  
6   could be significantly different.

7           Q    So could it be material from an accounting  
8   standpoint?

9           A    The difference in the number could be  
10  material, despite the accounting policies, perhaps,  
11  not being materially different.

12          Q    In other words, even though it may be true  
13  as a general proposition that general accounting  
14  policies in the two systems are not materially  
15  different, can their application lead to materially  
16  different results?

17          A    Yes.

18          Q    Now, is there an entry on the Form 6 that  
19  Olympic filed that is affected by asset disposition?  
20  We have looked at this balance sheet here, which has  
21  this retained earnings section on it. By the same  
22  token, is there also a part of form No. 6 that would  
23  be affected by the asset disposition calculations?

24          A    Yes. In Exhibit 1104 on page 113, this is  
25  the 2001 Form 6. And -- oh, I am sorry. Wrong



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1 page. The one before that page, 111.

2 Q Okay.

3 A On line 31 what is reflected on that line  
4 is accrued depreciation of carrier property, which  
5 also happens to be account 31. That's consistent  
6 with the accrued depreciation balance. Well, we  
7 looked at a different balance on the financials, but  
8 this is where it would be reflected directly in the  
9 Form 6 information.

10 Q And if the financial statements of the  
11 company were prepared on a GAAP basis, and in fact,  
12 there had been a significant asset disposition,  
13 would you expect to find the same number under  
14 accrued depreciation in the GAAP statement as on  
15 this Form 6?

16 A No, I would not.

17 Q And specifically, why not?

18 A Specifically because the net salvage value  
19 realized on any asset retirement, whether they have  
20 been sold or just removed from service, whatever the  
21 net salvage is would be applied to this balance in  
22 Account 31 in the Form 6.

23 Q Okay. Now, as a general proposition, is  
24 this the only area where there would be a potential  
25 effect, or in general -- let me ask you more

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1 generally.

2           Could you fill out form No. 6 with the sole  
3 exception of the accrued depreciation section using  
4 a GAAP based financial system?

5           A    No. The corresponding change to what I  
6 have been describing as the difference that would  
7 result in the accrued depreciation balance would  
8 also flow through to the retained earnings balance  
9 on page 113. I believe it appears on line 70 on  
10 page 113.

11           Q    Now, was the FERC, in fact, asked by the  
12 pipeline industry to conform the USoA to GAAP  
13 principles?

14           A    Yes, the industry --

15           MR. TROTTER: I will interrupt. I will  
16 object. We're rehashing testimony he quoted  
17 directly from this in his direct, and we're hearing  
18 it again.

19           MR. HARRIGAN: He was cross examined on  
20 this very subject, and the extent to which FERC's  
21 order did, in fact, adopt Generally Accepted  
22 Accounting Principles. And that's precisely what I  
23 am getting at in this question.

24           MR. TROTTER: That's why it was asked and  
25 answered. It was in his direct.

1                   JUDGE WALLIS:  If it's in his direct, you  
2     can cite to it and you need not inquire into it  
3     again.

4                   Q    BY MR. HARRIGAN:  You were asked on cross  
5     examination -- excuse me.  Let me find my notes on  
6     that.

7                   You were asked about a FERC order that was  
8     designed to, quote, meet regulatory requirements and  
9     industry needs, and to up indicate the Uniform  
10    System of Accounts to be more consistent with GAAP.

11                   In connection with that order, what was the  
12    FERC's ultimate decision with regard to adopting  
13    GAAP as the basis for USoA?

14                   A    Ultimately the Commission declined to  
15    simply accept financial GAAP.  GAAP has statements  
16    in lieu of Form 6 and USoA.

17                   Q    Has the WUTC indicated to the pipeline  
18    industry in this state whether it requires the use  
19    of Form 6 in connection with proceedings such as  
20    this?

21                   MR. TROTTER:  I object to the form of the  
22    question.  One, he testified in his direct the  
23    Commission by rule has described Form 6, for  
24    reporting purposes, although his question was for  
25    rate making.  I am intrigued with that answer.  But

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1 in terms of his testimony, he's already addressed  
2 the reporting function.

3 But if the question is specifically to Form  
4 6 for rate making, and the witness has knowledge of  
5 what this Commission has described for rate making,  
6 I will withdraw.

7 JUDGE WALLIS: Mr. Harrigan.

8 MR. HARRIGAN: I will stick with the direct  
9 testimony that Counsel has alluded to, and move on.

10 Q BY MR. HARRIGAN: Does the use of Form 6  
11 for reporting purposes require that the entity  
12 maintain a system of account consistent with the  
13 USoA system?

14 A Yes.

15 Q So, for example, if you were to look at  
16 such a financial statement resulting from such  
17 accounts, you would find entries consistent with  
18 USoA, and where that differed from GAAP, you would  
19 find differences?

20 A Yes.

21 MR. TROTTER: Let me object after the fact.  
22 We're into a lot of leading questions, and this has  
23 been described in his direct testimony.

24 MR. HARRIGAN: The witness has answered the  
25 question. If necessary, I will move on.

1           JUDGE WALLIS: Mr. Harrigan, we are in a  
2 situation where we have some time pressures. We  
3 certainly want the examination of the witness to be  
4 complete, but to the extent that it becomes  
5 repetitive, that is likely unnecessary and is a  
6 burden.

7           So we would ask you to avoid raising,  
8 again, matters that the witness has testified to  
9 either on cross or on direct. And the same form, if  
10 you are opening an area and want to make a  
11 foundation for further questions, then certainly  
12 preliminary questions are appropriate.

13           MR. HARRIGAN: Thank you, Your Honor.

14           Q BY MR. HARRIGAN: Mr. Ganz, you were asked  
15 with regard to the second set of criterion of the  
16 financial standards accounting -- Financial  
17 Accounting Standards Board to determine whether FASB  
18 applies to certain situations, and you referred to a  
19 provision that says that the criterion depends in  
20 part on whether rates were designed to reflect the  
21 cost base of the entity.

22           A Yes.

23           Q Okay. And then you were also asked what  
24 happens, what is the significance if one of two  
25 things is the case; one, the entity, in fact,

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1 applies, for example, to this Commission for rates  
2 that are based on cost. How does that affect the  
3 applicability of FASB 71 under that criteria? And  
4 secondly, what would be the effect of this  
5 Commission, in fact, setting rates?

6 And lastly and finally, in connection with  
7 that, you discussed the fact that rates can be  
8 indexed. What is the effect of the fact that rates  
9 can be indexed by FERC on the application of FASB 71  
10 to a company such as Olympic?

11 MR. TROTTER: I will pose an objection.  
12 This is addressed on page 7 of the testimony.

13 MR. BRENA: I object on relevance grounds.

14 MR. HARRIGAN: The specific issue is not  
15 addressed, and that is whether the application by  
16 Olympic, or the setting of the rates by this  
17 Commission falls within the criterion.

18 The witness merely stated on direct that  
19 the criteria is not satisfied. He did not address  
20 the two questions raised on cross.

21 JUDGE WALLIS: The witness may respond.

22 THE WITNESS: I am sorry. I lost the  
23 question.

24 Q BY MR. HARRIGAN: Did the applicability of  
25 FASB 71 under the second criteria change if, for

1 example, Olympic applies to both the FERC and this  
2 Commission for rates that are set on a cost basis?

3 A I don't believe it does.

4 Q Why is that?

5 A Applying for it, and assuming even that  
6 rates are approved on that basis, does not make cost  
7 of service or cost based rates. The, I will say,  
8 Evergreen provision by which rates are set, the  
9 rates that are set at the FERC based on costs become  
10 the rates that will be indexed going forward. So a  
11 one-time resetting of the rates on a cost of service  
12 basis does not imply that they will be set and  
13 matched with costs on any other occasion when the  
14 company seeks to change the rates.

15 Q And does FASB 71 itself address the subject  
16 of its application to indexed rates?

17 A Yes, it does address it specifically. One  
18 of the explanatory discussions says -- it's  
19 paragraph 65 of FASB 71. It says, "The second  
20 criterion is that regulated rates are designed to  
21 recover the specific enterprise's costs of providing  
22 the regulated services or products. If rates are  
23 based on industry costs, or some other measure that  
24 is not directly related to the specific enterprise's  
25 costs, there is no cause and effect relationship

1 between the enterprise's cost and its revenues. In  
2 that case, price would not revenues approximately  
3 equal to the costs.

4 "Thus the basis for the accounting  
5 specified in this statement is not present under  
6 that type of regulation. That criterion is intended  
7 to be applied to the substance of the regulation  
8 rather than its form.

9 "If an enterprise's regulated rates are  
10 based on the costs of a group of companies, and the  
11 enterprise is so large in relation to the group of  
12 companies that its cost are in essence, the group's  
13 costs, the regulation would meet the second  
14 criterion for that enterprise."

15 Again, that is not what the indexes at the  
16 FERC would accomplish.

17 Q And the word used in the criterion are  
18 whether the rates are designed to reflect the cost  
19 of the enterprise, correct?

20 A Yes.

21 Q And what about the notion that FASB 71  
22 could apply in part, because the state Commission  
23 sets rates on one basis, and the FERC may set them  
24 on another basis? Is that a feasible way of  
25 applying FASB 71?



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1                   MR. BRENA:  Objection; this is beyond the  
2  scope of his cross.

3                   MR. HARRIGAN:  The cross asked that very  
4  question, Your Honor, but I don't think the answer  
5  was complete.

6                   MR. TROTTER:  That does raise the point,  
7  the question was asked and he answered.

8                   MR. HARRIGAN:  There seems to be  
9  disagreement.

10                  MR. TROTTER:  If the question can focus on  
11  the nature of what Counsel believes was an  
12  incomplete answer, it might be appropriate.

13                  JUDGE WALLIS:  Mr. Harrigan, please don't  
14  repeat a question that was asked.

15                  MR. HARRIGAN:  I will refrain from that,  
16  Your Honor.

17                  Q   BY MR. HARRIGAN:  Is it feasible to apply  
18  FASB 71 on a partial basis between two different  
19  rate making entities?

20                  A   I don't believe you can apply it partially  
21  to a company.  There's one nature of operations that  
22  Olympic performs, and splitting a portion of its  
23  operation to apply FASB 71 is -- I don't think is  
24  addressed in it.

25                  Q   Would you go back to Exhibit 1107 for a

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1 moment. This is, again, the December financial --  
2 december '98 financial statement. And does the  
3 second page of the notes for those financial  
4 statements contain a statement regarding the  
5 criteria that are applied by Olympic in  
6 differentiating expenses from capital items?

7 A Yes. The second full paragraph, first  
8 sentence starts, "Expenditures for major renewals  
9 and betterments are capitalized, while minor  
10 replacements, maintenance, and repairs which do not  
11 improve or extend asset lives are expensed as  
12 incurred."

13 Q Is there, in your view, a conceptual  
14 difference in expensing versus capitalizing between  
15 the line lowering based on the information you have  
16 about what was done and, for example, painting tanks  
17 or valves?

18 MR. TROTTER: I object to the question.  
19 It's in the direct.

20 MR. BRENA: That specific example is in  
21 the direct.

22 JUDGE WALLIS: Mr. Harrigan.

23 MR. HARRIGAN: I don't think the comparison  
24 is in the direct.

25 MR. BRENA: Well, the painting tanks

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1 comparison is.

2 MR. HARRIGAN: I guess, Your Honor, perhaps  
3 it would be -- a better explanation of the reason  
4 for this question is a number of questions were  
5 asked about this very subject, and I believe that an  
6 explanation of the reasons why the two are or are  
7 not analogous will shed some light on a number of  
8 those questions. Just because the subject was  
9 touched on in direct does not mean it was fully  
10 explored in light of the other issues that were  
11 raised.

12 JUDGE WALLIS: Perhaps if you rephrase your  
13 question.

14 Q BY MR. HARRIGAN: If the painting of an  
15 object, such as a tank or valve, improved the  
16 efficiency of the operation by preventing rust, for  
17 example, would that mean it should be capitalized?

18 A No. That's a maintenance type activity.  
19 It would be a by-product of the painting that it  
20 extended the life, or made it more efficient. But  
21 the nature of the activity is maintenance.

22 Q And you have also been asked about a  
23 criterion that is sometimes employed to  
24 differentiate capital versus expense items; namely  
25 whether they will provide benefits beyond the period

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1 of one year. What is the triggering event for  
2 applying that criterion?

3 A That criterion I am most familiar with  
4 being applied in the instances where you're  
5 constructing or improving assets, versus maintaining  
6 asset.

7 Q So you use the criterion to decide whether  
8 you are constructing or improving them, or is it the  
9 other way around?

10 A It's the other way around. And that  
11 criteria itself is an accounting principle that is  
12 consistent with why you would capitalize the costs  
13 in the event that you are constructing or improving.

14 Q And does the outcome with respect to this  
15 line lowering issue, in your view, change whether  
16 you apply USoA or GAAP accounting principles?

17 A No.

18 Q In the same connection, and I want here to  
19 clarify the current situation, you referred to the  
20 prior existence of something called units of  
21 property which were originally defined in certain  
22 ways, and said they were no longer rigidly defined,  
23 but the company now determines what its units of  
24 property are.

25 Does the company determine that after the

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1 fact; that is, does Olympic look at the line  
2 lowering and say, we're going to call that a unit of  
3 property or not a unit of property, or is it  
4 prospective?

5 A That is something that is established and  
6 followed, versus established at the time there's a  
7 need for it.

8 Q So, in other words, today, could you look  
9 at records of Olympic and find out what its units of  
10 property were?

11 MR. BRENA: Objection; there's no  
12 foundation that this witness has any information or  
13 knowledge relative to the records of Olympic  
14 whatsoever.

15 MR. HARRIGAN: I will change the question,  
16 Your Honor.

17 JUDGE WALLIS: Very well.

18 Q BY MR. HARRIGAN: Is Olympic required to  
19 have prospective designation of its units of  
20 property?

21 A Olympic is required under USoA to maintain  
22 a units of property list, and justify any changes to  
23 it. The fact that Olympic has been in operation for  
24 a number of years, they were operating at the time  
25 prior to about a year and a half ago when the FERC

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1 removed the specific prescribed units of property  
2 listing from the USoA, but that would mean that  
3 they were operating when they were subject to the  
4 prescribed list. And at this point, if they want to  
5 deviate, they have to justify any deviation.

6 Q And under the -- under that general  
7 approach, if you are moving a pipe of a length of 20  
8 or 30 feet, does that, under the prior system, come  
9 within the expense or capital category?

10 A In dealing with a piece of pipe of 20 or 30  
11 feet, would be less than a unit of property. That  
12 would be considered a minor item. And to the extent  
13 that that event involved replacing it, it would be  
14 expensed.

15 Q You were asked about a prior case in which  
16 you testified with respect to the calculations of  
17 AFUDC. Do you recall that?

18 A Yes.

19 Q What was the -- what was the situation in  
20 that case which gave rise to the need for an  
21 estimate, which in that instance, in your case was  
22 50 percent for AFUDC, as opposed to a traditional  
23 calculation?

24 A The nature of the issue that was addressed  
25 in the excerpt that I was referred to in Exhibit

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1 1109 is that the company had maintained records, but  
2 the records were not in a form that were convenient  
3 or conducive to developing AFUDC calculated based on  
4 monthly construction work in progress balances.

5           So it was more the form of the data that  
6 was at issue there, rather than whether they had the  
7 data. But I would note this related to the data  
8 upon which AFUDC would be calculated, not whether or  
9 not a calculation was done, or whether it was  
10 recorded on their books. It was how the calculation  
11 was done.

12           Q And what was the data that was not in  
13 appropriate form, or in a form that was readily  
14 useable?

15           A The data that was not readily useable was  
16 monthly construction in progress balances by  
17 individual construction project.

18           Q In this case, the Staff has made a  
19 criticism of Olympic's records relating to AFUDC.  
20 Is that analogous at all to the issue that you just  
21 described?

22           A No. The issue that I am responding to in  
23 my testimony had to do with recording AFUDC in their  
24 books and records; not the form of the information  
25 on which you would calculate it.

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1           Q    And what does the USoA system of accounting  
2   prescribe with respect to whether one records AFUDC  
3   contemporaneously or monthly, or any other predicted  
4   way on books and records?

5           A    It does not address it.  There is no  
6   provision for recording it.

7           Q    And apart from there being no provision for  
8   recording it, is it practical to do so, say, on a  
9   monthly basis?

10          A    I am not sure I understand the "practical"  
11   issue.

12          Q    Is there a difference between the  
13   prescription in the gas and electric utility  
14   regulations with respect to this subject, and  
15   whatever is provided for pipelines?

16          A    Yes, there's a vast difference.  The gas  
17   and electric Uniform System of Accounts provide  
18   specific instructions on it.  There are no  
19   instructions, period, in the oil pipeline USoA.  
20   Aside from that, as I believe I mentioned, there's  
21   no rate of return authorized, so it would be a guess  
22   and subject to challenge in recording something.  
23   Just to have it changed seems like a little bit of  
24   an administrative burden.

25          Q    Now, is there anything about the fact that



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1 Olympic does not record AFUDC that suggests it's out  
2 of compliance with the USoA requirements?

3 A No.

4 Q Is there anyplace on Form 6 for putting  
5 AFUDC?

6 A There are not accounts for recording AFUDC.  
7 It would only appear on page 700, where the cost of  
8 service under opinion 154B is reported.

9 Q Then you were asked about a FERC decision,  
10 I believe, No. 351, that changed the cost of  
11 construction to include AFUDC, and you indicated  
12 that it did not change the USoA to call for  
13 recording it. Why is it that the latter was not  
14 done, even though the former was done?

15 A As far as why the discussion in Opinion 351  
16 was addressing a rate making presentation, it was  
17 not addressing an accounting requirement. I think  
18 the FERC is fully aware of its accounting  
19 requirements, and the disparity between the rate  
20 making treatment and the accounting requirements  
21 that don't address it.

22 Q Then, finally, going back for a moment with  
23 regard to Opinion 435, the decision that you were  
24 discussing, what was the difference between the  
25 outcome and what you testified to that you were

3638

1 asked about?

2 A The difference is that the -- what is  
3 described in this excerpt in Exhibit 1109 is that  
4 the method of calculation that I had proposed was to  
5 take 50 percent of the capital additions for the  
6 sections of the company that were at issue in this  
7 proceeding, and to use that as the, say, AFUDC  
8 earnings base. And the outcome of the case was that  
9 the 50 percent factor was changed to something just  
10 under 30 percent.

11 Q And in questioning you earlier, Mr. Brena  
12 referred to a 50 percent issue arising in this case.  
13 Did the two have anything to do with each other?

14 A No. The 50 percent issue that I understand  
15 arises in this case had to do with a percentage of  
16 construction work in progress that was  
17 representative of the investment placed in service.  
18 And that was applied to a construction work in  
19 progress balance, versus being applied to a capital  
20 addition amount.

21 Q On the subject of the test year, when was  
22 this case filed?

23 A My understanding is that the proceeding  
24 that we're in here to talk about Olympic's  
25 intra-state rates began when they filed the direct

3639

1 case in December of 2001.

2 Q And what test year was used?

3 A The test year that was used -- again, using  
4 this Commission's terminology, the test year was  
5 October 2000 through September 2001.

6 Q And is the use of that test year correct  
7 under the applicable criteria?

8 A I believe.

9 MR. TROTTER: I object until we define what  
10 applicable criteria -- if he means FERC or WUTC  
11 applicable criteria.

12 Q BY MR. HARRIGAN: Let's start with FERC  
13 applicable criteria.

14 A There's a mix in concepts here. I think it  
15 is under this Commission's regulations that the rate  
16 filing is considered to have happened in December of  
17 2001, but that would not be FERC criteria.

18 Q Okay. But given that it was deemed to be  
19 December 2001 under which Commission's criteria,  
20 under the FERC criteria, or any other applicable  
21 criteria, what is it appropriate -- was the test  
22 year the appropriate one that was used?

23 A The test year that was used in the December  
24 filing of the direct case is consistent with my  
25 understanding of how this Commission defines test

3640

1 period.

2 Q And how is that?

3 A The test period is defined as a recent  
4 12-month period for which income statements and  
5 balance sheets are available.

6 MR. BRENA: I move that that be struck. I  
7 explored this witness' knowledge. Over the lunch  
8 hour he obviously went and got a regulation and read  
9 it.

10 If he's going to give that sort of  
11 testimony, I should have an opportunity to ask  
12 whether he knew this Commission's regulation, or  
13 whether it was consistent or not. The line of  
14 examination was related to FERC, and he didn't know  
15 any of these things. So if knowledge has  
16 miraculously appeared, I should be able to explore  
17 it.

18 MR. HARRIGAN: Your Honor, I think the  
19 witness' direct testimony contains that statement of  
20 the criteria, if I am not mistaken.

21 Q BY MR. HARRIGAN: Mr. Ganz, can you  
22 enlighten me about that?

23 A Page 26 of Exhibit 1101, starting at line  
24 9.

25 JUDGE WALLIS: So is there any need to go

3641

1 through this again?

