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July 8, 2002

VIA EMAIL, FACSIMILE, AND OVERNIGHT COURIER

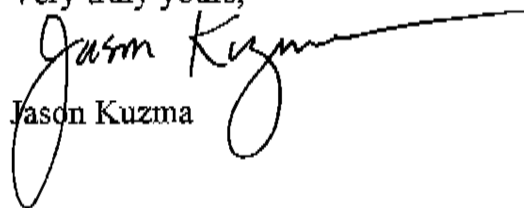
Carole J. Washburn
Office of the Secretary
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Drive SW
Olympia, WA 98504-7250

Re: Docket No. TO-011472
Olympic Pipe Line Company's proposed cross-examination exhibits for Staff witness Danny Kermode

Dear Ms. Washburn:

Enclosed please find the original and nineteen (19) copies of Olympic Pipe Line Company's proposed cross-examination exhibits for Staff witness Danny Kermode.

Very truly yours,



Jason Kuzma

JK:jk
Enclosures

[33202-0006/BA021890.020]

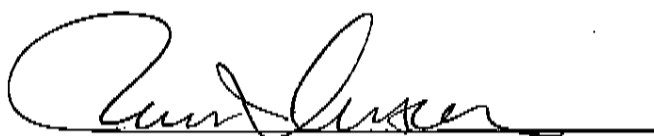
CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this date I caused to be served copies of Olympic Pipe Line Company's proposed cross-examination exhibits for Staff witness Danny Kermode and this Certificate of Service via email, facsimile and overnight mail, to the following:

Mr. Donald T. Trotter/Lisa Watson Washington Utilities and Transportation Commission 1400 S. Evergreen Park Drive S.W. P. O. Box 40128 Olympia, WA 98504-0128 360-586-5522 (Fax) dtrotter@wutc.wa.gov	Mr. Edward A. Finklea/Chad Stokes Attorney at Law Energy Advocates LLP Attorneys at Law 526 N.W. 18th Avenue Portland, OR 97209-2220 503-721-9121 (Fax) efinklea@energyadvocates.com
Robin O. Brena, Esq. Brena Bell & Clarkson, P.C. 310 K Street, Suite 601 Anchorage, AK 99501 907-258-2001 (Fax) rbrena@brenalaw.com	C. Robert Wallis Administrative Law Judge 1300 S. Evergreen Park Drive S.W. Olympia, WA 98504-7250 bwallis@wutc.wa.gov

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

Dated this 8th day of July, 2002 in Bellevue, Washington.



Pam Iverson

Olympic Pipe Line Co. - Exhibits 07-08-2002		
Number	**Witness**	**Description**
	Kermode	Wiley GAAP 2002, Interpretation and Application of Generally Accepted Accounting Principles 2002 (10 pages) (Olympic)

Exhibit No. ____
Olympic Pipe Line Co.
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WILEY

GAAP 2002

up to
40
credits

Interpretation and Application of GENERALLY ACCEPTED ACCOUNTING PRINCIPLES 2002

Patrick R. Delaney
Barry J. Epstein
Ralph Nach
Susan Weiss Budak

Property, plant, and equipment:			
Land		$xxx	
Buildings		xxx	
Machinery and equipment		xxx	
Furniture and fixtures		xxx	
Leased assets		xxx	
Leasehold improvements		xxx	
Less accumulated depreciation and amortization		(xxx)	
Total property, plant, and equipment			xxx
Intangible assets net of amortization:			
Goodwill of acquired businesses		$xxx	
Patents		xxx	
Trademarks		xxx	
Total intangible assets, net			xxx
Other assets:			
Installment notes due after 2003		$xxx	
Unamortized bond issue costs		xxx	
Assets to be disposed of		xxx	
Total other noncurrent assets			xxx
Total assets			$xxx
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable		$xxx	
Commercial paper and other short-term notes		xxx	
Salaries, wages, and commissions payable		xxx	
Taxes withheld from employees		xxx	
Income taxes payable		xxx	
Dividends payable		xxx	
Rent revenue collected in advance		xxx	
Other advances from customers		xxx	
Current portion of long-term debt		xxx	
Current obligations under capital leases		xxx	
Deferred tax liability		xxx	
Short-term portion of accrued warranty		xxx	
Other accrued liabilities		xxx	
Total current liabilities			$xxx
Noncurrent liabilities:			
Notes payable due after 2003	$xxx		
Plus unamortized note premium	xxx	$xxx	
Long-term bonds:			
10% debentures due 2013	xxx		
9 1/2% collateralized obligations maturing serially to 2006	xxx		
8% convertible subordinated debentures due 2018	xxx		
Less unamortized discounts net of premiums	(xxx)	xxx	