2 MR. HARRIGAN: Your Honor, I am merely  
3 leading up to a final question, which is not  
4 repetitive at all. I want to establish that it's  
5 the witness' view that the correct year was used  
6 based on the applicable WUTC criteria. And my final  
7 question is, who, in this proceeding, is seeking to  
8 change the test year? Is Olympic seeking to do so?

9 MR. BRENA: Objection; beyond the scope.

10 MR. TROTTER: I object, Your Honor, because  
11 the authority that he has cited on his page talks  
12 about the 12-month period for which income sheets  
13 and balance sheets are available, and that's what  
14 Staff used. So Staff's case meets the definition  
15 that Mr. Ganz is quoting in his testimony. So  
16 there's no basis for the question.

17 MR. HARRIGAN: Your Honor, first of all,  
18 that is not correct, because the 12-month period  
19 used by the Staff hadn't ended yet in December when  
20 the filing was made. So that information was not  
21 available for that 12-month period.

22 And secondly, on cross the witness was  
23 asked whether Olympic was seeking to change the test  
24 year. My question is, A, is that true, and B, who  
25 is seeking to change the test year?

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1           MR. TROTTER: My point is that the  
2 authority that they rely on does not speak to the  
3 issue of whether it's appropriate for another party  
4 in the proceeding to use balance sheets from a more  
5 recent period. It's not addressed. At least we  
6 stipulate 2001 data balance sheet and accounting  
7 statements were not available to Olympic when they  
8 filed. But that's not addressed by these  
9 precedents.

10           JUDGE WALLIS: I think the objection should  
11 be sustained.

12           Q BY MR. HARRIGAN: Was the most recent  
13 12-month period for which income statements and  
14 balance sheets were available, one that ended on  
15 December 31 at the time that this case was filed?

16           A No.

17           Q What was the 12-month period for which that  
18 information was available?

19           A The period is the October 2002 to September  
20 2001 period that Olympic used in its direct case.

21           Q With regard -- you were asked some  
22 questions about the sale of Sea-Tac, and the actual  
23 figures that were generate by various people.

24                   In connection with that sale, did Olympic  
25 in its treatment of the Sea-Tac sale, perform the

3643

1 analysis and calculations in accordance with the  
2 USoA requirements as you have already described  
3 them?

4 A Yes.

5 Q And did Mr. Twitchell's calculations of the  
6 same matter conform to the USoA criteria?

7 MR. TROTTER: Objection; again his  
8 testimony addresses it in his direct. It's asked  
9 and answered.

10 MR. HARRIGAN: Your Honor, the witness was  
11 asked about resulting numbers, and I want to clarify  
12 something. I want to clarify, basically, that the  
13 differences between the numbers that were discussed  
14 on cross do not have anything to do with the  
15 difference of opinion about the methodology.

16 MR. TROTTER: And that is stated in the  
17 direct.

18 JUDGE WALLIS: The objection is sustained.

19 Q BY MR. HARRIGAN: You were asked questions  
20 about the starting rate base issue on cross  
21 examination?

22 A Yes.

23 Q And what was the Staff criticism of  
24 Olympic's treatment of starting rate base?

25 A The one I addressed in terms of my

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1 testimony was primarily that there was nothing  
2 recorded on their books for the starting rate base.

3 Q And is that consistent or inconsistent with  
4 USoa?

5 A The fact that there is nothing recorded on  
6 the books and records is consistent with the USoA.

7 Q Is there any analogy between that and the  
8 AFUDC issue where similarly there is nothing  
9 recorded on the books?

10 A Yes. For the same reason the USoA does not  
11 provide for recording those items. Because as the  
12 FERC methodology is applied, those items are purely  
13 rate making elements. They are calculated when you  
14 are developing a cost of service presentation under  
15 the methodology that was promulgated in opinion  
16 154B.

17 Q And you were asked questions about the  
18 treatment of income tax items with respect to  
19 Bayview. Has the Staff consistently treated the  
20 presence of Bayview in the rate base?

21 MR. TROTTER: Objection.

22 MR. BRENA: I object, too.

23 MR. TROTTER: This is also addressed in his  
24 direct testimony.

25 MR. HARRIGAN: I will withdraw the question



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1 and ask another one.

2 Q BY MR. HARRIGAN: What is the concern that  
3 you have with regard to the treatment of income tax  
4 related expenses in relationship to Bayview that was  
5 partially reviewed with you on cross?

6 MR. TROTTER: I object again. He explored  
7 this on his direct. He might as well refer him to  
8 his testimony and read it. It's the same thing.

9 JUDGE WALLIS: The question will be  
10 allowed.

11 THE WITNESS: The concern that I was  
12 addressing was the inconsistent treatment of the  
13 costs associated with Bayview. The impact of that  
14 was that it was understating the rate base, and  
15 understating -- overstating the interest expense as  
16 it would relate to the tax calculations. And the  
17 result of that was that I believe it understated the  
18 recommended rate increase according to the way that  
19 those were established in the Staff's calculations.

20 Q BY MR. HARRIGAN: How did this  
21 understatement of the rate base come about,  
22 specifically?

23 A By removing the plant associated with  
24 Bayview from the rate base, but leaving the deferred  
25 taxes associated with those same facilities. Since

3646

1 deferred taxes are used as a reduction to the rate  
2 base, the part that reduced the rate base was left  
3 in the rate base that Staff had used, but the plant  
4 associated with it was removed. The Staff treatment  
5 is, I consider to be inconsistent.

6 Q And then Commissioner Showalter (sic) asked  
7 you questions about the role of accounting and  
8 accountants in either determining what actually  
9 occurred versus determining whether expenses or  
10 other items are reasonable.

11 And I just wanted to -- you have already  
12 explained what the role of an accountant in general  
13 is in that. I just wanted to ask you, what about  
14 auditors? Is that an area where the accounting  
15 profession does get involved in assessing the  
16 reasonableness of expense items, and that sort of  
17 thing or not?

18 A As I understand what happens with an audit,  
19 the concern is to record the costs, not to consider  
20 whether they are reasonable for some purpose. This  
21 is primarily a backwards-looking exercise to record  
22 and report economic activity that has occurred.

23 MR. HARRIGAN: I have no other questions.

24 JUDGE WALLIS: Any followups?

25 MR. TROTTER: I have a couple, Your Honor.

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1 JUDGE WALLIS: Mr. Trotter.

2

3 RE CROSS EXAMINATION

4

5 BY MR. TROTTER:

6 Q Mr. Ganz, at the beginning of your redirect  
7 you indicated understanding of the common treatment  
8 of the sale of an asset under USoA, and your  
9 understanding of the treatment of the sale of an  
10 asset under GAAP. Do you recall that?

11 A Yes.

12 Q Do you consider the difference in those  
13 two, as you understand them, to be material  
14 differences?

15 A I think the degree to which that is  
16 material would have to do with the nature of the  
17 company, the size of their asset base, what they  
18 sell, and for how much.

19 Q For Olympic?

20 A I have not reviewed Olympic's history to  
21 know whether that does or doesn't produce a material  
22 difference. I know that that is a difference that  
23 one would find.

24 Q With respect to treatment of the sale of  
25 Sea-Tac, is it your understanding that Olympic's

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1 next -- as of Olympic's next audit, it will show a  
2 \$6,803,408 gain on its books to reflect that sale?

3 A As I mentioned before, there were some  
4 differences in the numbers that Ms. Hammer had come  
5 up with, so I can't vouch for the number.

6 Q Approximately 6.8 million?

7 A My expectation is you would not see that  
8 number on their income statement or reported  
9 anywhere. So it would hit the retained earnings,  
10 being something netted into the accrued depreciation  
11 balance.

12 Q Under GAAP, the company would show a 6.8  
13 million dollar gain, as you understand it?

14 A Absent any consideration of rate  
15 regulation, GAAP recording of that transaction would  
16 be to show the impact of the proceeds as a gain on  
17 the asset sale, and that would be on the income  
18 statement.

19 Q Would that be material -- a material entry  
20 in your opinion, given Olympic's circumstances?

21 A I have not evaluated it in terms of that  
22 dollar amount for Olympic.

23 Q You have no opinion on that subject?

24 A I haven't analyzed it.

25 Q You said no rate of return had been

3649

1 authorized for Olympic. Is that because there's  
2 been no orders issued regarding rates for Olympic?

3 A That's because I am not aware of any rate  
4 being authorized from whatever source.

5 Q Is it appropriate to use the authorized  
6 rate of return for computing AFUDC, assuming a rate  
7 of return is authorized?

8 A I think if you have a rate of return that  
9 is authorized, it would be the most likely thing  
10 that a company would use.

11 Q So just filing rates and having them go  
12 into effect does not constitute authorizing a  
13 specific rate of return?

14 A The kind of authorization I am speaking of  
15 is where a Commission affirmatively authorizes and  
16 adopts, and the company know that it can rely on  
17 that amount, because it has been authorized by the  
18 Commission to use it.

19 Q And simply filing a tariff and having it go  
20 into effect without such an order doesn't do that,  
21 does it?

22 A I don't believe it does. I don't know if  
23 there's a legal distinction that could be drawn that  
24 might suggest otherwise.

25 MR. TROTTER: Nothing further. Thank you.

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1 MR. BRENA: Just a couple of questions.

2

3

REXCROSS EXAMINATION

4

5 BY MR. BRENA:

6 Q Was it your testimony that the filed rate  
7 increase occurred at the same time as they filed the  
8 direct case in this proceeding?

9 A That's my understanding of how things are  
10 viewed here at this Commission.

11 Q So if I were looking at a Staff memo saying  
12 on October 31st Olympic filed a 62 percent rate  
13 increase, then that would be wrong?

14 A If you are looking at a memo that I have  
15 never seen before, I can't tell you one way or the  
16 other.

17 Q Is the fact that I cited from the memo  
18 correct? Are you aware that they filed for the 62  
19 percent rate increase in October 31st, 2001, well  
20 before they filed their supporting information in  
21 December?

22 A I am not sure I have the exact dates of any  
23 of the filings that may have been made. But my  
24 understanding is that the Commission expects the  
25 direct case to be filed with the rate filing, and

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1       until it is filed, that that was not accepted as a  
2       rate filing.

3           Q     Now, I understand that the Commission  
4       typically expects support for a rate filing with the  
5       rate filing.  But wasn't Olympic given the courtesy  
6       of filing their direct case at the same time in  
7       conformance with the FERC schedule in this  
8       particular case, and the rate filing was a couple of  
9       months before?

10          A     I don't know.

11          Q     So to go back to your analysis of test  
12       periods, isn't your entire analysis that you just  
13       went through on test periods dependent on the fact  
14       that they didn't make a rate filing in October?

15          A     No, I don't think it would really change my  
16       opinion.  If they had made the rate filing in  
17       October, the fact is they still would not have had  
18       calendar year 2001 data available to them, and my  
19       testimony is primarily about what the appropriate  
20       test year is, and whether it should be changed.

21          Q     Is it your testimony that they did  
22       something different there than they did at FERC?

23          A     Something different, well --

24          Q     That they did anything different, and they  
25       filed the same case in two jurisdictions, correct,

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1 identical?

2 A My understanding is that it was not  
3 accepted here when it was filed, because it did not  
4 have the testimony filed with it.

5 Q So it's your understanding that this  
6 Commission rejected the rate filing in October,  
7 because it didn't have the supporting direct case,  
8 and that it was refiled in December with the direct  
9 case?

10 A I don't know if there are some specific  
11 semantics getting into not accepted versus rejected.  
12 But the clock that started running on the seven  
13 months, I understand, began when the December  
14 testimony filing was made. And I understand that  
15 has to do with when the rate was filed, and the  
16 period of time in which the case is supposed to be  
17 litigated.

18 Q Okay. Now, in response to Mr. Trotter you  
19 said you understood there were some differences in  
20 the numbers Ms. Hammer came up with with regard to  
21 the treatment of Sea-Tac.

22 Now, let me phrase this question this way.  
23 Isn't it true that in the financial books and  
24 records of British Petroleum Pipeline what happened  
25 was that they, after they sold Sea-Tac, they moved



3653

1 Sea-Tac into CWIP?

2 A I don't know. I said before I haven't  
3 looked at their specific books and records, or how  
4 they recorded transactions. But to the extent that  
5 that happened, I really couldn't tell you. I  
6 haven't looked at the books.

7 Q Do you know whether or not Mr. Collins used  
8 the treatment off the financial records that were  
9 provided to him with regard to the sale of the  
10 Sea-Tac terminal?

11 A My understanding is the way Mr. Collins has  
12 reflected the transaction is consistent with what I  
13 have described as what is prescribed by the Uniform  
14 System of Accounts.

15 Where he got the information, as far as  
16 that might go, I would expect he got it from  
17 Ms. Hammer. But I don't know specifically where.

18 Q And specifically, you don't know how in the  
19 financial books and records they recorded the  
20 Sea-Tac sale?

21 A As I've said several times, I have not  
22 looked at the books and records for the accounting  
23 for any specific transactions.

24 Q Well, what did you mean when you said there  
25 were differences in the numbers Ms. Hammer came up

3654

1 with? What differences were you referring to?

2 A My understanding is that there were some  
3 specific items that were included in the numbers  
4 that Mr. Twitchell had come up with that I used for  
5 the purpose of my discussion in my testimony, and  
6 the numbers that Ms. Hammer came up with, because  
7 some of the facilities were not included in the  
8 sale.

9 MR. BRENA: Thank you.

10 MR. FINKLEA: Tosco has no questions.

11 JUDGE WALLIS: Anything further from the  
12 bench? Anything further of the witness?

13 MR. HARRIGAN: No, Your Honor.

14 JUDGE WALLIS: Mr. Ganz, you are excused  
15 from the stand at this time. Thank you for  
16 appearing in this proceeding.

17 And let's be off the record.

18 (Brief recess.)

19 JUDGE WALLIS: Let's be back on the record.  
20 Mr. Brena is moving admission of 722 for  
21 identification, and an excerpt from Gaviota Terminal  
22 Company docket before the Federal Energy Regulatory  
23 Commission.

24 There Is no objection to that, subject to  
25 leave to offer a complete version of the document as

3655

1 another exhibit. With that reservation, 722 is  
2 received in evidence.

3 (EXHIBIT ADMITTED)

4 JUDGE WALLIS: Is there anything remaining  
5 pertaining to the prior witness?

6 (NO RESPONSE.)

7 JUDGE WALLIS: Let the record show that  
8 there is no response.

9 The Intervener, Tosco, is calling to the  
10 stand at this time its witness, Robert C. Means.

11 JUDGE WALLIS: Please stand, and raise your  
12 right hand.

13

14

ROBERT C. MEANS,

15 produced as a witness in behalf of Tosco, having been  
16 first duly sworn, was examined and testified as follows:

17

18 JUDGE WALLIS: In conjunction with this  
19 witness's appearance, several documents were marked  
20 at the administrative conference on June 13. They  
21 are Exhibits 2201 through 2210.

22 In addition, Tosco has submitted today  
23 three documents. The first is a substituted Exhibit  
24 2203, which is entitled 2203 Corrected, and it has  
25 submitted an errata sheet, which we are designating

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1 as 2211 for identification.

2 (EXHIBIT IDENTIFIED.)

3 JUDGE WALLIS: Finally, it has submitted a  
4 document entitled the Oral Rebuttal Exhibit, which  
5 is 2212 for identification.

6 (EXHIBIT IDENTIFIED.)

7 JUDGE WALLIS: I believe that takes care of  
8 our paperwork.

9 Mr. Finklea.

10 COMMISSIONER HEMSTAD: Off the record for a  
11 moment.

12 JUDGE WALLIS: Yes, we're off the record.

13 (Discussion off the record.)

14 JUDGE WALLIS: Let's be back on the record,  
15 please.

16 Mr. Finklea.

17

18 DIRECT EXAMINATION

19

20 BY MR. FINKLEA:

21 Q Mr. Means, good afternoon. Have you marked  
22 for identification in this proceeding and submitted  
23 Exhibit 2201-T, which is your prefiled direct  
24 testimony, and attached to that prefiled direct  
25 testimony Exhibits 2202 through 2210?

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1 A Yes, I am -- yes, I have.

2 Q Do you have any corrections or additions to  
3 that testimony at this time?

4 A Yes, I do.

5 Q And are those identified on what has been  
6 marked for identification as 2211?

7 A With one exception, yes, they are, Counsel.

8 Q And could you walk us through those changes  
9 at this time?

10 A Very good. Beginning with the first errata  
11 sheet on page 3, line 12, the No. 9.1 million should  
12 be changed to 10.3 million.

13 On page 4, line 10, the 34.7 million should  
14 be changed to 35.9 million. And the one omission is  
15 that 33 million at the end of that same line should  
16 be changed to 34 million.

17 Still on page 4, line 16, the .3923 should  
18 be changed to .4013.

19 And going now to page 27, line 20, the .070  
20 should be changed to .079. And on line 22, the 9.1  
21 million should be changed to 10.3 million.

22 On the second errata sheet, the first one,  
23 the first error listed on that sheet, the reference  
24 should be page 21, line 14. And the phrase, "end of  
25 2001" should be inserted following the word "proxy

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1 groups," so that it reads, "The proxy group's end of  
2 2001 median capital structure."

3 On page 27, lines 1 and 2, the question  
4 should be, "What is the impact of your modification  
5 on Olympic's interest cost deduction," question  
6 mark.

7 And finally, on that same page, on line 18,  
8 I have no recommendation with respect to the per  
9 barrel DRA component.

10 These numerical changes then are reflected  
11 in several of the lines of Exhibit RCM-3.  
12 Specifically --

13 Q Has that been marked for identification as  
14 Exhibit 2203?

15 A Excuse me, yes, it has, Counsel.  
16 Specifically the line for fuel and power, the total  
17 cost of service, and the cost per barrel on all of  
18 those the columns for with recommendations and  
19 difference are modified in the corrected version of  
20 the exhibit.

21 Q So should the 2203 that was originally  
22 attached to your exhibit be substituted with what  
23 has been marked as Corrected 2203?

24 A That's correct, Counsel.

25 Q With those changes?

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1                   COMMISSIONER HEMSTAD: With regard to the  
2 very last change, the last number is 1,257. Does  
3 that replace the negative of 394? I think I am  
4 looking at the corrected page.

5                   CHAIRWOMAN SHOWALTER: Is there any  
6 correction to the corrected page?

7                   THE WITNESS: No, they are not, Counsel --  
8 or I am sorry, no, they are not, Commissioner.

9                   Is there a question pending to me?

10                  MR. TROTTER: Off the record, please.

11                  JUDGE WALLIS: Yes.

12   (Brief recess.)

13                  JUDGE WALLIS: Let's be back on the record,  
14 please.

15                  Q   BY MR. FINKLEA: With those corrections, if  
16 I were to ask you the questions contained in your  
17 prefiled direct testimony 2201, would your answers  
18 be the same today?

19                  A   Yes, they would.

20                  MR. FINKLEA: At this time, Your Honor,  
21 pursuant to your earlier ruling, Mr. Means will be  
22 giving some oral rebuttal testimony in response to  
23 Olympic's rebuttal testimony, and I will begin my  
24 examination orally. And when that is completed, I  
25 understand that then the witness is available for

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1 cross examination.

2

3

SURREBUTTAL EXAMINATION

4

5 BY MR. FINKLEA:

6 Q Mr. Means, Olympic has filed extensive  
7 testimony in its rebuttal concerning the potential  
8 impact on the company should Staff's or Intervener's  
9 recommendations regarding rates be adopted by this  
10 Commission.

11 Can you comment on what you believe is the  
12 proper regulatory response to the dilemma that  
13 Olympic poses in its rebuttal case.

14 A Yes. I think it's useful to understand  
15 that Olympic poses two distinct financial problems  
16 that are described by its witnesses.

17 One of them I will call the increasing cost  
18 problem. And just some brief historical  
19 perspective, decisions like Hope and Bluefield were  
20 in text books going back decades. But through the  
21 1960s, in fact, there were very, very few rate  
22 cases. Utilities expanded, but they didn't come in  
23 for new rate cases.

24 And the reason was that their costs were  
25 stable, or going down. And so the rates that were



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1 established for selling 100 units would finance the  
2 investment that you needed to sell 110 units. There  
3 was no need for a rate increase to expand.

4 That broke down in the late '60s. 1970s  
5 inflation, and also at least the slowing of  
6 technological progress, and that's the time first  
7 time you start to hear and read a lot of discussion  
8 about things like regulatory lag, because costs were  
9 increasing rapidly, and the rates that were an  
10 adequate return on 100 units didn't give the  
11 pipeline or the electric company or the gas  
12 distribution company an adequate return on the new  
13 investment it had to make to handle 110 units.

14 And so various things were discussed,  
15 future looking test years, use end of test period  
16 data, various things. But mostly what happened was  
17 there were a lot of rate cases.

18 And the reason that there were a lot of  
19 rate cases, and the reason that no other alternative  
20 proved satisfactory is that cost based regulation  
21 assumes that the regulatory body, this Commission,  
22 the FERC, whatever is able to make a reasonably  
23 precise assessment of costs and revenues. And that  
24 limits how far you can look out into the future.

25 And so the response to the need to make new

1 investments, which may be more costly, and then the  
2 existing average cost had to be found, and has to be  
3 found in what is sometimes known as the regulatory  
4 compact. That the is the assurance from this  
5 Commission, the FERC, from other public utility  
6 commissions, that if a new investment is made, then  
7 in a rate case in which that investment and the  
8 operating costs can be reflected, rates will be  
9 established that will give return not just on the  
10 old investment, but the new investment as well.

11 Again, the reason for this is not that it's  
12 good to have more rate cases. Clearly it's not.  
13 The reason is that cost based regulation rests on  
14 being able to make a reasonably accurate assessment  
15 of costs and revenues.

16 In this case, witnesses for Olympic have  
17 given projections, and I don't doubt that those are  
18 good faith projections. But they are just that.  
19 They are projections. They are not associated with  
20 the volumes that would go with it. They don't have  
21 what would be needed.

22 So it is very difficult to take into  
23 account in this case, based on the costs and volumes  
24 and revenues that are before the Commission in this  
25 case, to do anything that is sensible to assure that

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1       there will be a return on some investment that has  
2       not even been made yet.

3               That -- the assurance that Olympic needs,  
4       Olympic as a business needs to believe it's going to  
5       get a reasonable return on new investments. But  
6       that assurance cannot come from distorting the costs  
7       in this case. It has got to come from the assurance  
8       that the regulatory body will take proper account of  
9       those investments when they are made, and a rate  
10      case based on them is made. That's one part -- that  
11      is one part -- one part of the financial problem.

12              The second part which I think is the  
13      principal part that figures, especially in the  
14      testimony of Dr. Schink, is what he calls the  
15      financial risk. Now, up to a point I agree with  
16      Dr. Schink's testimony. First, I agree that  
17      financial risk, like business risk, will affect the  
18      cost of raising money. And it will do so for the  
19      reason that Dr. Schink describes. If an investment  
20      is risky, for whatever reason, then investors will  
21      require a higher return.

22              Secondly, I agree that Olympic at this  
23      point does carry a financial risk. Indeed, if it do  
24      not have indulgent corporate parents, he probably is  
25      correct, that it would be in bankruptcy.

1           But where I disagree with Dr. Schink is  
2           that I believe there is a fundamental inconsistency  
3           in the argument that Olympic and he, on behalf of  
4           Olympic, are making. The capital structure that  
5           Dr. Schink wishes to use in determining the allowed  
6           return in this case is one of approximately 87  
7           percent equity, and 13 percent debt.

8           If Olympic, in fact, had that capital  
9           structure, it wouldn't be facing the risk of  
10          bankruptcy. It is -- I think it's -- Oscar Wilde  
11          referred to the man who killed his parents and then  
12          asked for mercy because he was an orphan.

13          One of the contributing factors in putting  
14          Olympic in financial risk is its capital structure.  
15          Some witnesses have argued that it should be  
16          required to change its capital structure. And I am  
17          not arguing that.

18          However, if it makes the choice of its  
19          current capital structure, for reasons that in  
20          particular I think Mr. Wilson describes well in his  
21          testimony, then it is doing that for its own  
22          business reasons. If that choice leads to a  
23          financial risk, because the company is very thinly  
24          capitalized, then that financial risk is not  
25          something that should be taken into account in

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1 determining the return on equity that should be  
2 allowed the company in this proceeding.

3           If the company had an 87 percent  
4 debt-equity ratio, if it had the roughly 50/50  
5 debt-equity ratio, then it would have a much more  
6 comfortable financial cushion for dealing with the  
7 financial problems.

8           It doesn't have those things. It didn't  
9 have those things for -- partly because of the  
10 Whatcom Creek incident, but partly because of the  
11 choices it has made. Again, I am not arguing that  
12 those choices were improper. I am arguing only that  
13 the consequences of those choices is to be placed on  
14 the company, and not on the company's customers.

15           Q    So in your opinion, what is the proper  
16 regulatory response to the dilemma posed by --  
17 dilemma posed by Olympic's rebuttal case?

18           A    Two-fold, which is nothing peculiar to this  
19 case, or Olympic. This regulatory Commission, like  
20 any regulatory Commission, should stand ready to  
21 give the utility a return rate that gives it a  
22 return on its investments when they are made that is  
23 adequate to attract capital. The operative or  
24 important part of that statement, "the investments  
25 when they are made." Not on a projection of what

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1 the utility, the pipeline may make in the future.

2 I think that there is nothing to indicate  
3 that on an operational basis Olympic is more risky  
4 than other pipelines as far as a business risk is  
5 concerned. It's financial risk is, in large part,  
6 at least, the creation of its own decisions on  
7 capital structure.

8 What follows from that, I believe, is that  
9 the return on equity that should be allowed to it is  
10 not one that should include a risk premium.

11 Q Are there other aspects to how a Commission  
12 can respond in the situation that Olympic presents?

13 A Well, what Olympic mostly needs, presumably  
14 wants as a business matter, is the assurance that if  
15 it makes this 66 million dollars in investments and  
16 comes in for a rate case, that it will be allowed  
17 rates in that case that will give it an additional  
18 return, additional revenues that will make up a  
19 reasonable return on that investment.

20 But, again, there's nothing peculiar to  
21 this case. I mean, that's the basic task of a  
22 utility commission dealing with any -- it is with  
23 any company. It is, as I say, part of what is  
24 referred to as a regulatory compact.

25 If you, the regulated company, do these

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1 things, you will receive this treatment from the  
2 regulatory agency.

3 Q Is there also considerable uncertainty  
4 regarding this pipeline concerning its through-put?

5 A There is. The uncertainty -- the rate case  
6 uncertainty -- the uncertainty in the rate case  
7 appears to have three components. One concerns its  
8 through-put for whatever is being treated as the  
9 test period in this case. And that uncertainty is,  
10 I think, largely gone out, because we simply have  
11 the facts. We know what has happened.

12 The other two elements are what kind of a  
13 through-put will it be able to achieve at 100  
14 percent operating pressure. And that's a factual  
15 question. And part of that question is the question  
16 of what contribution will Bayview make to its  
17 through-put at that time.

18 The other is the conceptual question which  
19 is -- conceptual question which is faced with the  
20 situation where presumably everybody agrees that the  
21 through-put that Olympic should have within the  
22 relatively near future is significantly higher than  
23 its through-put today. How should the Commission  
24 then deal with the current through-put which is  
25 limited by the limitation on its operating pressure?

1           In my direct testimony I set out several  
2 alternative ways in dealing with that, and made one  
3 recommendation. I think, perhaps, the two  
4 principles are first one, does not want rates based  
5 on its current through-put, that is the product of  
6 the operating pressure limitation, to be locked in  
7 forever.

8           The second is that it is desirable that  
9 there be an incentive for Olympic to bring its  
10 system back up to 100 percent operating pressure as  
11 soon as possible.

12           Now, within those principles there are  
13 various mechanisms that are available, and I  
14 describe what appear to be the general alternatives  
15 in my answering testimony in this case.

16           Q   In its rebuttal case, Olympic has suggested  
17 an adjustment mechanism, and I would like you to  
18 contrast the adjustment mechanism you have suggested  
19 on through-put to the one that the company has  
20 suggested.

21           A   Well, it's described fairly briefly in the  
22 testimony, rebuttal testimony, of a couple of the  
23 Olympic witnesses. My understanding of what Olympic  
24 is proposing is that it is proposing a pure tracking  
25 mechanism. By pure tracking mechanism, I mean a



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1 mechanism that adjusts rates for changes in  
2 through-put. And I believe as described by one of  
3 their witnesses for changes in costs, it does so  
4 fully, so that changes in through-put and changes in  
5 cost neither increase nor reduce the company's  
6 net -- the company's net revenues.

7           If that is an accurate interpretation of  
8 what Olympic is proposing, then it poses the same  
9 problem that is posed by any pure tracking  
10 mechanism, and that is that there is no incentive  
11 for the pipeline either to minimize the additional  
12 costs that it will be incurring, or to hasten the  
13 increase in volume that will come with 100 percent  
14 operating pressure.

15           Q    When you say hasten the return, do you mean  
16 consistent with safety constraints, or not?

17           A    Yes. I think perhaps as Dr. Schink -- at  
18 least one of the witnesses noted, return to 100  
19 percent operating pressure is not entirely within  
20 Olympic's control. It needs to obtain approval.

21                    On the other hand, this is not something  
22 that is entirely outside its control. In my  
23 experience, one area in which pure tracking  
24 mechanisms have been used is where there is, for  
25 example, a cost item that is totally outside the

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1 control of the company.

2 The FERC, for example, in the past,  
3 sometimes has used those for electric power costs  
4 where the electric power costs were themselves  
5 subject to regulation. There was basically nothing  
6 that the natural gas pipeline could do about those  
7 costs. So incentives would play no role. There was  
8 no way the pipeline could respond to incentives.

9 Here, it seems clear that Olympic does have  
10 a role to play in returning -- safely returning the  
11 pipeline to 100 percent operating pressure.

12 Q And how does your mechanism balance those  
13 concerns, in your opinion?

14 MR. MARSHALL: Well, Your Honor, this was  
15 addressed in his answering testimony, so it's not  
16 proper rebuttal or oral redirect. It's in there.  
17 It's laid out. It's repetitive. It's asked and  
18 answered.

19 MR. FINKLEA: Well, Your Honor, we are  
20 responding -- Mr. Means put forward a mechanism in  
21 his testimony, and the company in their rebuttal put  
22 forward a mechanism that is quite different and  
23 could easily be confused as being similar.

24 But what we're doing with this oral  
25 testimony today is responding to the rebuttal case

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1 of Olympic, which was filed when it was. And this  
2 is the way we have been allowed to address the  
3 rebuttal.

4 So I am concentrating strictly on  
5 Mr. Means' recommendations and contrasts to the  
6 company's rebuttal case.

7 MR. BRENA: I would join with Tosco. The  
8 questions and answers have been comparing and  
9 contrasting a specific mechanism that this witness  
10 has not had an opportunity to previously address and  
11 compare and contrast his mechanism and discussion.  
12 It seems entirely proper.

13 JUDGE WALLIS: The area is proper.

14 MR. MARSHALL: This witness did compare and  
15 contrast those various calculations. It's just that  
16 the question at hand is asking for him to repeat the  
17 methodology on tracking that he's already testified  
18 to in his prefiled answering testimony. It's  
19 repetitive.

20 JUDGE WALLIS: We would expect that the  
21 preliminary questions would be relatively brief.  
22 And once the basis for understanding the witness's  
23 testimony by a brief reference to the direct, that  
24 the witness would be able to go on to compare and  
25 contrast.

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1 Mr. Finklea, is that your intention?

2 MR. FINKLEA: Yes, Your Honor.

3 JUDGE WALLIS: Please proceed.

4 THE WITNESS: I guess the way I would view  
5 it is that Olympic's proposal, and my proposal are,  
6 in essence, end points on a continuum. Under  
7 Olympic's proposal, if I have correctly interpreted  
8 it -- there would be what I call pure tracking  
9 mechanisms, which means no risk.

10 Under my proposal there would be a  
11 surcharge that would be based on Olympic's  
12 statements about when it would be able to resume  
13 operations. But that surcharge then would not be  
14 adjusted for what in fact happened. Which means  
15 that if Olympic were able to bring its system to 100  
16 operating pressure more quickly, it would keep the  
17 additional revenues. If it did more slowly, it  
18 would bear the loss.

19 As I say, these are end points. Between  
20 those two end points, there are the alternatives of  
21 various kinds of sharing where the pipeline bears  
22 half, 50 percent of the risk, and the other 50  
23 percent is fully tracked.

24 And the question to the extent that the  
25 Commission wishes basically to have something that

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1       adjusts for this limitation, is how much of the risk  
2       of deviations from what we can now project, how much  
3       of that risk is to be placed on the pipeline. And,  
4       of course, incentives are the other side of risk.

5                What is the mixture? The advantage of a  
6       pure tracking mechanism is it takes account of  
7       changed circumstances. The disadvantage of a pure  
8       tracking mechanism is it takes account of changed  
9       circumstances, which means it did not create the  
10      incentive. And regulatory agencies can use  
11      intermediate ones where some incentive, some parts  
12      of the burden or risk is placed on the pipeline, but  
13      not 100 percent.

14             Q    You spoke about the capital structure  
15      question. And not to get into the specifics of  
16      which number is right, but in light of the fact that  
17      the utility is 100 percent debt, and the utility is  
18      suggesting equity ratio of 86 percent in its  
19      rebuttal case, how would you, as a decision maker,  
20      sort this record out and try to come to a decision  
21      on what is the proper capital structure for purposes  
22      of rate making?

23             MR. MARSHALL: Asked and answered. Again,  
24      this witness directly responded to that capital  
25      structure issue in his answering testimony. The

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1       only change has been from 83 percent to 86 percent  
2       equity, which is a 3 percent -- is not the kind of  
3       issue for which he should be opened up on a  
4       rerebuttal.

5                 If he wants to address is the 3 percent  
6       somehow going to change his opinion, I think that  
7       would be proper for this oral redirect. But not  
8       otherwise.

9                 MR. FINKLEA: Your Honor, the company in  
10       its rebuttal went on to not only suggest a higher  
11       equity return, but to suggest a whole parade of  
12       horribles unless this Commission adopts its  
13       recommendation.

14                And I am trying to explore with Mr. Means  
15       this question of how to sort out this issue, given  
16       the totality of what has been placed before the  
17       Commission by the company in its rebuttal.

18                MR. BRENA: Could I make one brief comment.  
19       We have only got an hour. We have been given an  
20       hour. And so you just can't get too far afield in  
21       that amount of time.

22                And if we're going to spend it -- well,  
23       this shouldn't be part of it. But it's just -- they  
24       put on a comprehensive whole new case. In rebuttal  
25       they put on 14 witnesses --

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1                   JUDGE WALLIS: We're ready to make a  
2 ruling, Mr. Brena.

3                   And the ruling is that this does respond to  
4 the rebuttal case. It is permissible. And the  
5 witness may respond to the question.

6                   MR. FINKLEA: Thank you, Your Honor.

7                   COMMISSIONER HEMSTAD: I would like to add  
8 an additional comment. It seems to me in this kind  
9 of oral surrebuttal, if that's what we're describing  
10 this as, the counsel and the witness have to be  
11 given rather broad latitude to be able to respond to  
12 the rebuttal case that has been filed.

13                   And I think with that admonition, the  
14 question ought to be able to be asked, and the  
15 witness ought to be able to answer with a generally  
16 broad latitude to respond.

17                   CHAIRWOMAN SHOWALTER: And I would like to  
18 add to that, that the company was given leave by  
19 this Commission to file the rebuttal testimony on  
20 the condition that the other parties be given a  
21 chance to rebut it in a very short period of time  
22 orally, as distinct from the company filing a very  
23 extensive written case.

24                   MR. MARSHALL: And, again, I was only  
25 mindful of the time and hoped to prevent asked and

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1 answered questions.

2 MS. SHOWALTER: Well, Mr. Marshall, you and  
3 your objections are what is taking the time.

4 JUDGE WALLIS: Does the witness have the  
5 question in mind?

6 THE WITNESS: Yes, I do. It may be helpful  
7 of thinking of this as having three levels.

8 The first is very basic, and that is the  
9 company should be placed in the same position as if  
10 it were not a subsidiary of Equilon BP. But suppose  
11 that this company were like Buckeye, and were out in  
12 the market having to raise money with debt and  
13 equity. What kind of a debt-equity ratio might it  
14 have now?

15 On the other two levels, I am agreeing with  
16 Dr. Schink testimony that there are two questions.  
17 One is what is reasonable and, the second is having  
18 a non-arbitrary methodology for coming up with some  
19 specific number. Because you can't set rates based  
20 on ranges. Ultimately you have to have a number to  
21 plug into the calculations.

22 I don't think Dr. Schink knows, I don't  
23 think I know, precisely the debt-equity ratio that  
24 Olympic would have if it were out in the market  
25 having to raise its own capital. Maybe it would be



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1 40 percent, maybe 60 percent, maybe 50 percent. It  
2 may well be that that is a reasonable range.

3 But what one needs, then, is some kind of  
4 non-arbitrary methodology that over one of the cases  
5 doesn't favor the pipeline, doesn't favor the  
6 shippers.

7 And the one I proposed -- and I think it  
8 was not original with me -- is, well, let's look at  
9 the company's proxy group companies, which are  
10 ranked, and let's use the median number. And not  
11 because I think that there's four-digit accuracy in  
12 my estimate of what the debt-equity ratio should be,  
13 but because that's a reasonable number and it's a  
14 non-arbitrary reasonable methodology for reaching a  
15 specific number.

16 And the Commission -- for instance, the  
17 Commission could use the average, rather than the  
18 median. There are other alternatives that are  
19 available. But the important thing is to have a  
20 result that is reasonable, and have behind that  
21 result for coming up with a specific number, which  
22 is needed for the rates, a non-arbitrary methodology  
23 for determining in this case, or in other cases, the  
24 capital structure that should be used for  
25 determining the rates.

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1           Q    In your opinion, if the Commission adopts,  
2   for rate making purposes, your recommendations for  
3   establishing rates, or the recommendations of Staff,  
4   or the other Intervener Tesoro, will this company  
5   have a reasonable opportunity to earn a return on  
6   its investment, given the circumstances that it  
7   faces coming off of an accident and having to make  
8   substantial capital improvements?

9           A    It will make a reasonable investment. It  
10   will make a reasonable investment return on the  
11   investment it already has for the reason I have  
12   indicated. To the extent it has new investments  
13   that will raise its average costs, those will have  
14   to be dealt with in future rate cases, because there  
15   simply is no way that one can, with any precision,  
16   assess them in this case.

17                    So the answer is, yes, but for the  
18   reasonable return on the future investments that the  
19   company is going to have to make, the company's  
20   assurance must be the assurance that the Commission  
21   will deal with them fairly when a rate case is filed  
22   that does, in fact, have those investments in it.

23           Q    In addition to capital structure,  
24   Dr. Schink made new recommendations concerning rate  
25   of return, and in particular, introduced a new risk

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1 factor. And I would like you to take a moment to  
2 help the Commission assess how to think about this  
3 risk factor that's been introduced in the rebuttal  
4 case.

5 A Well, as I have indicated, I think that  
6 financial risk does affect cost of equity. The  
7 question is whether the financial risk, which is  
8 partly created by the capital structure, is one that  
9 should be taken into account in determining the  
10 return on equity.

11 And for the reasons I indicated, I don't  
12 think it is. Not because fiscal risk, financial  
13 risk is not real, but because it stems from choices  
14 that the company has made for its own business  
15 reasons.

16 Once you strip out financial risk, then one  
17 is left with a debate that I really don't have any  
18 part of. I have no quarrel with Dr. Schink in his  
19 application of the FERC methodology.

20 There is, however, a question before this  
21 Commission as to whether the Commission should use  
22 that methodology. Mr. Hanley has presented  
23 testimony using a different methodology. Mr. Wilson  
24 has submitted what I think is very powerful  
25 testimony criticizing that testimony. That's not an

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1 issue I am addressing; rather my argument or  
2 testimony is whatever methodology, basic methodology  
3 the Commission uses there, it is not appropriate to  
4 have a risk premium in this case.

5 Q Could you turn to what has been marked for  
6 identification as 2212. And if you would turn to  
7 the substantive page, as opposed to the cover page,  
8 could you explain what you have done with this  
9 updated oral rebuttal exhibit?

10 A In his rebuttal testimony, Mr. Collins made  
11 a calculation of what the cost of service would be  
12 using a depreciated original cost rate base.

13 What this does is simply take Mr. Collins'  
14 Exhibit 11-C, which does that, and his Exhibit 8-C,  
15 which has the trended original cost rate base, and  
16 then puts in my recommendations regarding return and  
17 capital structure.

18 I should add that because I am starting  
19 with Mr. Collins' own exhibits, if you compared this  
20 with my original Exhibit 3, this will incorporate  
21 some changes that Olympic itself made in its rate  
22 base between its direct case and rebuttal case.  
23 They are relatively small. But this is Mr. Collins'  
24 exhibits in all respects, except for rate of return  
25 and capital structure.

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1           Q    Does it also, compared to the original  
2           case, adjust what Olympic's recommended through-put  
3           is?

4           A    Yes.  For the cost of service, for the --  
5           it does.  And therefore, it gives average cost per  
6           barrel both, with my recommended designed  
7           through-put, and also with the Olympic  
8           through-put -- or the through-put -- designed  
9           through-put that has now been recommended by Olympic  
10          which, I believe, is 103.5 million barrels.