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Accrued pension cost		xxx	
Obligations under capital leases		xxx	
Deferred tax liability		xxx	
Long-term portion of accrued warranty		xxx	
Total noncurrent liabilities			xxx
Total liabilities			$xxx
Capital stock:			
$12.50 convertible preferred stock, $100 stated value, 200,000 shares authorized, 175,000 outstanding	$xxx		
12% cumulative preferred stock, $100 stated value, callable at $115, 100,000 shares authorized and outstanding	xxx		
Common stock, $10 stated value, 500,000 shares authorized, 450,000 issued, 15,000 held in treasury	xxx		
Common stock subscribed 10,000 shares	xxx		
Less: Subscriptions receivable	(xxx)	$xxx	
Additional paid-in capital:			
From 12% cumulative preferred	xxx		
From common stock	xxx		
From treasury stock transactions	xxx		
From stock dividends	xxx		
From expiration of stock options	xxx		
Warrants outstanding	xxx	xxx	
Retained earnings		xxx	
Accumulated other comprehensive income:			
Net unrealized loss on available-for-sale securities	(xxx)		
Unrealized loss from foreign currency translation	(xxx)		
Excess of minimum pension liability over unrecognized prior service cost	(xxx)	(xxx)	
Less: Treasury stock at cost		(xxx)	
Total stockholders' equity			$xxx
Total liabilities and stockholders' equity			$xxx

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PERSPECTIVE AND ISSUES

The primary focus of financial reporting is to provide information about an entity's performance that is useful to present and potential investors, creditors, and others when they are making financial decisions. In financial reporting, performance is primarily measured by net income and its components, which are provided in the income statement. Although information in the income statement is information about past performance, investors, creditors, and others use that information to predict future performance.

As contrasted to the balance sheet, which provides information about an entity at a point in time, an income statement provides information about a period of time. It reflects information about the transactions and other events occurring within the period. Most of the weaknesses of an income statement are a result of its periodic nature. Entities are continually creating and selling goods and services, and at any single point in time some of those processes will be incomplete. Thus, measurement of net income for a period involves estimates. The degree of completion of inventories, the amounts of inventories that have been manufactured or purchased but ultimately will not be sold, and the amounts of goods and services that have been sold but ultimately will not result in cash receipts are just of few of the many

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estimates that must be made in order to present an income statement. The entity's ability (or inability) to make these estimates is reflected in the performance measure for the period.

For years, performance was measured only by the income statement. In the last few years, a second performance measure has been added—comprehensive income. Comprehensive income is a broader notion of performance than net income. It includes all recognized changes in equity that occur during a period except those resulting from investments by owners and distributions to owners. Thus, included in comprehensive income but excluded from net income are foreign currency adjustments, unrealized changes in the fair value of available-for-sale securities, and minimum pension liability adjustments. Because comprehensive income includes the effects on an entity of economic events largely outside of its management's control, some have said that net income is a measure of management's performance and comprehensive income is a measure of entity performance.

The requirement to report comprehensive income in addition to net income is another step in the movement toward the capital maintenance concept of income mentioned in Chapter 2, Balance Sheet. Under that concept of income, income is earned only if the amount of an entity's net assets at the end of the period exceed its net assets at the beginning of the period after excluding the effects of transactions with owners. A capital maintenance concept of income is more consistent with investors' expectations that an investment should generate more financial resources than were invested.