11          Q    And on what line would you find what your  
12          recommended rate, then, would be, first with your  
13          through-put recommendation, and then with Olympic's  
14          through-put recommendation?

15          A    The lines are not numbered, but the third  
16          line from the bottom, cost per barrel at design  
17          through-put, .3554 would be the resulting per barrel  
18          cost.  That is approximately 2 percent higher than  
19          Olympic's rates before the emergency rate increase.

20                  With the surcharge that I have recommended,  
21          the rate increase for the five years at the  
22          surcharge would be 10 percent.

23                  The very last line is at Olympic's design  
24          through-put, .4477.  And I believe that is 29 -- I  
25          believe 29 percent.  And, of course, there would be

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1 no surcharge, the 29 percent all in increase in its  
2 rates.

3 I might add, again, that that is not a  
4 complete cost of service analysis. Commission Staff  
5 and Tesoro have made additional recommendations  
6 regarding cost of service. This is simply with  
7 Mr. Collins exhibits, and the specific changes that  
8 I have made.

9 MR. FINKLEA: Your Honor, Tosco, at this  
10 time, would offer Exhibit 2212. And with that,  
11 we would make Mr. Means available for cross  
12 examination.

13 JUDGE WALLIS: Is there objection to the  
14 Tosco exhibits?

15 MR. MARSHALL: No, Your Honor.

16 JUDGE WALLIS: The exhibits are received.

17 (EXHIBIT ADMITTED)

18 JUDGE WALLIS: Let's be off the record for  
19 a scheduling discussion.

20 (Discussion off the record.)

21 (Brief recess.)

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

24 MR. FINKLEA: The witness is available for  
25 a cross examination.

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1                   JUDGE WALLIS: Very well. Mr. Marshall,  
2 do you have preference as to whether you go first,  
3 or other parties who may have questions?

4                   MR. MARSHALL: I mean, after the redirect  
5 or the surrebuttal?

6                   JUDGE WALLIS: No, both Tesoro and the  
7 Commission Staff have indicated that they have some  
8 brief questions for the witness.

9                   MR. MARSHALL: I will go after those, then.  
10 That would be fine.

11                   MR. TROTTER: Your Honor, we did not  
12 designate any time for this witness, so we have no  
13 questions at this time.

14                   MR. BRENA: Your Honor, we did designate  
15 time, but I have no questions.

16                   JUDGE WALLIS: Very well. That makes it  
17 very simple.

18                   Mr. Marshall.

19                   MR. MARSHALL: We're back to the same  
20 point, not entirely circular logic, but --

21

22                   CROSS EXAMINATION

23

24 BY MR. MARSHALL:

25                   Q Mr. Means, you mentioned in your testimony

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1 a minute ago a discussion about the regulatory  
2 compact. And my question is, how does that  
3 regulatory compact relate to investor expectations,  
4 or does it?

5 A Well, it does. The expectations for  
6 investors in a regulated firm -- and just add  
7 parenthetically, customarily companies that are  
8 subsidiaries like Olympic were treated like  
9 they were free-standing companies, so that's the  
10 standard by which they are judged.

11 So we're looking at what would be the  
12 expectations of the investors in a company like  
13 Buckeye, that actually had publicly traded shares,  
14 or partnership interest.

15 The expectations of investors in such  
16 a company will be determined partly by the business  
17 prospects of the company. But assuming it has good  
18 business prospects, will be, to large extent,  
19 determined by their expectations regarding the  
20 regulatory treatment.

21 Q But I guess I focused on the regulatory  
22 compact that you used. Maybe you could use that  
23 more specifically. What do you mean when you use  
24 the word regulatory compact?

25 A Regulation, cost based regulation has been



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1 sometimes analogized to a long-term contract between  
2 the utility and its customers with the utility  
3 Commission serving as administrator for the  
4 contract.

5 And the terms of the contract are basically  
6 a reasonable return on investment with the usual  
7 qualifications about prudence. The details will  
8 vary from jurisdiction to jurisdiction, depending on  
9 such matters as the choice between trended original  
10 cost and depreciated original cost as a methodology.

11 Q When you refer to the terms of the  
12 contract, would it be fair to say in your view the  
13 regulatory compact should not have its terms changed  
14 unless there is good reason to make a change?

15 A Well, obviously in its detail the compact  
16 is constantly being changed. Where it is changed in  
17 more fundamental matters, then that raises some  
18 important issues.

19 But they are not issues that can be  
20 answered in the abstract. That is, one has to look  
21 to what specific fundamental change is being  
22 proposed, and what are the circumstances in which it  
23 is being proposed.

24 Q But the more fundamental the change, the  
25 more you would analyze it. Is that fair to say?

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1           A    Yes, I guess that would be fair,  
2    Mr. Marshall.

3           Q    Let me have you turn to page 6, line 10 of  
4    your testimony?

5           A    This would be the answering testimony,  
6    Counsel?

7           Q    Yes. Do you have other testimony?

8           A    Well, don't I have cross answering?

9           Q    You just have cross answering at the FERC.

10          A    I beg your pardon. Yes. Counsel, yes.  
11    All right. I am with you.

12                   CHAIRWOMAN SHOWALTER: What page?

13                   MR. MARSHALL: Page 6, line 10.

14                   THE WITNESS: Yes, I am with you, Counsel.

15          Q    BY MR. MARSHALL: At that page and line you  
16    indicated that you had conducted your analysis for  
17    your testimony within the frame work of the TOC  
18    methodology. Then you go on to state, "However, I  
19    am making no recommendation with respect to either  
20    the acceptance of that methodology in this case, or  
21    the use of a starting rate base if the methodology  
22    is accepted." Do you see that?

23          A    Yes, I do.

24          Q    So for purposes of my questions in this  
25    next series, I won't ask you about recommendations

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1 because I understand you are not giving  
2 recommendations. But I will ask you questions to  
3 understand your use of that frame work, as you call  
4 it?

5 A Very good.

6 Q Because I don't want to open up a whole  
7 line of questions if you haven't given any  
8 recommendations.

9 The first, you have said you conducted your  
10 analysis within the frame work of the TOC  
11 methodology, and you did conclude in your analysis a  
12 transitional starting rate base; is that correct?

13 A That's correct.

14 Q With regard to the transitional starting  
15 rate base, you make a specific recommendations on  
16 amortization period for Olympic starting rate base?

17 A Yes. That is correct.

18 Q And it's just -- when you use the phrase  
19 transitional starting rate base, does that refer to  
20 a specific feature of oil pipeline rate setting?

21 A Yes. It may exist in the regulatory  
22 context. But I'm not familiar with one where it  
23 does exist, Counsel.

24 Q As far as you know, that transitional  
25 starting rate base is unique to oil pipeline rate

3688

1 making?

2 A Yes, with the emphasis on, as far as I  
3 know.

4 Q In a sentence or two, can you generally  
5 state what the transitional starting rate base is  
6 for oil pipelines, just the definition?

7 MR. BRENA: Objection.

8 MR. MARSHALL: I am not asking him to go  
9 into the details, but what is that concept.

10 MR. TROTTER: I object to the question,  
11 because it's vague, oil pipeline regulation, where  
12 it may be at FERC or maybe elsewhere, but --

13 MR. MARSHALL: I will recast the question.

14 JUDGE WALLIS: Mr. Marshall, let's wait to  
15 see what Mr. Brena has to say.

16 MR. MARSHALL: Well, I have withdrawn the  
17 question.

18 JUDGE WALLIS: Very well.

19 MR. MARSHALL: That way we can --

20 JUDGE WALLIS: Please proceed.

21 Q BY MR. MARSHALL: When you use the term  
22 transitional starting rate base, can you explain  
23 what you mean by that term?

24 A I refer in the most specific ways to a rate  
25 base item that is created pursuant to methodology

3689

1 that was defined by the FERC that was viewed as  
2 being a way of creating transition from the ICC  
3 methodology to the trended original cost  
4 methodology.

5 Q Why is it called transitional?

6 A Because it is viewed as being part of the  
7 transition between one way rate methodology and  
8 another.

9 Q What was the rate methodology that it was  
10 in transition from?

11 MR. BRENA: Objection, Your Honor. First  
12 of all, he says expressly in his testimony that he's  
13 not addressing these issues, and he hasn't put in  
14 testimony with regard to the transitional rate base,  
15 or deferred earnings, or the methodology issues at  
16 play.

17 And he even goes to the point of saying, "I  
18 am not testifying about this," and now the line of  
19 cross is designed to expand it into testimony on  
20 those very issues that he said he was not testifying  
21 about. So I would object to that as beyond the  
22 scope.

23 And I would also like to point out where  
24 that ultimately goes is to a critique of Tesoro's  
25 case. This Commission's schedule does not allow

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1 Tosco and Tesoro to comment on each other's case.  
2 There was no opportunity for cross-answering  
3 testimony. So here's a witness that said, "I didn't  
4 talk about this." Here's a procedural schedule that  
5 didn't allow any comment as between the Interveners,  
6 and here's a line of cross examination headed right  
7 into what he said he didn't testify to.

8 This is an improper line of cross  
9 examination, so I object as to it being beyond the  
10 scope, the stated scope of this witness's testimony.

11 And I would also like to point out that,  
12 you know, in 2012, I mean, he used a DOC. So he's  
13 used one of each, and he said he hasn't taken a  
14 position on this issue.

15 MR. TROTTER: Your Honor --

16 MR. BRENA: So all I say is it's not only  
17 beyond the scope, he said, "I am not going to talk  
18 about this." That's as clear of a scope of  
19 objection as I can get.

20 MR. TROTTER: We join the objection for the  
21 reason when we read this testimony, we understood  
22 him not to be addressing the issue of the  
23 appropriate rate making methodology. He used the  
24 frame work for purposes of his numbers for  
25 comparative purposes, and his oral testimony

3691

1 confirmed that.

2 We didn't do any discovery, and now if this  
3 is allowed, that's a whole different dimension to  
4 the testimony that we did not reasonably anticipate  
5 by reading its clear terms. So we're prejudiced by  
6 it.

7 MR. FINKLEA: Your Honor, it is beyond the  
8 scope of the witness's testimony. And in Tosco's  
9 opinion, and we couldn't have been more clear, we  
10 don't think, in the Q and A that is on page 6.

11 And when we just had oral colloquy, we,  
12 again, did not raise this issue. This is just not  
13 an issue that Dr. Means is testifying on.

14 MR. MARSHALL: Actually, it is. On page 25  
15 he goes into great detail on how to redo the  
16 calculations on starting rate base. And that's  
17 where I was headed. I just needed to lay the  
18 foundation that he's talked about and redone the  
19 schedule on this, and it's in his testimony.

20 And I could move directly to page 25, and  
21 ask my questions based on this witness's prefiled  
22 testimony discussing starting rate base and why the  
23 calculation and amortization period for the starting  
24 rate base he recommends being changed.

25 And I do want and need to ask him questions

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1 about why he made those changes.

2 MR. BRENA: If I could comment briefly,  
3 Your Honor, on this shifted argument. Because we  
4 just shifted pages, up 20 pages. Their rebuttal  
5 case, they accepted this change. There is no  
6 difference. So this is friendly cross. There's no  
7 difference between Dr. Means' calculations of  
8 starting rate base for putting it in the  
9 comparative, and what was adopted in the rebuttal  
10 case.

11 So if they are going to shift forward 20  
12 pages, then the nature of my objection shifts with  
13 it. And this is friendly cross examination, because  
14 with regard to this calculation, it's what they  
15 used.

16 MR. TROTTER: Mr. Collins did, in fact,  
17 accept this adjustment.

18 (Discussion off the record.)

19 JUDGE WALLIS: Mr. Marshall, the witness  
20 has excluded on page 6 his references to  
21 transitional rate base. If you want to inquire into  
22 the topic on page 20, you need to illustrate the  
23 differences between your client's position on this  
24 matter and this witness' position.

25 MR. MARSHALL: Well, again, I guess it's



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1 just designed to try to figure out how these  
2 calculations that this witness has shown on his  
3 exhibit now, I think it's 2203 on the amortization  
4 period, and I think it all tracks together.

5 But I do need a little latitude in talking  
6 about why these different calculation changes have  
7 been made. And I have yet to be accused of asking  
8 friendly cross examination from any witness from  
9 Staff or Interveners. I find that a new,  
10 enjoyable --

11 But I think it's helpful to the Commission  
12 to have in mind what it is about starting rate base,  
13 and why these calculations are made at the time  
14 they were being made, too. The timing, I think, is  
15 important in terms of -- this was set up back in  
16 1983, 1984, and it was established then.

17 Mr. Brena has asked a whole series of  
18 questions designed to say you shouldn't be using  
19 starting rate base amounts that are the amounts this  
20 witness has put in. --

21 CHAIRWOMAN SHOWALTER: Mr. Marshall, isn't  
22 the difference -- is that, isn't yours what you  
23 propose to do, friendly cross, meaning you are  
24 agreeing -- you have agreed with -- your client has  
25 agreed with what is done here. And so by drawing

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1 out what might otherwise be fairly interesting stuff  
2 about starting rate base, aren't you engaging in  
3 friendly cross?

4 MR. BRENA: And before he responds, if I  
5 could just comment, as I heard it, opposing counsel  
6 has asked specifically to point out the differences  
7 between this witness' calculation of a transitional  
8 rate base and their company's rate base.

9 That hasn't happened. He used that, then,  
10 to go into talking about starting rate base, and  
11 what Tesoro did. Now, that is what is wrong with  
12 that line of cross.

13 He's trying to use a witness who said he's  
14 not here to testify in methodology, and then they  
15 adopt one suggestion in his methodology that he  
16 uses, and he's not recommending it either way. They  
17 adopt it, and they are going to try to use him to  
18 critique the methodology issues.

19 This is not appropriate. I mean, ask this  
20 witness questions related to what he's testified to.

21 MR. MARSHALL: We would have been finished  
22 with all of this by now, but for the objections.

23 (Discussion off the record.)

24 JUDGE WALLIS: Mr. Marshall, in the absence  
25 of a demonstration as to why it is appropriate, that

3695

1 is, wherein your client's position differs from the  
2 testimony of the witness that that seems to resolve  
3 the issue. So the objections are sustained.

4 Q BY MR. MARSHALL: There are various choices  
5 that are made in the rate making process, as a  
6 general proposition. Is that fair to say?

7 A Yes.

8 Q And whether to use one approach rather than  
9 another, for example, whether to use starting rate  
10 base versus not using it, whether to use trended  
11 original cost or use depreciated original cost,  
12 those are examples of choices that are made in the  
13 rate making process.

14 MR. BRENA: Objection; this witness has not  
15 offered testimony with regards to rate making.

16 MR. MARSHALL: This is preliminary to the  
17 next series of questions. I would like a little  
18 latitude.

19 JUDGE WALLIS: We will allow some latitude  
20 in this regard.

21 THE WITNESS: Yes.

22 Q BY MR. MARSHALL: Within these choices, you  
23 have tried to provide a frame work, and also there  
24 are other choices that will also affect the end  
25 result, correct?

3696

1 A Yes.

2 Q Rate making, when it comes right down to  
3 it, is a series of choices between areas in which we  
4 can have disagreement?

5 A That's correct.

6 Q Now, the parties that presented different  
7 choices on capital structure, rate of return,  
8 adjustments to cost of service, through-put volumes,  
9 and other issues, you have seen them all, right?

10 A Yes.

11 Q And do you have an -- and you have an  
12 Exhibit 2203 in your testimony, that corrected one,  
13 now, that compares your testimony with Olympic's,  
14 right?

15 I did not write down -- that would be my  
16 original -- that would be my corrected Exhibit 3,  
17 Counsel?

18 Q Yes.

19 A Yes. Yes, I do.

20 Q And you, in fact, provided that in  
21 answering testimony at the FERC; is that right?

22 A Well --

23 Q This corrected version?

24 A There were two rounds of corrections. I  
25 provided it to parties in data responses. The

3697

1 original RCM-3 was part of the answering testimony  
2 at the FERC.

3 I don't think the corrected version was  
4 ever filed, but it was provided as a data response.

5 Q But in any event, this exhibit was to  
6 compare Olympic's proposal with your  
7 recommendations, and then to identify the  
8 differences, where they exist?

9 A Yes, that's correct.

10 Q And these can be looked at as a series of  
11 choices?

12 A Yes.

13 Q Now, the first choice up here at the top on  
14 what is labeled Permanent Rate is the cost of  
15 equity, and you have in parentheses the word  
16 "Real"; is that right?

17 A Yes.

18 Q And Olympic's testimony at that time was  
19 13.23 percent, and your recommendation was 11.28  
20 percent?

21 A Yes.

22 Q Now, on the cost of equity, on this  
23 particular line, you used the -- basically used the  
24 FERC DCF methodology; is that correct?

25 A Yes. And to be more precise, I used

3698

1 Dr. Schink's of that methodology.

2 Q You accepted that as being the appropriate  
3 calculation for FERC DCF methodology?

4 A I think it would be more accurate to say I  
5 did not dispute it, as I indicated, in part of my  
6 oral direct testimony. I have not entered into the  
7 question regarding the choice between the FERC's  
8 methodology and the methodology proposed by  
9 Mr. Hanley and Mr. Wilson. So I did not challenge  
10 it, and I believe that Dr. Schink's calculations are  
11 correct application of the FERC methodology.

12 Q In this area you would regard Dr. Schink as  
13 a fairly experienced, knowledgeable person?

14 MR. BRENA: Objection; friendly cross.

15 Q BY MR. MARSHALL: On the DCF methodology,  
16 you accepted Dr. Schink's approach, correct?

17 A Yes.

18 MR. BRENA: Objection; friendly cross.

19 JUDGE WALLIS: The question is repetitive,  
20 but will be allowed. The witness has answered.

21 Q BY MR. MARSHALL: All right. Do you now  
22 have an understanding of what the WUTC's methodology  
23 for establishing cost of equity is, whether it's  
24 different in any marked way from the FERC DCF  
25 methodology?

3699

1           A    I assume the testimony of Mr. Wilson is at  
2    least consistent with the WUTC methodology.  I have  
3    not looked at WUTC precedents.

4           Q    Do you see any major difference between  
5    what the FERC does on DCF methodology, versus this  
6    Commission here?

7           A    Well, I would be only comparing the FERC  
8    methodology with the testimony of Dr. Wilson.  Is  
9    that going to stand as the WUTC methodology?  That's  
10   the only way I could answer the questions because I  
11   have not examined the WUTC precedents.

12          Q    He had several components, but I believe he  
13   sets forward a methodology you have reviewed.

14          A    Yes.  And I am not questioning that,  
15   Counsel.  You are referring to the WUTC methodology,  
16   and I can only speak in this proceeding to the  
17   testimony that was submitted by or on behalf of WUTC  
18   Staff.  Am I to take that by what you mean to be the  
19   WUTC methodology?

20          Q    Let's assume Dr. Wilson's DCF methodology,  
21   and he has four different ways of dealing with cost  
22   of equity, for the purposes of this question, is the  
23   same as the WUTC approach.

24          A    Yes.

25          Q    So if you have that in mind, is the FERC

3700

1 DCF methodology the same as that component of  
2 Dr. Wilson's?

3 A No.

4 Q And it differs in what regard?

5 A The most important respect would be the  
6 treatment of the growth component, how one  
7 calculates the growth component of the DCF formula.

8 Q Whether it's in one or two stages?

9 A No, whether one relies on IBS, which is  
10 essentially a compilation of stockbrokers'  
11 projections of growth, and further, if one relies on  
12 an unmodified projection of GDP growth or not.

13 Q This, again, is another series of choices  
14 that one makes in methodologies, whether to use that  
15 type of backup for DCF versus another type of  
16 backup. Is that fair to say?

17 A Yes. In order not to burden the record, I  
18 am not going for note each time that in some cases,  
19 one choice is dictated and one choice is clearly  
20 preferable to another. But, yes, that is one of the  
21 choices.

22 Q So at any rate, your suggestion was to go  
23 with the FERC DCF approach in your testimony?  
24 That's what you were -- that's what you were using  
25 as opposed to what you have identified Dr. Wilson



3701

1 used?

2 A I am responding to Dr. Schink's testimony.  
3 I am not entering into the choice between FERC  
4 methodology, and other methodologies. So I accept  
5 Dr. Schink's use of the methodology, including one  
6 change that relates to the way that one treats the  
7 period one dividends.

8 I am not endorsing that, and in particular,  
9 I am not endorsing that in relationship to either of  
10 the methodologies used by Mr. Hanley or the  
11 methodology used by Dr. Wilson.

12 Q Fair enough. Now, you specifically also  
13 used in your cost of equity the FERC proxy group of  
14 five oil pipeline companies; is that correct?

15 A That's correct.

16 Q And if you would turn to page 10 of your  
17 testimony, and look at line 14.

18 A Yes, I have that, Counsel.

19 Q When you say, "In this case there are only  
20 five observations," do you mean there are only five  
21 oil pipeline companies in the proxy group?