Sources of GAAP					
ARB	*APB*	*SFAS*	*TB*	*EITF*	*SOP*
43, Ch. 2	9, 16, 18, 20, 30	4, 7, 15, 16, 44, 64, 101, 128, 130,142	85-6	85-36, 87-4, 87-24, 90-16, 95-18, 00-9, 00-10	98-5

DEFINITIONS OF TERMS

Comprehensive income. The change in equity of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period, except those resulting from investments by owners and distributions to owners (SFAC 6).

Development stage enterprise. An entity that is devoting substantially all its efforts to establishing itself as a new business and either its principal operations have not commenced or its principal operations have commenced but have not generated a significant amount of revenue.

Disposal date. The date of closing the sale if the disposal is by sale or the date that operations cease if disposal is by abandonment (APB 30).

Distribution to owners. Decreases in net assets of a particular enterprise resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners.

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Distributions to owners reduce the ownership interest of the receiving owners in the entity and reduce the net assets of the entity by the amount of the distribution. Such transactions are displayed in the statement of changes in equity.

Expenses. Decreases in assets or increases in liabilities during a period resulting from delivery of goods, rendering of services, or other activities constituting the enterprise's central operations (SFAC 6).

Extraordinary item. Events and transactions that are distinguished by their unusual nature and by the infrequency of their occurrence (APB 30).

Gains. Increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from revenues or investments by owners (SFAC 6).

Investments by owners. Increases in net assets of a particular enterprise resulting from transfers to it of something valuable to obtain or increase ownership interests (or equity) in it.

Investments by owners may be in the form of assets, services, or the payment of entity liabilities. These investments are displayed in the statement of changes in equity. The purchase of an ownership interest from another owner is not a net investment because such a transfer does not increase the net assets of the entity.

Losses. Decreases in equity (net assets) from peripheral or incidental transactions of an entity from all other transactions and other events and circumstances affecting the entity during a period except those that result from expenses or distributions to owners (SFAC 6).

Measurement date. The date on which the management having the authority to approve the action commits itself to a formal plan to dispose of a segment of the business, whether by sale or abandonment (APB 30).

Realization. The process of converting noncash resources and rights into money or, more precisely, the sale of an asset for cash or claims to cash (SFAC 6).

Recognition. The process of formally recording or incorporating an item in the financial statements of an entity (SFAC 6).

Revenues. Increases in assets or decreases in liabilities during a period from delivering goods, rendering services, or other activities constituting the enterprise's central operations (SFAC 6).

Segment of a business. A component of an entity whose activities represent a major line of business or class of customer. A segment may be in the form of a subsidiary, a division, or a department, and in some cases, a joint venture or other nonsubsidiary investee. Its assets, results of operations, and activities can be clearly distinguished, physically and operationally, and for financial reporting purposes, from the other assets, results of operations, and activities of the entity (APB 30).

CONCEPTS, RULES, AND EXAMPLES

Limitations of the Income Statement

Economists have generally adopted a wealth maintenance concept of income. Under this concept, income is the maximum amount that can be consumed during a period and still leave the enterprise with the same amount of wealth at the end of the period as existed at the beginning. Wealth is determined with reference to the current market values of the net productive assets at the beginning and end of the period. Therefore, the economists' definition of income would fully incorporate market value changes (both increases and decreases in wealth) in the determination of periodic income.

Accountants, on the other hand, have generally defined income by reference to specific events that give rise to recognizable elements of revenue and expense during a reporting period. The events that produce reportable items of revenue and expense are a subset of economic events that determine economic income. Many changes in the market values of wealth components are deliberately excluded from the measurement of accounting income, but are included in the measurement of economic income.