22 A That's correct.

23 Q And are five -- when you say, "only five  
24 observations," are you implying by that phrase that  
25 that is a relatively small group?

3702

1           A    Yes, it's what we have to work with.  It  
2   means that probably there's not much to be gained by  
3   using sophisticated statistical tests when you only  
4   have five data points.

5           Q    With regard to the five, you then point out  
6   on page 10, line 19, that one of the members of the  
7   proxy group, Kinder Morgan, appears to, in your  
8   words, heavily influence the cost of equity, because  
9   their cost of equity is 17.94 percent.  Do you see  
10  that?

11          A    Yes.

12          Q    And then on the next page, page 11, you  
13  state, "The contrast is striking, because Kinder  
14  Morgan has a low debt-equity ratio."  In fact, you  
15  say it has the lowest debt-equity ratio of the five  
16  proxy companies?

17          A    Yes.  Yes.

18          Q    How low of a debt-equity ratio do they  
19  have?  What do you mean by that?

20          A    If I want a percentage, I have to look at  
21  the relative exhibit.  Do you want me to do that  
22  now, Counsel?

23          Q    Yes.  So we have that in mind?

24          A    This is from -- I don't have the hearing  
25  exhibit numbers, but it was marked for

3703

1 identification as RCM-5.

2 MR. FINKLEA: That would be 2205.

3 THE WITNESS: So I add 2200 to the "mark  
4 for number". In Exhibit 2205, Kinder Morgan has a  
5 debt percentage of 41.4 percent.

6 Q BY MR. MARSHALL: So if you reversed that,  
7 that means what in terms of what percentage of  
8 equity?

9 A 58.6.

10 Q So although it has a very high rate of  
11 return on equity of nearly 18 percent, it also has a  
12 very high equity share of its capital structure?

13 A That is right.

14 Q And that's why you said that was striking?

15 A That is correct. In a sense, that is very  
16 closely related to the point that Dr. Schink made on  
17 his rebuttal testimony regarding the relationship  
18 between return and debt-equity ratio.

19 Q But then at line 5, page 11 you say, "All  
20 things being equal, it," meaning Kinder Morgan,  
21 "should face the smallest financial risk." Do you  
22 see that?

23 A I recall saying that. What is the line,  
24 again, please?

25 Q It is line 5, page 11.

3704

1 A Yes.

2 Q You go on to say that, "The market  
3 apparently evaluates and is facing a much higher  
4 business risk than the other companies."

5 A Yes.

6 Q Do you know why Kinder Morgan has that  
7 higher business risk than the other companies?

8 A Well, a major component of Kinder Morgan is  
9 the SFPP Pipeline, which has been involved in a  
10 lengthy FERC proceeding, and which a lot of money is  
11 at stake.

12 I certainly have not examined what the  
13 stock analysts have said, but that would be  
14 certainly one candidate for an explanation.

15 Q So part of a business risk that Kinder  
16 Morgan faces in the market is uncertainty about rate  
17 treatment?

18 A That's true for any regulated company. In  
19 this case Buckeye faces the risk that its rates are  
20 by and large market based rates. But Kinder Morgan,  
21 I have not compared its rate cases with anybody  
22 else's. But certainly it's involved in a large rate  
23 case at the present. I assume that has some impact  
24 on the stock valuation.

25 Q Of the five, you indicate Buckeye has the

3705

1 lowest rate of return on equity?

2 A Yes.

3 Q Just accept that, subject to check?

4 A Yes. Yes.

5 Q Is Olympic more like Kinder Morgan than  
6 Buckeye, out of the five proxy group oil companies?

7 A I guess that's a question that I just could  
8 not -- just could not answer. Along, you mean, one  
9 could imagine a number of different dimensions. I  
10 am not sure I would be able to answer on any of the  
11 dimensions. But if you would be more specific,  
12 Counsel.

13 Q You have indicated that you don't believe  
14 Olympic is any riskier than the five proxy group  
15 companies, and you have chosen the median of those  
16 proxy group members to establish a rate of return  
17 equity?

18 A Yes.

19 Q I am exploring the basis for comparing  
20 Olympic to these five members of the oil proxy  
21 group. Are all five members of the oil proxy group  
22 much larger, financially, than Olympic?

23 A That probably is true. At one point I  
24 looked at their 10K reports. I think that probably  
25 is true, Counsel.

3706

1           Q    Would you accept, subject to check, that  
2   the average of the five proxy group members'  
3   financial strength is 1.5 billion, compared to 800  
4   million for Olympic?

5           A    That would be balance sheet figures?

6           Q    Yes.

7           A    It was in -- a number of them were in the  
8   one billion plus range, so that is not an  
9   unplausible number.

10          Q    Are you aware that all five members of the  
11   oil proxy group are much larger than Olympic in  
12   terms of miles of pipeline?

13          A    The ones of the proxy group I am familiar  
14   with are much larger, Counsel.

15          Q    Do you know how many miles Olympic has?

16          A    Tip to tip it's a few hundred miles. By  
17   the time you counted it, I don't know what it would  
18   be. But I suppose it would still would be in  
19   hundreds of miles.

20          Q    Are all five members of the group more  
21   geographically diverse than Olympic?

22          A    That would be true of the ones I am  
23   familiar with.

24          Q    And all five companies have other product  
25   lines, other than petroleum products, that they move

3707

1 through their systems?

2 A I don't know whether all five also have  
3 crude lines.

4 Q Let me ask you a hypothetical just designed  
5 to test the issue of comparison between Olympic and  
6 these other companies. Let me ask you to make this  
7 assumption: assume there's a regulated toll bridge  
8 operator, and that a company with one toll bridge is  
9 riskier than a company that owns 10 toll bridges  
10 throughout the company?

11 A If all of the 11 toll bridges have earnings  
12 that are subject to basically the same degree of,  
13 volatility, and if the volatility for the 10 owned  
14 by one company is not correlated, then the one with  
15 10 would have a lower risk?

16 Q It's always riskier to have all your eggs  
17 in one basket, isn't it?

18 A Not necessarily. I suppose, having all of  
19 your eggs in T bills would be less risky than having  
20 them diversified portfolio consisting of Global  
21 Crossing and Enron.

22 Diversity -- I mean, diversity is a benefit  
23 if the risks of the various components are not  
24 correlated, if they don't all go up and down at the  
25 same time. But whether the diversified portfolio is

3708

1 less risky depends on if the portfolio starts out  
2 being a lot more risky, and after you diversify,  
3 it's only a little lot more risky. So you can't  
4 answer that in the abstract.

5 But clearly one of the standard ways to  
6 reduce risk is to diversify among company projects  
7 that have earnings that tend to go up and down  
8 independently of each other.

9 Q Or that have more units, or more  
10 geographically diversity, and so on?

11 A Those are reasons they might go up and down  
12 independently of each other. That is, if you have  
13 geographical diversity, you may be subject -- the  
14 Midwest doesn't always go up and down at the same  
15 time as the Pacific Northwest, but sometimes it  
16 does. Sometimes you have a nation-wide recession,  
17 and you have gained nothing by geographical  
18 diversity.

19 The stocks, it was once thought some money  
20 in the US and some money abroad, but during the '90s  
21 the foreign stockmarket tended to go up and down  
22 with the US stockmarket, and you weren't gaining  
23 anything. It's a factual question.

24 Q If you had to put all of your retirement  
25 investment in one company, would it be Olympic or



3709

1 one of the five oil proxy companies?

2 A I honestly can't answer that -- answer that  
3 without looking -- if Olympic pick were a publicly  
4 traded stock, and that's what we have to assume for  
5 purposes of a question like that, its stock would  
6 now be selling at a very, very low level, because  
7 the market value of your stock under cost base  
8 regulation tends to be roughly its book value, and  
9 book value right now is very, very low. So a dollar  
10 will buy a lot more Olympic stock than it will buy  
11 limited partnership interests in Buckeye. So that's  
12 your starting point.

13 Going forward, which company has the larger  
14 risks -- and I don't want to be non-responsive, but  
15 I simply don't know. Clearly, Olympic has taken a  
16 major hit because of the Whatcom Creek incident, and  
17 that's true whether you think it was their for fault  
18 or wasn't their fault. But that hit is past, and  
19 we're looking forward. Looking forward is -- and  
20 for looking forward we look at what was Olympic's  
21 record before the Whatcom Creek incident.

22 And what one sees are earnings and  
23 through-put that are going up with really monotonous  
24 regularity. Is there some reason to think that will  
25 not be the case after they return to 100 percent

3710

1 operating pressure? Perhaps there is, Counsel, but  
2 I don't have any reason for thinking that.

3 Q Are you aware that there's another  
4 independent issue going on with Olympic in terms of  
5 what has been called the ERW pipe issues?

6 MR. BRENA: Objection; scope.

7 MR. MARSHALL: I am following up on his  
8 last question, Your Honor, and on a going forward  
9 basis --

10 THE WITNESS: Since my answer is going to  
11 be no --

12 JUDGE WALLIS: Can I ask the witness to  
13 refrain from saying anything until we rule on the  
14 objection.

15 And it does go to risk. The question is  
16 whether he's aware of it, and that would resolve it.  
17 So the witness may respond to the question.

18 THE WITNESS: No.

19 Q BY MR. MARSHALL: You are saying no?

20 A No, I am not.

21 Q Are you aware of generally what is known in  
22 new Federal regulations as high consequence areas,  
23 what the impact of that might be?

24 A I am familiar in general terms, yes.

25 Q Are you aware of integrity management

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1 programs within that context?

2 A Again, in general terms, I am aware of  
3 that.

4 Q Do you know anything specifically about the  
5 impact of that on Olympic on a going-forward basis,  
6 not looking at the past, but on a going-forward  
7 basis?

8 A I know in Olympic's testimony it's has made  
9 reference to that as one of the problems it has to  
10 deal with. It's not part of the testimony that was  
11 relevant to mine. I have not analyzed it, but I am  
12 aware of the existence.

13 Q You are only generically aware of it, not  
14 on a specific level?

15 A I am generically aware of the existence of  
16 the issue. And through testimony for Olympic, I am  
17 aware that it is an issue for Olympic. But beyond  
18 that, I am not.

19 Q Are you aware that it's an issue for any of  
20 the oil pipeline proxy members?

21 A I don't know if it is or not.

22 Q Now, let's go to the next part of your  
23 chart on the cost of debt on Exhibit 2203. You have  
24 Olympic's cost of debt at 6.74 percent. And your  
25 recommendation then was 6.74 percent, the same as

3712

1 Olympic's. And in your revised Exhibit 2212, you  
2 have reduced that now to 5.26 percent; is that  
3 right?

4 A Yes.

5 Q Now, both on the original exhibit and on  
6 your Exhibit 2212, you set your cost of debt based  
7 on, as I understand it, Olympic's parents' embedded  
8 cost of debt?

9 A As described by Dr. Schink.

10 Q What you did was took Olympic's embedded  
11 cost of debt, the 6.74 percent from the year 2000,  
12 and then when Dr. Schink updated that for 2001, and  
13 found that the parents' embedded cost of debt was  
14 5.26 percent, you used that; is that right?

15 A That's correct.

16 Q Are you aware the reason Dr. Schink used  
17 the parents' cost of debt is because he used the  
18 parents' capital structure? That was his reasoning  
19 for using the cost of debt of the parents, rather  
20 than some market cost of debt?

21 A I will accept that, Counsel. I don't  
22 remember those particular sentences from his  
23 testimony. But I will accept that as the case.

24 Q If you used a market cost of debt for a  
25 stand-alone company, assuming you just create

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1 Olympic as a stand-alone company, what would be the  
2 cost of debt, or do you know?

3 A I believe that -- and I believe it's  
4 Dr. Wilson -- found that at the time he filed his  
5 testimony it was 7 percent, which sounds about  
6 right. I have not looked at it independently.

7 Q Would Olympic, as a stand-alone company,  
8 without its parents backing it, have debt rated at a  
9 junk bond status, or do you know what the rate would  
10 be?

11 A You mean if it had its current debt-equity  
12 ratio, and didn't have the backing of its parents?

13 Q Yes. You are using Dr. Schink's  
14 assumption, so I am trying to back Olympic away from  
15 its parents all together, and ask you to try to find  
16 for me an appropriate cost of debt based on what  
17 kind of rating it would get in the market?

18 A Well, if you actually took Olympic's  
19 capital structure, then you would have a very low  
20 junk bond rate of interest. However, that would be  
21 the only return there would be. There would be no  
22 equity return.

23 Q What would the typical junk bond interest  
24 rate be for a company like that in that  
25 circumstance?

1                   MR. BRENA: Your Honor, I would like to  
2 object at this point. This witness has simply  
3 adopted some of Dr. Schink's numbers without  
4 endorsement for the purposes of illustrating the  
5 five recommendations that he has made.

6                   This is -- what he's doing by exploring  
7 these issues, first, all he did was accept what they  
8 did. And then added his recommendations to them.  
9 None of the cross is going to where they are  
10 separate; all of the cross is going to where they  
11 are the same.

12                   And he's using that as a portal point for  
13 friendly cross examination that may support what Dr.  
14 Schink did. It's friendly cross, and it's beyond  
15 the scope of what that witness has testified.

16                   MR. MARSHALL: This is hardly friendly  
17 cross examination. I am showing his use of  
18 Dr. Schink's is inconsistent. Dr. Schink had one  
19 set of methodology in mind, and one outcome in mind.  
20 And if you don't regard his setting of the capital  
21 structure the way he does, then you have to look  
22 at a different approach.

23                   And that's what I am probing. It's proper  
24 cross examination. I didn't think I was being that  
25 friendly in this area, unless I can start frowning a

3715

1 little more.

2 MR. BRENA: I withdraw my objection with  
3 that explanation.

4 JUDGE WALLIS: Does the witness have the  
5 question in mind?

6 THE WITNESS: Yes, obviously it's higher  
7 than 7 percent. I don't have the figure in mind for  
8 current junk bond return.

9 Q BY MR. MARSHALL: Could it be as high as  
10 the Kinder Morgan rate of return on equity of 17.94  
11 percent?

12 A That sounds very high for junk bond. But I  
13 cannot, without being able to testify what it is, I  
14 can't tell you it's not the Kinder Morgan level.

15 Q Now, skipping for the moment, income tax on  
16 your chart 2203, next in the chart is fuel and  
17 power. And then you have the parenthetical,  
18 "Including DRA." Do you see that?

19 A Yes.

20 Q And in creating your fuel and power  
21 assumptions, they are different? Do you see that  
22 between Olympic and your recommendations?

23 A Yes.

24 Q They are different. So let's explore why  
25 they are different. Did you -- you assume a higher

3716

1 through-put than Olympic as you go down to the  
2 bottom of the page, right?

3 A Yes.

4 Q So is the reason why your fuel and power is  
5 different, does that relate to the different  
6 through-put, or is there -- are there two or more  
7 combinations or reasons why you have a different  
8 fuel and power? Because I would like to focus on  
9 the component if you have more than one component.

10 A In the world as it stood when reflected in  
11 this corrected exhibit RCM-3, the difference stemmed  
12 partly from difference in through-put and partly  
13 from a difference in fuel costs per barrel.

14 Since that time, since my original  
15 answering testimony, I corrected two errors which  
16 had the effect of raising my fuel and power cost.  
17 And those corrections are reflected in this exhibit.

18 In Olympic's rebuttal testimony they  
19 substantially reduced the fuel and power costs per  
20 barrel. The difference now is down to about  
21 two-tenths of a cent per barrel. And if we had more  
22 recent data, that might even disappear.

23 If you are comparing the current positions  
24 of the parties, then difference in fuel and power  
25 costs are based almost entirely -- are based



3717

1 substantially entirely on through-put.

2 Q So if you were to isolate the through-put  
3 factor, you are assuming a linear relationship  
4 between more barrels and fuel and power?

5 A Yes.

6 Q And are you aware that the higher the  
7 pressure, the higher the resistance, the more power  
8 is required for each incremental barrel to push oil  
9 through an oil product pipeline?

10 A There is typically -- there's a fairly flat  
11 part in that curve. And then beyond some point the  
12 curve representing pressure or fuel consumption,  
13 electric power consumption per barrel starts to go  
14 up because of the higher pressure required.

15 Q In the range of 80 percent, when you start  
16 going above 80 percent to get to your higher  
17 through-put number, you are in the higher part of  
18 the range, aren't you? Between 80 and 100 percent,  
19 you are in that higher part of the range?

20 A That's possible, Counsel, but I don't know  
21 that. The maximum allowable operating pressure is  
22 not set by the characteristics of the pumps; it is  
23 set by the characteristics of the pipe. What you  
24 said may be well be true, but I don't know it.

25 Q Isn't it true that the relationship between

3718

1 increased power and increased pressure is highly  
2 non-linear?

3 A It becomes -- at some point, it becomes  
4 highly non-linear. Whether we're at that point in  
5 going to 100 percent maximum operating pressure, I  
6 don't know, Counsel.

7 Q Okay.

8 A Could I just continue very briefly,  
9 Counsel. When I present this kind of testimony, I  
10 expect the company -- I mean, I regard this, believe  
11 it or not, as a collaborative enterprise.

12 When I present this kind of testimony, I  
13 expect the company, if a linear relationship in this  
14 instance is wrong, to come back and say, No, Means,  
15 that's not right. We have looked at our pumps and  
16 their characteristics, and it's non-linear. And  
17 taking all of your assumptions, the cost should go  
18 from 8 cents per barrel to 8.5 cents per barrel.  
19 Because they have -- I don't have the data on the  
20 pumps. They have it.

21 Yes, as an abstract matter, the  
22 relationship is non-linear, and at some point it  
23 becomes very non-linear. The problem is the only  
24 party that is capable of showing the non-linearity  
25 is Olympic, and they didn't do it in the rebuttal

3719

1 testimony.

2 Q So you made an assumption in your testimony  
3 that it was linear, and you were expecting Olympic  
4 to respond to your testimony that you submitted?

5 A That's correct.

6 Q And to say that you were wrong about some  
7 aspect of this calculation?

8 A The linear assumption is the only  
9 assumption that one can make without having detailed  
10 information on the pumps, and that is the assumption  
11 I made.

12 Q What if Olympic responded to your testimony  
13 by saying that your entire amount of designed  
14 through-put was not based on a correct assumption,  
15 and further stated that unless there were adequate  
16 tariffs, which none of the Staff or Interveners is  
17 proposing, there wouldn't be the money to get the  
18 through-put up. Is that, in your view, a response  
19 to your testimony?

20 A We have shifted now from through use to  
21 design through-put, Counsel?

22 Q If your hypothetical through-put number of  
23 129 million barrels per year is not based on  
24 anything other than conjecture, and if Olympic  
25 challenged that, do they need to challenge other

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1 parts of your theory?

2 A No. The design, the recommended design  
3 through-put of approximately 130 million barrels was  
4 based on the through-put that Olympic, in fact,  
5 achieved in 1998.

6 Q That's your assumption?

7 A That's the number that Olympic reported in  
8 its Form 6, and --

9 Q That's your only assumption, the only  
10 basis?

11 A No, Counsel. I'm not finished. And on  
12 Olympic's representation concerning the amount of  
13 additional through-put that would be allowed by the  
14 Bayview Terminal.

15 Now, I assumed that Olympic is not  
16 challenging their through-put for 1998. They now  
17 say that the representation that they made to the  
18 WUTC and FERC considering what would be allowed by  
19 Bayview is wrong. However, they have not set up  
20 what is right.

21 If some other number is right, and Olympic  
22 puts it in, I certainly would take that into  
23 account. But Olympic has not put any other number  
24 in their evidence.

25 Q Let's get this correct on fuel and power.

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1 Your fuel and power number is an adjustment to what  
2 the Staff calls a test period. We're using a test  
3 period of calendar year 2001 that Staff is using,  
4 and Staff is using a period, for sake of this  
5 question, of calendar year 2001.

6 So assume we're trying to make an  
7 adjustment to a known and measurable condition to  
8 that test year, which is the way we set rates,  
9 right?

10 A Yes.

11 Q Now, your assumption about what the fuel  
12 and power costs, including DRA, is not based on  
13 known and measurable conditions, but based on an  
14 assumption. Is that what you are testifying to?

15 A Counsel, it's based on the assumption that  
16 there's a linear relationship over some range that  
17 is a reasonable assumption.

18 Q What is known and measurable about your  
19 fuel and power cost adjustment? Can you tell me  
20 anything that is known and measurable, rather than  
21 just an assumption?

22 A What is known and measurable is the per  
23 barrel costs that Olympic was incurring during the  
24 first six months of 2001. What is known and  
25 measurable is the through-put that they achieved in

3722

1 1998. And what is certainly known is the  
2 representation that Olympic made concerning the  
3 additional through-put that would be allowed by the  
4 Bayview Terminal.

5 Now, if I don't make any adjustment, what I  
6 am left which is recommending 130 million barrels of  
7 through-put, and Olympic's test period fuel and  
8 power costs, which is highly unfair to Olympic.  
9 Unless I make some increase in the fuel and power  
10 costs, I clearly am understating Olympic's cost of  
11 service.

12 Q Let's examine what is not known and  
13 measurable in what you have just said. It is not  
14 known and measurable when Olympic will achieve 100  
15 percent operating pressure, if it ever does, is it?

16 A I was, for my dates, I was using Olympic's  
17 own projection of when it would return to maximum  
18 operating pressure.

19 Q Are projections allowed in trying to make  
20 adjustments to test numbers? Can Olympic just make  
21 a projection, and use that to just a test year  
22 number that Staff might have introduced?

23 A No.

24 Q Have you inquired on the basis for that  
25 projection whether it's out of date, whether it fits

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1 with any of the intervening facts about whether  
2 there's available capital to do these things,  
3 whether the permits are available, whether the  
4 testing has been done that would allow of any of  
5 these schedules to be done? Have you done any of  
6 that analysis?

7 A No. To the best of my knowledge, that is  
8 the only specific projection that Olympic has made.  
9 And I am not aware of any challenge to that  
10 projection.

11 Q Do you know what the through-put was in  
12 Staff's calendar year, in calendar year 2001? Are  
13 you aware of how many million barrels per year that  
14 was?

15 A It was less than the 103 million barrels.  
16 I don't know -- I don't -- I don't have the precise  
17 number.

18 Q Do you know if it was less than 90 million  
19 barrels?

20 A I think it was in the 80s, but I don't  
21 recall.

22 Q Would you accept, subject to check, that it  
23 was 83 million barrels in that calendar test year?

24 A I would accept that.

25 Q Are you aware that Staff moved the test

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1 year three months back? In other words, took three  
2 additional months of data that Olympic didn't use so  
3 that it could add extra time for through-put at an  
4 80 percent pressure with the whole system up?

5 MR. BRENA: Objection; scope. He's cross  
6 examining Staff's case.

7 MR. TROTTER: I join. This witness does  
8 not address Staff's case.

9 MR. MARSHALL: But he comes up with his own  
10 projections and adjustments to something. It has to  
11 be a test year of some type. I am trying to  
12 explore, and I am trying to use this, because I  
13 think everybody agrees that the Staff test year  
14 corresponds, at least in Staff's view, to what the  
15 Commission would use as a test year.

16 MR. TROTTER: And I would add, Your Honor,  
17 that the company itself has not used the through-put  
18 for their base year for rate making purposes. If  
19 they are not using actual figures, they are  
20 including estimates. So the same criticisms apply  
21 equally to the company.

22 MR. BRENA: My only point is he can  
23 challenge the basis for this person's assumptions in  
24 this testimony. He can cross him. But he's asking  
25 questions about Staff's case specifically, and he



3725

1 doesn't address Staff's case. And it's  
2 inappropriate, and beyond the scope of cross.

3 CHAIRWOMAN SHOWALTER: I want to interject  
4 a note of caution. I think a couple times,  
5 Mr. Marshall, you have equated either a Staff  
6 witness or Staff's position with the Commission's  
7 position, or the WUTCs position.

8 And in this case, the Staff is a separate  
9 party from the Commission, and the Commission has  
10 yet to decide these methodologies and other matters.

11 MR. MARSHALL: Agreed. Thank you very  
12 much. I just want -- let me withdraw that question,  
13 and ask a slightly different question.

14 Q BY MR. MARSHALL: What test period did you  
15 use that you were making your adjustments to on  
16 fuel, power and DRA?

17 A I was using Olympic's case 2 numbers. I  
18 was using -- from within those numbers for  
19 projecting future per barrel fuel and power costs, I  
20 was using actual data for the first six months of  
21 2001.

22 Q For the first six months of 2001?

23 A For the per barrel costs, yes.

24 Q Before the pipeline became up and  
25 completely running in 2001. Is that your testimony?

1           A    Yes.  Those were -- at the time the  
2           testimony was prepared, the most recent actual data  
3           that were available to us were the data for the  
4           first six months of 2001.

5           Q    Your understanding is that Olympic used the  
6           preceding 12-month period, ending in what date for  
7           its test year, as the Commission defines the base  
8           year, as the FERC defines it?

9           A    Case 2 period ends September 30, 2001.  Is  
10          that responsive, Counsel?

11          Q    Yes.  And so your adjustments were being  
12          made to that period, or not, or do you know?

13          A    Well, I am not sure what you mean.  
14          Olympic, then, in their rate filing, I believe, says  
15          in a footnote, With adjustments to June 30, 2002.  
16          That's from memory, Counsel, their footnote to case  
17          2.

18                        So since I am, for most purposes, using  
19          Olympic's case, those would be the data that I would  
20          be using.

21          Q    Now, are you aware, as a general regulatory  
22          principle, that to make an adjustment to a test  
23          period you have to have a known and measurable  
24          condition, right?

25          A    That's right, yes -- I am sorry, Counsel.

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1           Q    And my next question is, is it your  
2           understanding that Olympic, for purposes of  
3           through-put, is trying to use known and measurable  
4           data consisting of actual through-put data from July  
5           of 2001, when the system got back up to full force  
6           at 80 percent pressure, up until the most recent  
7           date, for which they had actuals which would have  
8           been done May of this year, or do you know that?

9           A    I am sorry.  When they got up to 80 percent  
10          of pressure, I think I missed -- do I know the date  
11          when they came to 80 percent of pressure?

12          Q    Let's start with that.  Do you know the  
13          date when they came to 80 percent pressure for the  
14          whole system back up?

15          A    It was by July, may have been June, if it  
16          was May or June, but prior to July.

17          Q    So trying to look at conditions, actual  
18          conditions, do you understand that Olympic has tried  
19          to adjust the base period for FERC, test period for  
20          this Commission, using July 2001 actual data, all  
21          the way up through the end of May?  Do you  
22          understand that?

23          A    I thought it was end of April.  But, yes, I  
24          understand that they used actual data, at least for  
25          some of the variables.  They used 10 months of data

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1 up through April. They may have used actual data  
2 for other variables.

3 Q But your adjustment to that test year base  
4 year makes assumption about whether the pipeline  
5 will ever get back up to 100 percent pressure, makes  
6 assumptions about the dates that that will occur,  
7 makes assumption about things like the cost of  
8 power, the cost of DRA, and assumes that apparently  
9 all of the permits will be obtained, and there will  
10 be no further regulatory issues associated with  
11 that. You make all of those assumptions to get to  
12 your proposed adjustment; is that correct?

13 A That's correct. I assume that they will  
14 come to 100 percent operating pressure by a certain  
15 date.

16 Q Let's turn for the cost -- the price of  
17 power itself. Let's focus on the price of  
18 electricity.

19 Did you review Staff's case and Mr. Colbo's  
20 adjustments he made to operating costs and the cost  
21 power area?

22 A I read Mr. Colbo's testimony. I did not  
23 analyze his testimony.

24 Q Did you read that part of his testimony  
25 where he said that he was not going to use Olympic's

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1 price for power, because it assumed a rate increase  
2 that has been announced, but has not been placed  
3 exactly into effect?

4 MR. BRENA: Objection.

5 MR. TROTTER: I object, Your Honor. That's  
6 not the testimony in any respect. The testimony was  
7 that there was a filed tariff requesting, I believe,  
8 an 18 percent increase, and it has not been  
9 resolved, so it assumes a fact not in evidence.

10 MR. MARSHALL: I stand corrected.

11 MR. BRENA: I would object because he's  
12 asking questions about the Staff's case instead of  
13 this witness's case.

14 JUDGE WALLIS: Mr. Marshall.

15 MR. MARSHALL: Let me recast a new  
16 question.

17 Q BY MR. MARSHALL: Do you understand that  
18 Staff was unwilling to make a projection of a future  
19 cost for power based on announced increase, because  
20 in their view, it was not known and measurable?

21 MR. BRENA: Objection. The basic issue is,  
22 is this a proper witness to cross examine on Staff's  
23 case? I don't think so.

24 MR. MARSHALL: I am not cross examining  
25 Staff's case. I am asking this witness and

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1 exploring his view on why he uses assumptions and  
2 projections instead of actual known and measurable  
3 conditions.

4 MR. BRENA: He may do that, but he may not  
5 do it within the context of another party's case.

6 MR. FINKLEA: And, Your Honor, I have a  
7 further objection. I think this is asked and  
8 answered. Mr. Means has already clarified that he  
9 used the company's figures.

10 JUDGE WALLIS: Very well. I think the  
11 objections have merit and should be sustained.

12 Q BY MR. MARSHALL: What is your  
13 definition -- rephrase that.

14 What do you understand the definition here  
15 in the state of Washington is for rate regulation  
16 for known and measurable conditions? Do you have a  
17 definition that you are aware of?

18 A I am familiar with the definition at the  
19 FERC. I have not examined the WUTC precedent. So  
20 if you would like, I will tell you my general  
21 understanding of the term.

22 Q Let me just ask, have you read anything of  
23 the WUTC that defines known and measurable?

24 A No.

25 Q Have you spoken to anybody at the WUTC or

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1 anybody who has told you what the definition is of  
2 known and measurable here?

3 A No.

4 Q Have you looked at the testimony of Staff  
5 to see what they say is a definition of known and  
6 measurable?

7 A I have looked at the testimony of Staff. I  
8 have not looked at it with a view to finding that  
9 definition.

10 Q Have you looked at any examples where Staff  
11 has used -- where they say something is not known  
12 and measurable?

13 A I have read their testimony. I do not  
14 recall whether Staff invoked the known and  
15 measurable standard in reviewing or rejecting a  
16 certain rate increase -- certain increases in the  
17 cost of fuel and power, Counsel.

18 Q Do you know of any other example where they  
19 used the definition of known and measurable in the  
20 specific of a -- in the context of a specific  
21 adjustment?

22 A No.

23 Q Let's look at your chart 2203, the next  
24 issue. The next line item down is Other Operating  
25 Expenses. Do you see that?

3732

1 A Yes.

2 Q And for that you had the same amount as  
3 Olympic?

4 A Yes.

5 Q On 2203. And then if you go to look at  
6 2212, do you have that same amount -- well, excuse  
7 me. You have a different amount. You have  
8 24,560,000 compared to 25,578,000?

9 A Counsel, is there a question pending now?

10 Q Yes. In both of these cases, both Exhibit  
11 2203 and 2212, you are using the same operating  
12 expenses as Olympic; is that correct?

13 A That's correct.

14 Q And on depreciation you use the same?

15 A Yes.

16 Q Now, on amortization of AFUDC, there's a  
17 slight change, is that correct, on 2203, and then no  
18 change in 2212?

19 A I am sorry. We're on --

20 Q I'm trying to do a side by side.

21 A But you are on -- are we on 2203 or 2212?  
22 That's what I wasn't sure about.

23 Q Looking at 2203, there's a small \$39,000  
24 change?

25 A Yes.



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1 Q And then when you look at 2212, you don't  
2 have any difference?

3 A That is correct.

4 Q Still a small amount. Then on amortization  
5 of deferred return on 2203, there's an amount of  
6 250,000 difference on 2203. About a 628,000  
7 difference on Exhibit 2212. Do you see that?

8 A Yes.

9 Q And the amortization of deferred return, is  
10 that part of this FERC frame work that we referred  
11 to earlier?

12 A That's correct. But in 2203 I am comparing  
13 two sets of numbers, both of which are using trended  
14 original cost. So the change stems from different  
15 capital structure, and different returns on equity.

16 Q Right --

17 A Whereas in 2212, I am comparing two  
18 different methodologies.

19 Q And 2212, that line shows zero for that  
20 amount, because under the depreciated original cost,  
21 you don't have amortized return -- amortization of  
22 deferred return; is that correct?

23 A Yes, that's correct.

24 Q You are familiar with FERC Form 6, aren't  
25 you?

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1 A Yes.

2 Q And does FERC Form 6 set out as a separate  
3 item on any of its pages the amortization of  
4 deferred return?

5 A I believe it's included in the page 700  
6 calculations, which is a 154B calculation, Counsel.

7 Q And the instructions on FERC Form 6 are to  
8 use 154B to do that calculation for amortization of  
9 the deferred return?

10 A Well, page 700, my recollection is,  
11 Counsel, intended to be a 154B calculation. And  
12 this is part of the 154B calculation.

13 Q This amortization of this deferred return  
14 is part of that?

15 A Yes, it's part of 154B. I don't recall the  
16 instruction, Counsel, but I would assume it's  
17 included.

18 Q Then going down to the total cost of  
19 service, you have on your revised exhibit, corrected  
20 Exhibit 2203, you show a total cost of the service  
21 of 52,154,000, FERC difference of some 8,835,000; is  
22 that correct?

23 A Yes, Counsel.

24 Q Now, if you were to use -- going down to  
25 the next line, if you were to use Olympic's actual

3735

1 through-put numbers, which I think on Exhibit 2212  
2 you have as 103,165,000 barrels per year, what would  
3 be the cost per barrel? Have you done that  
4 calculation?

5 A No, I can't do it in my head, Counsel.  
6 Do you want me to do that?

7 Q Yes, if you wouldn't mind, if it won't take  
8 too long.

9 A So the question is if you take the  
10 52,154,000 and use the original Olympic design  
11 through-put, or the new one?

12 Q Using the updated 103,165,000 barrel  
13 number?

14 A (Complies.)

15 Did you want a result on that?

16 Q Yes.

17 A I get 50.55 cents.

18 Q Per barrel?

19 A Per barrel.

20 Q Now, switching topics, and try to go  
21 through the rest of this quickly.

22 Here at page 19 of your testimony, you  
23 indicate that at the end of 1998, Olympic had a  
24 capital structure that had less than 30 percent  
25 capital?

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1 A Can you refer me -- oh, yes, all right.

2 Q Lines 7 and 8.

3 A Yes.

4 Q It had a, what, about 30 percent, almost 30  
5 percent? Is that your recollection?

6 A It's the very high 20s. I don't have the  
7 precise number.

8 Q Close to 30 percent, but under 30 percent?

9 A That's correct.

10 Q And you say in your testimony for prior  
11 years, which would include 1998, you think Olympic  
12 should have had a capital structure of 50/50, 50  
13 percent equity, 50 percent debt. Do you recall that  
14 testimony?

15 A No, I didn't say that, Counsel.

16 Q Well, let me ask you what capital structure  
17 did you recommend that would have been true for the  
18 end of 1998 for Olympic?

19 A Well, I think the problem lies in the word  
20 "recommend." I didn't recommend any capital  
21 structure. What I recommended is that its rates be  
22 calculated on the basis of a 50/50 capital structure  
23 for that period.

24 Q Do you have a recommended capital structure  
25 that you believe would be appropriate for the end of

3737

1 1998 for a company like Olympic?

2 A Counsel, what do you mean by "appropriate"?

3 If you mean, am I recommending that Olympic change  
4 its capital structure, the answer is no. And so I  
5 am not making any recommendation on that point.

6 I do have a recommendation regarding  
7 what capital structure should be used for  
8 determining Olympic's rates, and for 1998 that was a  
9 50/50 capital structure.

10 Q Assume for purposes of the next couple of  
11 questions that the recommendation is not just for  
12 rates, but it depreciates property to have a capital  
13 structure for Olympic of 50/50 in 1998, and your  
14 testimony is they have close to a 30 percent equity  
15 component at the end of 1998, so in order to get to a  
16 50 percent capital structure at the end of 1998 do  
17 you know approximately how many additional dollars  
18 they would have had to have put in to equity  
19 to get to that level?

20 A Well, there are two ways to get to that.  
21 One is you substitute equity for some of the debt.  
22 The other is you put in additional equity and leave  
23 the debt as it is.

24 In the first case, presumably there would  
25 be few, if any, additional dollars.

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1           In the second -- Counsel, I am sorry. I  
2       don't recall the numbers from this, what  
3       they were -- what they would have been.

4           Q     Just somewhere in the range of 25 to 30  
5       million dollars additional, or do you have even a  
6       ballpark in mind of how much additional equity would  
7       have to be put in to arrive at that 50 percent  
8       figure?

9           A     Counsel, I don't have a close enough  
10      recollection for it to be useful for me to respond  
11      to the question.

12          Q     If they had had a 50/50 capital structure  
13      at the end of 1998, do you have an opinion -- have  
14      you advanced an opinion as to whether they would  
15      have been able to weather the Whatcom Creek issues  
16      in 1999?

17          A     Well, if they had a -- if they had 29  
18      percent, and what essentially Whatcom -- essentially  
19      Whatcom Creek did was to knock them down to  
20      essentially zero. It's a little worse than zero,  
21      but very close to zero. Then presumably if the  
22      point had been 20 percent higher, you would have  
23      knocked them down to a 20 percent equity.

24          Q     Do you have an opinion as to whether they  
25      could have weathered Whatcom Creek if they had

3739

1 started out with 50 percent capital structure  
2 instead of 30 percent capital structure at the end  
3 of 1998?

4 A I am not sure what the question is. They  
5 did weather Whatcom Creek, so I am not sure what you  
6 mean.

7 Q Did they weather Whatcom Creek because the  
8 parents put in a lot of money?

9 A Yes.

10 Q Let's turn to page 20. You state at line  
11 6, "Olympic's capital structure has not been market  
12 tested." Then you go on to say, "All of the shares  
13 are held by its corporate parents, and those parents  
14 also either hold or guarantee its debt."

15 A Yes.

16 Q Then you add, "Under ordinary  
17 circumstances, the balance that Olympic's parents  
18 choose to strike between equity and debt, and  
19 Olympic's capital structure would be of no relevance  
20 to Olympic's rate case." Do you see that?

21 A Yes.

22 Q Have you ever given testimony before  
23 Congress on the origin for the high debt ratios that  
24 oil pipelines had have had historically? Have you  
25 elucidated the historical reasons for that before

3740

1 Congress?

2 A The only testimony I gave to Congress on  
3 oil pipelines was when I was head of Policy Office  
4 at the FERC. So that would have been '82 or 1983.  
5 I have a feeling you know what I said. I don't know  
6 what I said, Counsel.

7 Q It's all available in the public record,  
8 right?

9 A No doubt it is.

10 Q I can cite to hearings before the  
11 Subcommittee on Surface Transportation Regulatory  
12 Reform on the Oil Pipeline Industry, and I would  
13 find your testimony, wouldn't I?

14 A That sounds right, Counsel.

15 Q Well, I won't bother to ask you the  
16 questions, because I can cite that later on.

17 But generally speaking, do you know the  
18 historical reasons offhand? I am not asking you to  
19 take a memory test. If you need to see it, I can  
20 show it to you.

21 A Well, the reasons were partly that they did  
22 tend to be subsidiaries, no matter what else was  
23 true. If they weren't subsidiaries of somebody, you  
24 couldn't get by with this.

25 The second reason stemmed from the



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1     peculiarity of the ICC methodology, which in effect,  
2     created an incentive for a debt heavy capital  
3     structure.

4             Q     And how did that work?

5             A     Counsel, that's not one of the things I  
6     filed away in long-term memory.  It was an -- I  
7     mean, it was -- the D.C. Court of Appeals said it  
8     was a highly irrational methodology.  It did not, in  
9     fact, take account of anything that might  
10    approximate the company's true cost of capital.  I  
11    don't think I can go into any more detail without  
12    refreshing my recollection on the ICC.

13            Q     So we have to rely on your testimony?

14            A     It was a lot fresher in my mind 18 years  
15    ago than it is now, Counsel.

16            Q     Just a couple of other areas here, and then  
17    we will be finished.

18                    You said at page 13, line 6 -- starting at  
19    line 6, but going down, I think, probably around  
20    line 6 to 12, that the impact of rates for  
21    transportation oil pipeline transportation rates is  
22    relatively small.  Is that the gist of what you are  
23    saying here, less than one cent a gallon?

24                    MR. BRENA:  Objection; friendly cross.

25                    JUDGE WALLIS:  The question may be

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1 preliminary.

2 MR. MARSHALL: It is.

3 JUDGE WALLIS: Please proceed.

4 THE WITNESS: The impact on retail rates is  
5 relatively small, yes.

6 Q BY MR. MARSHALL: And do you know what the  
7 impact on retail rates would be here for the  
8 increase that Olympic is asking for? Have you done  
9 any calculations on that?

10 MR. BRENA: Renewed objection.

11 MR. TROTTER: We join. That does appear to  
12 be purely friendly cross.

13 JUDGE WALLIS: We will sustain the  
14 objection, Mr. Marshall.

15 Q BY MR. MARSHALL: Did you also give  
16 testimony in a different Congressional hearing on  
17 the -- for the Subcommittee on Commerce Science and  
18 Transportation to the US Senate Oil Pipeline  
19 Deregulation, where you strongly supported a move  
20 for deregulation of the oil pipeline industry,  
21 because of much of the regulation is burdensome for  
22 both of Commission, and the parties subject to it,  
23 and doesn't bring any commensurate gain to the  
24 public?

25 MR. FINKLEA: I object to the use of

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1 documents that were not predistributed. If  
2 Mr. Marshall intended to use documents for cross  
3 examination, they should have been predistributed.

4 MR. BRENA: I would like to join the  
5 objection. I understand we're all doing the best we  
6 can, and sometimes cross examination exhibits aren't  
7 available as quickly as they can be.

8 But it's certainly been the common  
9 practice, and we have adhered to it, that as soon as  
10 we have them and know we're going to use them, we  
11 distribute them in the hearing room on the day they  
12 are to be used, at a minimum.

13 This is the second document that has been  
14 used for cross examination that this witness --  
15 this is a surprise cross examination document, line  
16 of cross examination. It's the second time he's  
17 done it in a row.

18 I understood the Commission's practice to  
19 ask that the witness have an opportunity to review  
20 those. So if this is the -- if this is what is  
21 going to be allowed, then that's fine. But let's  
22 just set the clear rule, and let's keep the rule  
23 through the hole proceeding. This is not fair.

24 MR. MARSHALL: We would --

25 MR. FINKLEA: Your Honor, it also goes

3744

1 beyond the scope of Mr. Means' testimony, because  
2 he's not here testifying on whether Olympic should  
3 be deregulated.

4 JUDGE WALLIS: Let's do these one at that  
5 time. The Commission's preference is that documents  
6 be available, but I think we have seen during the  
7 past couple of days that that has not always been  
8 possible, and documents have been provided to  
9 witnesses, including Olympic's witnesses, for  
10 examination while the witness is on the stand.

11 Mr. Marshall, what is the purpose of this  
12 line of inquiry?

13 MR. MARSHALL: To the public interest, and  
14 that's my last series of questions. And then I will  
15 conclude my cross examination.

16 JUDGE WALLIS: Could you be a little more  
17 specific about how you plan to tie your pending  
18 question into this line of questions?

19 MR. MARSHALL: I don't need to ask the  
20 question, because I will refer to this actual  
21 document. But I would like to point out that  
22 Mr. Means and his attached resume here refers at  
23 page 2 of 3 to the following statement, quote, I  
24 also testified before Congressional committees on  
25 natural gas policy, natural gas company mergers, and

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1 oil pipeline deregulation, and was responsible for  
2 the preparation of Congressional testimony by the  
3 commission chairman.

4 So I think when you attach something like  
5 that, you are fair game to have that done. I did  
6 ask Tosco's attorney if he could supply me with what  
7 these things were. He couldn't do that.

8 We scrambled and found it last night, and I  
9 didn't know whether I was going to use it or not.  
10 But it seemed appropriate, given the witness'  
11 testimony, particularly on the redirect, to use this  
12 public interest issue. It's clearly something that  
13 he's relying on to bolster his credentials.

14 JUDGE WALLIS: Well, I think we have  
15 crossed the bridge of whether we can mention it. If  
16 you are going to inquire into it, we would like to  
17 know a little bit more specifically how it will tie  
18 in, and we would like to have you make that  
19 document, or a copy of that document, available to  
20 the witness, and to counsel if you are going to  
21 question on it.

22 MR. MARSHALL: The public interest issue is  
23 how this rate increase might affect the public in a  
24 couple of different ways, assuming that all costs  
25 are passed through affects the cost of the product

3746

1 that people buy in petroleum.

2 Another public interest area that I'm not  
3 going to get into with this witness is the public  
4 safety aspect. But I do believe the public interest  
5 has to have a balance between what the cost might be  
6 versus what the benefits might be.

7 And, again, I am quoting this witness'  
8 testimony on deregulation, saying there really isn't  
9 a benefit to the public from regulation of oil  
10 pipelines.

11 CHAIRWOMAN SHOWALTER: How old is this  
12 testimony?

13 MR. MARSHALL: This testimony is when he  
14 was at the FERC back in the 1982 period of time.  
15 And if anything, there's less reason to have  
16 continued regulation. I could ask the witness that,  
17 but --

18 JUDGE WALLIS: Mr. Marshall, how does that  
19 tie in with an issue before the Commission in this  
20 proceeding?

21 MR. MARSHALL: Again, I do think it goes to  
22 the public interest. This has been the basis for a  
23 lot of the statements that have been made by FERC,  
24 and others about do we really need to regulate?

25 JUDGE WALLIS: Mr. Marshall, I don't see

3747

1 that whether or not the industry should be regulated  
2 is a question that is before the Commission in this  
3 proceeding. So I will sustain the objections.

4 And I would like to make it clear to all  
5 counsel that if we're going to examine based on a  
6 document, that that needs to be distributed in  
7 advance. We have the standard that documents to be  
8 used on examination should be prefiled well in  
9 advance.

10 We understand that this witness had  
11 additional direct by leave of the Commission. In  
12 light of the schedule, we have been relatively  
13 tolerant on that. But you did indicate that you had  
14 it this morning, and to that extent it would have  
15 been appropriate for possible use during examination  
16 to distribute it to other parties so it would be  
17 available.

18 MR. MARSHALL: Actually I had not read it  
19 until about 130. I had it this morning, but I had  
20 no been able to go through it. So, Your Honor is  
21 partially correct.

22 I will withdraw the question, because I  
23 think we can address that in other ways.

24 Q BY MR. MARSHALL: Are you aware that there  
25 are public interest standards that are imposed by

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1 law here in Washington State for regulation?

2 A Excuse me?

3 Q For rate regulation?

4 A I have not read the legislation, Counsel.

5 Q So would you know any of the public  
6 interest components?

7 MR. BRENA: If he could tie this back to  
8 the witness' testimony, I will be greatly  
9 appreciative.

10 MR. MARSHALL: This will be the last  
11 question I ask in this area.

12 MR. BRENA: I withdraw that objection on  
13 that representation.

14 MR. FINKLEA: On that basis, even I won't  
15 object.

16 JUDGE WALLIS: Does the witness have the  
17 question in mind?

18 Q BY MR. MARSHALL: Do you know any of the  
19 components in any of the public interest standards  
20 in this state, knowing you are not familiar with the  
21 law?

22 A I guess -- I think the answer is no. That  
23 is, no -- let me just answer simply no.

24 Q Now, one last series on this issue of  
25 indexes, or trying to figure out how to adjust



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1 through-put in the future. First, can you base  
2 rates on a projected 100 percent through-put by  
3 ignoring the requirement that you have to attract  
4 the capital sufficient to get to the 100 percent in  
5 the first place?

6 A Yes -- I am sorry, no -- restate the  
7 question, because I think I was answering a  
8 differently constructed sentence.

9 Q If you base rates on a projected 100  
10 percent pressure so you can get the through-put up,  
11 while ignoring the need for the rates to raise, the  
12 capital necessary to achieve it safely, aren't you  
13 in a position where you are stuck? How do you get  
14 to the 100 percent without the capital necessary to  
15 get there?

16 A Again, we're ignoring -- we're putting  
17 aside, one, the fact that it's a subsidiary. The  
18 standard is what would an independent company  
19 attract for investors to buy it's stock? Well, for  
20 investors to put money into the company they must  
21 believe they will get a reasonable return on their  
22 investment. So the question is whether the use of a  
23 surcharge of the kind that I have recommended is  
24 inconsistent with investors' beliefs that they will  
25 get a reasonable return on their investment.

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1           Obviously, I recommended it, I don't  
2 believe it is inconsistent, but that's the issue.

3           Q    Under the indexes that you have discussed,  
4 rates go down as through-put rises automatically; is  
5 that correct?

6           A    No, it's a surcharge which will produce the  
7 same net present value.  Essentially it levelizes  
8 the impact of the operating pressure restriction.  
9 But, no, the rates -- it's not a tracking mechanism,  
10 Counsel.

11          Q    Have you ever seen that mechanism be put  
12 into effect for any oil pipeline of the size of  
13 Olympic?

14          A    No.  When I was proposing it, I was -- the  
15 analogy I had in mind was the treatment of a  
16 one-time extraordinary expense where it's customary  
17 to spread that out over some period of time.  I am  
18 not -- this, in a sense, is that turned upside down.  
19 I am not aware of any instances in which it has  
20 been used.

21                   MR. MARSHALL:  No further questions.

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

24                                   (Brief recess.)

25                   JUDGE WALLIS:  Let's be back on the record,

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1 please. Questions from the bench.

2

3

EXAMINATION

4

5 BY CHAIRWOMAN SHOWALTER:

6 Q Thank you. I have several questions, some  
7 of which are just quick clarifications, I hope, from  
8 you, and others might be a more extended discussion.

9 But if you could turn to page 30 -- excuse  
10 me, page 2 of your testimony, lines 17 and 18 and  
11 19, this is where you recommend a capital structure  
12 of 50 percent debt and 50 percent equity, for quote,  
13 earlier years. And I don't really understand what  
14 this means.

15 It appears to be backward looking at years  
16 before the test year in FERC terms or WUTC terms? I  
17 am not sure.

18 A Well, I guess -- I am sorry, Madam  
19 Chairwoman.

20 Q But what is the effect of choosing a  
21 capital structure for prior years?

22 A The reason under a depreciated original  
23 cost methodology, it doesn't make any difference.  
24 The past is past, and it doesn't matter.

25 The trended original cost methodology,

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1 building the rate base up year by year, and the way  
2 in which that build-up occurs depends on the capital  
3 structure -- depends on the capital structure that  
4 is used for the earlier years to the relevance of  
5 the earlier years.

6           It's an artifact of the trended original  
7 cost methodology. That's why you see in the  
8 schedules that go with the trended original cost,  
9 you will see some schedules that they start in 1983,  
10 and they go all the way up to the test period in  
11 either your sense, or the FERC's sense.

12           Q   Okay. Thank you. The next area is a more  
13 extended area, and it is this issue of predicted  
14 future events. Or at least put another way, maybe  
15 setting rates that change over the course of the  
16 future, and how that fits or doesn't fit with  
17 regulatory principles?

18           A   Yes.

19           Q   And for example, this Commission has had  
20 natural gas trackers for its utilities that may be  
21 roughly comparable to the straight tracking options.  
22 But, also, recently, we have adopted power cost  
23 adjustment clauses for two of our utilities,  
24 different mechanisms for each utility.

25                   And in those mechanisms we set dead bands,

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1 and other bands that operate depending on what the  
2 costs are. We can't predict the costs. The utility  
3 can't control the costs.

4 On the other hand, it can control some  
5 things about those costs. They can -- it can make  
6 prudent decisions, it can make different decisions.  
7 We have it set up such that within certain zones,  
8 the company benefits if it either guesses right or  
9 operates right, and/or absorbs the loss. But beyond  
10 that point, it doesn't.

11 And I am raising this because I am trying  
12 to understand whether your proposal is similar in  
13 that it's a matter of degree, or is really different  
14 in that it's qualitatively different to assume a  
15 certain output in the future -- maybe the word  
16 "assume" is wrong -- to peg a rate to a revenue  
17 amount that would be the case if there were 100  
18 percent through-put.

19 I don't need you to answer in terms of this  
20 Commission. We're deciding what we will do with the  
21 future. But I would like an answer to that question  
22 in terms of regulatory principles as applied to what  
23 you might say is a changing situation for a given  
24 company.

25 A Okay. Based on your descriptions, I think

3754

1 the difference is a difference of degree. I think  
2 at one point in my oral surrebuttal testimony I  
3 describe a pure tracker and my recommendation as  
4 being two end points on a continuum.

5 In one, there's no risk placed on the  
6 company. On the other, the company gets 100 percent  
7 risk for good and for bad. I believe, as I  
8 understand your description, it's a mechanism where  
9 it puts part, but not all, of the risk on the  
10 company. There are boundaries, or there are various  
11 ways to do it. You can have sharing or boundaries,  
12 and the rules inside the boundaries are different  
13 than the rules outside.

14 But it's not either end of that continuum.  
15 It's where the company is bearing part of the risk,  
16 but it's not bearing all of the risk. To do that  
17 you need to make some projections, but if you don't  
18 make a projection, you have no way to draw the  
19 bands, or to do my surcharge, or something.

20 So Mr. Marshall was asking questions about  
21 going beyond the test period and using projections.  
22 If the Commission concludes that, under your  
23 principles you are operating under, you can't do  
24 that, then the alternatives that I described -- one  
25 of them is simply eliminated, because anything that

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1 puts part of the risk on the company does assume  
2 that you have got some standard that it will be the  
3 mid-point of the bands, or the point from which it  
4 starts, whatever you are doing.

5 And you are left, then, either with a pure  
6 tracker, which doesn't require that you make any  
7 projection, or you are left with one where, if you  
8 can, if you are permitted to do this in which you  
9 say, here's the rates, but you have got to come back  
10 in and file the new rate case in 18 months, 24  
11 months, whatever is the appropriate period.

12 But to answer your question specifically,  
13 the difference is a difference of degree. It  
14 relates to how much of the risk is placed on the  
15 pipeline.

16 Q And if we do adopt some kind of mechanism  
17 along the lines that you recommend, do you agree  
18 that if things prove disastrous, things don't pan  
19 out anything close to the way the mechanism is  
20 supposed to work, the company can come in and  
21 request a modification?

22 A Yeah. I assume the Commission could not,  
23 even if it wanted to, today's Commission cannot tie  
24 tomorrow's Commission's hands. There is a value.  
25 There's a value that attaches to the stability. But

3756

1 if the circumstances change, the Commission is  
2 legally free to change the approach.

3 Q Turning to page 6 of your testimony,  
4 there's a little discussion of starting rate base  
5 and transitional starting rate base. My only  
6 question is, is there a difference between  
7 transitional rate base and starting rate base?

8 A No. I think transitional is simply tacked  
9 on as an explanation for why there's a starting rate  
10 base.

11 Q And then on page 22 of your testimony, line  
12 8 you say, "For a given level of perceived business  
13 risk, the cost of equity increases to the proportion  
14 of debt in the company's capital structure."

15 Do you mean there actual company capital  
16 structure, or is it true in some other sense?

17 A No, I mean -- what I am talking about here  
18 is I am talking about a company that is actually out  
19 in the market selling its shares, or limited  
20 partnership interests. And it really has a capital  
21 structure.

22 They are not talking about a capital  
23 structure that has been imputed by a regulatory  
24 commission.

25 Q All right. And now that we're here on the



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1 subject of capital structure, you give, I guess it's  
2 a couple of pages later, the role of the capital  
3 structure or hypothetical capital structure.

4 And I am kind of confused about the second  
5 role that you describe. I am trying to find it. I  
6 see on page 23 there's discussion of the first role.  
7 Why don't we stop there.

8 I have a question. You say this first role  
9 has very limited relevance for the earlier years.  
10 What do you mean? What is the earlier years in that  
11 case?

12 A It's what I refer to earlier why --

13 Q The same thing?

14 A It's the way -- in other words, that part  
15 of the testimony. Again, if the Commission  
16 determines that it's going to use a depreciated  
17 original cost, rate base becomes irrelevant. It's a  
18 matter of building up the trended original cost rate  
19 base from year to year. And that build-up is  
20 affected by the capital structure that you assume  
21 for each of the earlier years.

22 Q And then here's the discussion of the  
23 second role on that page. It says, "Please discuss  
24 the implications of the second role played by  
25 capital structure." And maybe I do understand that.

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1 On the second page you are talking about if the  
2 capital structure is too high, it will result in too  
3 high a rate. If it's too low --

4 A Yeah, well, if you have a higher part of  
5 it, if you assume for the earlier years there's a  
6 larger component of equity, then the trended  
7 original cost rate base will build up faster. So  
8 when you get to the test period when you are  
9 actually establishing the rates, you will be using a  
10 larger trended original cost rate base.

11 Q I think somewhere in your testimony you  
12 make the assertion that what a company's actual  
13 structure debt-equity ratio is makes a difference.  
14 And you have a sentence somewhere that says that if  
15 you have some equity, it's a cushion for when things  
16 go bad?

17 A Yes. Yes.

18 Q Does the hypothetical capital structure  
19 that we adopt have any impact or incentive on the  
20 company to move in a direction of an actual higher  
21 equity than it currently has?

22 A I believe the answer is no. I mean, if --  
23 well, if the Commission were to use not the parents'  
24 capital structure, but the actual oil pipeline's  
25 capital structure, obviously that would create

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1 incentive for it to respond, because that becomes  
2 one of the inputs into your regulatory process,  
3 assuming that you use either the parents' capital  
4 structure, or something based on the proxy group.  
5 So it's not affected by what the company does.

6 I don't think that there is any impact that  
7 the company presumably will adopt a capital  
8 structure that maximizes its position, and that  
9 since its choice of the capital structure for the  
10 oil pipeline company itself isn't affecting anything  
11 that you are doing, then it doesn't appear to me  
12 that -- I mean, obviously I am thinking this out as  
13 I am talking about it.

14 But it doesn't appear to me that you create  
15 an incentive one way or the other, obviously, unless  
16 you explicitly address the issue as I think has been  
17 recommended by some witnesses.

18 Q And here I was referring to setting a  
19 hypothetical capital structure. But if you think  
20 that having more equity in the company would  
21 actually be a good thing, is there anything that a  
22 regulator can do to provide that incentive, short of  
23 a condition, I suppose, to say when we see so much  
24 equity in the company, then here is the regulatory  
25 response?

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1           A    Well, I suppose, in general terms, if the  
2           rates the company is charging, they are producing  
3           positive cash flow, they are financing the  
4           investments and so forth, that gives the company a  
5           relatively painless way to increase the amount of  
6           equity over time. So in that sense, that's not so  
7           much a matter of incentives as it is money is there.

8           Q    But the money need not go there?

9           A    No. The company, as a matter of corporate  
10          law, can allow -- fully pay out all of its profits  
11          as dividends.

12          Q    You mentioned the Oscar Wilde metaphor of  
13          the orphan that kills his parents, but this seems  
14          more like the parents who starve the child of  
15          equity, and then go to the State for more food that  
16          may not go to the child. It may for go to the  
17          parents again.

18          A    I guess I won't try to extend the --

19          Q    We always have one metaphor for every case.

20          A    And that's right, but I will leave this one  
21          in your possession. I won't try to extend somebody  
22          else's metaphor on this.

23                        Yes, my position is simply that the company  
24          should not be rewarded to the extent that you  
25          conclude that their financial problems, in fact, are

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1 in part a function of their capital structure, it  
2 would be inappropriate to give them a risk premium  
3 because of that financial risk.

4 Now, I think Olympic's view, as expressed  
5 in one of their witnesses, that's not the source of  
6 their financial risk. But if you view it as being  
7 not a sufficient cause -- well, one of the necessary  
8 causes in their financial risk, then they chose to  
9 take actions that led to the risk, and it would not  
10 be appropriate to add that risk premium to it.

11 Q Another question I actually have, back on  
12 the escalating rates or surcharges, as you would  
13 have it, when you think about the regulatory compact  
14 part of that, at least traditionally is that there  
15 is no return on plant until it's used and useful.  
16 Is that a concept that is or isn't compromised with  
17 your proposal?

18 A No, because it's strictly on through-put.  
19 I mean, the costs under my recommendation are the  
20 costs that you have before you -- I think that as I  
21 understand, as I interpret Olympic's recommendation,  
22 they are looking at a tracker that would relate both  
23 to costs -- well, would relate both to through-put  
24 and to costs. So it would take account  
25 automatically of additional costs.

1                   The witness said -- what the witness  
2                   said -- but that's my interpretations. But this  
3                   one, my recommendation is dealing strictly with  
4                   through-put.

5                   Q    Insofar as you are recommending a surcharge  
6                   to recover costs when through-put or capacity is at  
7                   less than 100 percent, does that imply that you have  
8                   no position on the question whether Olympic is at  
9                   fault in some regulatory sense for the lack of that  
10                  capacity?

11                  A    That's right. My recommendation does not  
12                  assume that they are at fault.

13                  Q    Okay. And there are three possibilities.  
14                  You take no position; you think they are at fault,  
15                  but that would be inconsistent with your proposal;  
16                  or you think they are not at fault in a regulatory  
17                  sense, and therefore should be entitled to recover  
18                  during this period?

19                  A    I take no position, because to deal with  
20                  that issue one really would have to go -- one would  
21                  have to go into the factual record in a way that I  
22                  have not done. So I have no position on that.

23                  So I since I have no position, of necessity  
24                  my recommendations assume they are not at fault,  
25                  that this is a conventional, their through-put went

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1 down, and some day it's going to go up.

2 CHAIRWOMAN SHOWALTER: That's all I have.

3 Thank you very much.

4

5

EXAMINATION

6

7 BY COMMISSIONER HEMSTAD:

8 Q Dr. Means, on page 33 of your prefiled  
9 testimony at line 10 you have a statement that  
10 follows on from the prior paragraph that seeks to  
11 describe a FERC approach to the regulation of oil  
12 pipelines. And you say, "FERC's approach to oil  
13 pipeline regulation is embodied in regulations that  
14 are, insofar as I know, unique to that agency."

15 And then I was looking back at the prior  
16 paragraph, and you are describing there a band of  
17 reasonableness in relation to the costs. Does the  
18 general statement, starting at line 10, does that go  
19 to the whole structure of the FERC methodology, or  
20 are you referencing some subpart of that?

21 A Well, it goes to the methodology which  
22 allows pipelines automatically to increase rates  
23 each year in a rate -- allows oil pipelines to  
24 increase rates each year by a percentage equal to  
25 the change in the producer price index, minus one

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1 percent.

2           And then basically allows an intervention,  
3 cost-based intervention if there's a substantial,  
4 quote, substantial, divergence between costs and  
5 revenue.

6           So in that sense, it's like the band that  
7 was referred to earlier. As long as you stay  
8 somewhere within the substantiality band, we're not  
9 going to ask what really happens to your cost. They  
10 are just going to change in proportion to the  
11 producer price index. I certainly don't know the  
12 regulations of all 50 states. I am just not aware  
13 of another mechanism like that.

14           Q   And the company's filings at FERC use the  
15 FERC methodology, and here implicate that structure  
16 that you are describing here. Is that a fair  
17 statement here?

18           A   That is right. They are, in effect, saying  
19 things have changed so much that producer price  
20 index minus one won't carry the weight.

21           But the regulation, and the opinion I was  
22 trying to make here is, it reflects a general FERC  
23 methodology to intervene actively as little as  
24 possible. Which, then, for me, creates questions as  
25 to whether it would be open to something like a



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1 tracking mechanism that adjusted the rates every  
2 quarter based on changes in through-put.

3 And for that reason, it seemed to me that  
4 there was one reason in favor of the fixed  
5 surcharge, which does not doesn't apply to this  
6 Commission.

7 Q Then I take it from your generalized  
8 statement there that you are not aware of any state  
9 public utility commission that utilizes that  
10 methodology?

11 A That's right. And I guess the relevant  
12 point would be, as I understand. I am told by  
13 counsel there's no counterpart, in particular, in  
14 the Washington Commission's regulation.

15 Q But my question was broader than that, your  
16 knowledge of other states?

17 A I am not aware of any. Now, as I am  
18 thinking now, having written it then, there are some  
19 states in the Telecom area that I think it sort of  
20 wounds up a mechanism and lets it run.

21 Q I am really focusing on pipeline  
22 regulation.

23 A I am not aware of any state that does this  
24 on pipeline regulation.

25 COMMISSIONER HEMSTAD: That's all I have.

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1 Thank you.

2 COMMISSIONER OSHIE: No questions.

3 JUDGE WALLIS: Very well. Follow-up

4 cross?

5 MR. BRENA: I have, at great risk, one or

6 two questions.

7

8 RECROSS EXAMINATION

9

10 BY MR. BRENA:

11 Q Chairwoman Showalter asked you a question  
12 whether or not there would be an incentive either  
13 way as the result of the imposition of a  
14 hypothetical capital structure. Do you recall that?

15 A Yes.

16 Q I would like you to make the following  
17 assumptions: that the actual capital structure of  
18 the firm, of the public service company is 90  
19 percent debt, and 10 percent equity. And that there  
20 is an imposition of a hypothetical capital structure  
21 that is 50 percent debt and 50 percent equity.

22 Okay?

23 A Yes, Counsel.

24 Q Now, if the public service company  
25 increases its actual equity percentage from 10 to

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1 20, then isn't it true, since the cost -- since the  
2 return on equity is greater than debt, that it will  
3 be lowering its return on equity as a percentage and  
4 in absolute terms?

5 A I think I must have fallen off the train at  
6 some point, Counsel, because initially it has a  
7 90/10 debt equity ratio.

8 Q That's the actual capital structure?

9 A And we're looking at what would happen if  
10 it would go to an 80/20 actual debt-equity ratio.  
11 Is that right, counsel?

12 Q We're looking at a company that is being  
13 regulated for rate purposes under a 50/50  
14 hypothetical capital structure.

15 A Yes.

16 Q But it actually has 90 percent debt, and 10  
17 percent equity. As it increases equity and its  
18 actual capital structure to begin to approach the  
19 hypothetical capital structure, then isn't it true  
20 that its return on equity will decrease?

21 A Will decrease, Counsel? I am sure that you  
22 thought this out, but I can't see why this would  
23 happen.

24 Q Okay. Let me stay with it for another  
25 second. I know the hour is late.

1                   CHAIRWOMAN SHOWALTER:  Why don't you use  
2   the words, actual return on its actual equity would  
3   decrease.

4                   Q   BY MR. BRENA:  Did you understand me to ask  
5   that I was talking about its actual return on its  
6   equity?

7                   A   What you mean is since the dollar return  
8   would stay the same, if I divide that dollar return  
9   by the actual equity, you will get a smaller amount.  
10  Is that the point, Counsel?

11                  Q   Let me try it a different way.  If you  
12  actually got 10 percent equity into a company, but  
13  they are giving you rates assuming you have 50  
14  percent equity in it, then you are getting equity  
15  dollar return for 50 percent, but you only have 10  
16  percent in?

17                  A   Yes.  Yes.

18                  Q   So as you increase your equity percentage  
19  to approach your hypothetical percentage, then the  
20  result of that is -- the impact of that is that your  
21  return on actual equity will go down, because you  
22  have greater equity invested, but you are not  
23  getting any greater rates?

24                  A   Yes.  I was thinking of dollar return.  But  
25  as a percentage return, that's correct.

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1           Q    So the effect of having an actual capital  
2   structure with very low equity and imposing a  
3   hypothetical capital structure is to create a  
4   disincentive to invest additional equity when you  
5   view it in terms of a percentage return on actual  
6   equity?

7           A    I don't think so, Counsel.  Although, as I  
8   indicated to Chairwoman Showalter, I am thinking  
9   this out on the stand, so I would be delighted to  
10  have our cross examination lead me to understand  
11  where I went wrong.

12                    First of all, we're talking about a  
13  subsidiary.  We're talking about this kind of a  
14  situation, Counsel?

15           Q    Just on a stand-alone basis.

16           A    So we're talking about a stand-alone  
17  company?

18           Q    Well --

19           A    What a stand-alone company would like to  
20  do, it would like to do two things.  It would, of  
21  course, like to get -- it would like to set its  
22  rates as high as possible, and so would like to  
23  affect the regulatory Commission's decisions in such  
24  a way that its rates go up.  It would, at the same  
25  time, like to minimize its actual costs.

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1           Now, in use, normally the two things are  
2   coupled the way you -- the reason that the utility  
3   gets higher costs -- or higher rates is because it  
4   has higher costs. But because we're using a  
5   hypothetical capital structure, the two things are  
6   decoupled.

7           So the regulatory commission will assume,  
8   for the time being, it's going to stick with a 50/50  
9   hypothetical capital structure. What the pipeline  
10  would like to do now is minimize its costs, and so  
11  it will select the capital structure that will  
12  minimize its costs. And in doing that, it will take  
13  account of the impact of the capital structure on  
14  the price it pays to sell additional shares, price  
15  it pays to sell additional debt, and also the risk  
16  of bankruptcy.

17           There is, on the face of it, no reason why  
18  that cost minimizing capital structure will be any  
19  different, because where the utility commission is  
20  setting the 50/50 hypothetical capital structure  
21  than where it's setting a 60/40 capital structure.

22           Q   Let me use specific numbers, and see if I  
23  can get there.

24           MR. MARSHALL: Is this hypothetical  
25  assuming no parent involvement?

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1                   MR. BRENA:  It's a stand-alone hypothetical  
2     exploring Chairwoman Showalter's --

3                   MR. MARSHALL:  I object.  That's not our  
4     situation here.  This company has parents, so it  
5     would be irrelevant.

6                   MR. BRENA:  Well, that's an issue.

7                   JUDGE WALLIS:  That is an issue.  And  
8     witnesses have addressed both stand-alone as a  
9     model, and subsidiaries as a model.  So the question  
10    is permissible.

11                  Q    BY MR. BRENA:  Let's say the cost of debt  
12    were 5 percent, and the equity return were 10.  And  
13    the same assumptions that I gave you before, the  
14    actual capital structure was 90 percent debt, and 10  
15    percent equity, but they had, for rate making  
16    purposes, been granted 50 percent -- the 50/50  
17    hypothetical capital structure.  Is the hypothetical  
18    clear so far?

19                  A    Yes.

20                  Q    Now, within that is the difference between  
21    your actual equity of 10 percent and the  
22    hypothetical equity of 10 percent, or 40 percent  
23    that they are actually paying the debt cost on, but  
24    getting the equity return on?

25                  A    Yes.

1 Q So in that 40 percent, they are paying 5  
2 percent for that 40 percent, in fact, but they are  
3 getting from the rate payers 10 percent, correct?

4 A Yes.

5 Q Now, if they go from 10 percent equity to  
6 50 percent equity, actual equity, then at that point  
7 they have 50 percent equity that costs 10 percent.  
8 So they are no longer getting that subsidy on the  
9 difference on their equity and debt, correct?

10 A That's correct.

11 Q So that would create -- why do they want  
12 to, if they are getting paid equity dollars but they  
13 are filling it with low cost debt, they would have a  
14 disincentive to take debt out and put equity in?

15 A I think we may have gone astray on the  
16 earliest exchanges, Counsel. My point is once --

17 Q Could I get an answer to that first,  
18 before --

19 A No --

20 Q Well --

21 A There's a disincentive, but the  
22 disincentive is created by the capital -- by the  
23 capital markets; that is, by using a hypothetical  
24 structure, the Commission has taken itself out of  
25 the game. It's going to give them the same amount



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1 of dollars no matter what they do.

2 So if it were the case that your cost of  
3 debt is the same when you have 90 percent debt, and  
4 your cost of equity is the same you have 90 percent  
5 debt as when you have 50/50 --

6 Q And I am intending to stay within that  
7 hypothetical.

8 A Right. If that is the case, that is,  
9 having a more heavily leveraged company doesn't  
10 increase your cost of debt, doesn't increase the  
11 cost of equity, doesn't make you start worrying  
12 about bankruptcy, then the company, in order to  
13 minimize its costs, is going to have as little  
14 equity in its capital structure as possible.

15 Now, in the real world, as the amount of  
16 debt in the capital structure goes up, the interest  
17 rate has to pay on its debt starts to go up, the  
18 return that shareholders will demand in order to buy  
19 stock will tend to go up, and at some point you  
20 start worrying about bankruptcy.

21 So presumably there will be some optimum  
22 point where the gains for more debt will start to be  
23 offset by the capital market's reaction to a company  
24 that is, in its view, excessively heavily leveraged.  
25 Whatever that point is, let's say it's 10 percent

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1 equity and 90 percent debt, as, long as its  
2 decisions on capital structure don't affect what the  
3 Commission does, then that's the only thing that the  
4 company will care about.

5           It's the same way we would minimize any  
6 other cost. If the Commission were to say, well, no  
7 matter what you may pay your salaries -- pay for  
8 salaries, we're going to assume you are paying each  
9 employee 40,000 a year, then the company's got a  
10 strong incentive, fine, we're going to get 40,000  
11 employed no matter what, they have an incentive to  
12 cut its wages.

13           Once the Commission no longer bases any  
14 element of the cost -- any element of the cost of  
15 service on what the company's actual costs are, then  
16 the company has an incentive to simply minimize that  
17 cost.

18           Q So stated, perhaps, somewhat differently,  
19 once a hypothetical capital structure is set, then  
20 a company will try to maximize debt to the point  
21 where debt introduces greater risk than it can  
22 absorb?

23           A That's correct.

24           MR. BRENA: No further questions.

25           JUDGE WALLIS: Mr. Marshall, any follow-up?

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1                   MR. MARSHALL: I thought that Mr. Finklea,  
2 if he wants to go, I would go at the end.

3                   MR. FINKLEA: I am going to do limited  
4 redirect. I don't have any cross for my own  
5 witness. No matter how late it is, I know I don't  
6 have any cross for him.

7                   JUDGE WALLIS: Mr. Marshall didn't  
8 want to followup on questions from the bench.

9                   MR. MARSHALL: There's one question I want  
10 to follow up that Commissioner Hemstad had asked.

11

12                                   CROSS EXAMINATION

13

14 BY MR. MARSHALL:

15                   Q He was asking at section on page 33 where  
16 you were talking about the automatic mechanism that  
17 FERC has to raise rates connected to the producer  
18 price index?

19                   A Right, yes.

20                   Q And to your knowledge, has Olympic or any  
21 other pipeline company out here, or has Olympic used  
22 a producer price index part of the FERC methodology  
23 at any time?

24                   A Counsel, I think I knew that once, because  
25 I looked at the past rate increases. But I can't

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1 tell you now.

2 Q If you don't use that automatic price  
3 adjustment, you have to come in for rates like we  
4 are here?

5 A If you don't use it in one year, you bank  
6 it. If it goes up 2 percent this year, and 2  
7 percent next year, and you didn't use it this year,  
8 you could increase your rates by 4 percent next  
9 year.

10 Q But if you assume Olympic has never used  
11 that, in other words, isn't asking for it, has no  
12 intention to ask for it, if it comes in for a rate  
13 increase using a methodology other than that, it  
14 would use the methodology we have been talking about  
15 here?

16 A What it would have to show would be that by  
17 simply using the index methodology, we could  
18 increase the rates to such and such. And then it  
19 would have to show that even with the rates at such  
20 and such, there is a substantial divergence between  
21 its cost and revenues.

22 Q Was this producer price index a way of  
23 trying to streamline regulation and regulatory  
24 burden, or do you know?

25 A Yes. Yes. The answer is yes.

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1 MR. MARSHALL: Yes. Thank you.

2 JUDGE WALLIS: Mr. Finklea.

3

4 REDIRECT EXAMINATION

5

6 BY MR. FINKLEA:

7 Q You were, first of all, asked some  
8 questions by Chairwoman Showalter about the used and  
9 useful standard, and how it may interplay with your  
10 through-put adjustment mechanism. How are you  
11 addressing the Bayview Terminal investment with your  
12 recommendation?

13 A It is in the cost of service in the same  
14 way that it is in Olympic's cost of service. I am,  
15 apart from the specific recommendations that I make,  
16 I have used Olympic's cost of service.

17 Q If you didn't assume that Bayview Terminal  
18 volume assumptions that were made by Olympic at the  
19 time it was put into rates were going to be used,  
20 would you then feel it would be necessary to address  
21 whether Bayview was used and useful?

22 A Yes. I assume that issue, but I can't  
23 address that issue. Yes, it would become an issue.  
24 I have no recommendations on that issue.

25 Q So in some sense, the way you are

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1 approaching Bayview is to address it through your  
2 through-put mechanism, rather than address the  
3 question of whether it's used and useful?

4 MR. MARSHALL: Objection; it's leading.

5 JUDGE WALLIS: In light of the hour, I  
6 think we should allow a little bit of latitude here.

7 THE WITNESS: The answer is yes.

8 MR. FINKLEA: And despite the hour, I will  
9 try to not lead.

10 Q BY MR. FINKLEA: You were asked a series of  
11 questions by Mr. Marshall about your 129 million  
12 barrel through-put assumption. Is that your  
13 recommendation if there is no adjustment mechanism?

14 A No. Since I have not addressed the issue  
15 of prudence, then if one does not find imprudence or  
16 does not find that Olympic is at fault in connection  
17 with the Whatcom Creek incident, in one way or  
18 another, it needs to receive rates that compensate  
19 it for -- based on its through-put during the period  
20 in which through-put is limited by the restriction  
21 on operating pressure. The surcharge is one way of  
22 doing that.

23 Q If some type of adjustment mechanism is not  
24 adopted, have you come to a conclusion on what  
25 through-put assumption should be made?

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1           A    Well, you mean, specifically the surcharge  
2   that I recommend is not adopted, Counsel?

3           Q    Well, if no surcharge or no adjustment  
4   mechanism is adopted?

5           A    Well, if there's no surcharge, and there's  
6   also no tracker, which I take it you would also  
7   include as an adjustment mechanism, then the only  
8   alternative that one is left with is mandatory  
9   reopeners, mandatory refiling of a rate case after  
10  some period of time.

11          Q    Next, you were asked to perform a  
12  calculation from your exhibit. I believe it was  
13  from Tosco 2212, the Oral Rebuttal Exhibit. And I  
14  believe you performed a calculation that involved  
15  simply dividing a cost of service number by a  
16  different through-put. Is that what you did?

17          A    Yes. But my recollection is it was within  
18  the context of 2203.

19               MR. FINKLEA: Okay. See, I can't lead him.  
20  He's leading me.

21          Q    BY MR. FINKLEA: So on 2203, you made a  
22  calculation on the -- from 2203 corrected, you made  
23  a calculation on the witness stand; is that right?

24          A    That's correct.

25          Q    Is there more to adjusting from a cost of

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1 service and through-put figure to a cost per barrel  
2 than went into the calculation that led to the 50.55  
3 figure you gave Mr. Marshall?

4 A Yes. When I responded to Mr. Marshall I  
5 wasn't thinking about the fact that the lower  
6 through-put would also, of course, reduce fuel and  
7 power costs. It would reduce them by about 2.1  
8 million dollars.

9 And so once one adjusts my cost of service  
10 for the lower fuel and power costs, the answer that  
11 I should have given Mr. Marshall is .4850.

12 Q In both the corrected 2203 and in 2212, you  
13 have started from Olympic's cost of service and then  
14 shown your adjustments. Is that meant in any way to  
15 comment on any of the other issues in the proceeding  
16 about what the proper level of cost of service is?

17 A No, it is not.

18 Q In your testimony, and also in 2203, you  
19 use the TOC method for purposes of calculations.  
20 And I am wondering just numerically why it was that  
21 you used that set of numbers?

22 A Basically for the same reason I used  
23 Olympic's other operating expenses. I used  
24 Olympic's filing, which was a TOC filing, except for  
25 the specific issues on which I had recommendations.



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1           Q    You were asked a number of questions by  
2   Mr. Marshall about Kinder Morgan, in particular, one  
3   of the companies in your proxy group.

4                    In your opinion, is it ever proper to set a  
5   utility's return on equity based on one company's  
6   return?

7           A    In practice, no.

8           Q    You were also asked a number of questions  
9   about differences that might exist between Olympic  
10   and members of the proxy group.  And to do any of  
11   the differences that Mr. Marshall pointed out call  
12   into question your use of these five companies as a  
13   proxy group?

14           A    No.  As came out in my discussions with  
15   Mr. Marshall, it certainly is possible that larger  
16   size could lead to lower risk because of  
17   diversification.  But in practice, up through 1998,  
18   Olympic's through-put and its revenues and their  
19   growth were about as steady as possible.

20           Q    And then, finally, in both 2203 and 2212,  
21   you are not in any way accepting the adjustments or  
22   the direct case that was used by Olympic, other than  
23   in you are only addressing the areas that you  
24   specifically addressed in your testimony?

25           A    Yes, that's correct.

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1 MR. FINKLEA: I have nothing further.

2 JUDGE WALLIS: Is there anything further of  
3 the witness?

4 (No response.)

5 JUDGE WALLIS: Let the record show there's  
6 no response.

7 Mr. Means, thank you for coming all the way  
8 out here from the East. Pleased to have you with  
9 us.

10 THE WITNESS: It's been a pleasure.

11 JUDGE WALLIS: You are excused at this  
12 point, and we are in recess.

13 MR. BRENA: Your Honor, before we have this  
14 recess, I have one procedural matter I would like to  
15 take up before the weekend.

16 Is Mr. Hammer a witness or not -- excuse  
17 me, Mr. Beaver. I just want to know whether I need  
18 to prepare cross for him. I understood your ruling  
19 and it leaves options. I don't know whether he's in  
20 or out.

21 JUDGE WALLIS: Has the company or Mr.  
22 Beaver made an election as of yet?

23 MR. MARSHALL: Mr. Beaver has a very ill  
24 child, and had to leave early. So I don't know the  
25 answer. I could find out and call Mr. Brena over

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1 the weekend.

2 MR. BRENA: Could I ask for a courtesy,  
3 that my cell phone number that Steve has, that that  
4 courtesy call be made so I don't spend my weekend  
5 preparing cross for a witness that is not going to  
6 appear?

7 JUDGE WALLIS: Very well. Mr. Marshall,  
8 you will do that; is that correct?

9 MR. MARSHALL: Yes, absolutely.

10 MR. TROTTER: If Mr. Marshall could also  
11 call my work phone, or use my e-mail, I would  
12 appreciate it.

13 JUDGE WALLIS: Mr. Finklea, do you want to  
14 get in line?

15 MR. FINKLEA: E-mail is fine. I will be at  
16 my office this weekend.

17 JUDGE WALLIS: I would like to remind the  
18 parties we're going to have an administrative  
19 conference on Monday morning at 9:00 to discuss  
20 scheduling, amongst other things. Thank you all.

21 MR. MARSHALL: 9:00 Monday morning?

22 JUDGE WALLIS: 9:00 Monday morning. Thank  
23 you all. We're off the record.

24 (ENDING TIME: 6:30 P.M.)

25