The discrepancy between accounting and economic measures of income is primarily the result of accountants' concerns for reliability and measurability. Those concerns prevent revenue and gains from being recognized until an acceptable level of assurance is obtained about the existence and amount of those revenues and gains. In general, accountants do not recognize revenues or gains until they are realizable—convertible into known amounts of cash or claims to cash.

However, some gains are realizable but are still not reported in net income. Holding gains on certain debt and equity investments are readily convertible into known amounts of cash. Those gains are currently excluded from net income for two reasons. First, many consider net income to be a measure of management's performance, and holding gains and losses result from market fluctuations that are outside the control of management. To report holding gains and losses in net income decreases the ability to use that measure to judge management performance. Second, many entities that purchase large amounts of investments finance those investments with liabilities, making money off the spread (the difference between the investment return and the interest expense). Including in net income unrealized holding gains and losses on only the investments, and not the related liabilities, could cause volatility in earnings that is not representative of how those entities are impacted by economic events. However, the FASB is currently working on a project that could lead to reporting certain liabilities at fair value; thus, future changes in accounting standards may eliminate this as a difference between accounting and economic measures of income.

Another reason for the discrepancy between accounting and economic measures of income is the periodic nature of the income statement. Both accountants and

economists realize that the earnings process occurs throughout the various stages of production, sales, and final delivery of the product. However, the difficulty in measuring the precise rate at which this earnings process is taking place has led accountants to conclude that income should normally be recognized only when it is fully realized. **Realization** generally implies that the enterprise producing the item has completed all of its obligations relating to the product and that collection of the resulting receivable is assured beyond reasonable doubt. For very sound reasons, accountants have developed a reliable system of income recognition that is based on generally accepted accounting principles applied consistently from period to period.

The economic measure of income would be relatively simple to apply on a life-cycle basis. Economic income would be measured by the difference between its wealth at the termination point versus its wealth at the origination date, plus withdrawals or other distributions and minus additional investments over the course of its life. However, applying the same measurement strategy to discrete fiscal periods, as accountants do, is substantially more difficult. Allocating earnings to individual years, quarters, or months requires both estimates and judgment. Consequently, accountants have concluded that there must be unambiguous guidelines for revenue recognition. These have required recognition only at the completion of the earnings cycle.

Accountants have moved closer to an economic measure of income by introducing the measure "comprehensive income" into the financial statements. Comprehensive income is the change in equity resulting from all sources other than distributions to owners and investments by owners. Thus, definitionally, it is similar to economic income. However, because of the realization and recognition concerns discussed earlier, comprehensive income remains a subset of economic income.

Whether economic income, comprehensive income, net income, or some other measure is the appropriate measure of income is partially dependent upon the perspective of the party doing the measuring. From the perspective of the outside investors taken as a whole, income might be defined as earnings before any payments to those investors, including bondholders and preferred stockholders as well as common shareholders. On the other hand, from the perspective of the common shareholders, income might better be defined as earnings after payments to other investors, including creditors and preferred shareholders. Analysts regularly use earnings before income taxes, depreciation, and amortization. Perhaps the best accounting can do is provide the broadest possible measure (comprehensive income) and include in the financial statements information that allows each reader to compute the measure that is most meaningful to him or her.

Recognition and Measurement

Revenues. Revenues represent actual or expected cash inflows that result from an entity's central operations. Revenues are generally recognized at the culmination of the earnings process—when the entity has substantially completed all it must do

to be entitled to future cash inflows (or to retain cash already transferred). Most often, an exchange transaction indicates that revenues have been earned. Merchandise is delivered or services are rendered to a customer, resulting in the receipt of cash or the right to receive cash in the future. Revenues are generally measured by the values of the assets exchanged (or liabilities incurred).

Revenues are different from gains for three reasons. Revenues result from an entity's central operations; gains result from incidental or peripheral activities of the entity. Revenues are usually earned; gains result from nonreciprocal transactions (such as winning a lawsuit or receiving a gift) or other economic events for which there is no earnings process. Revenues are reported gross, gains are reported net.

The existence of an exchange transaction generally is critical to the accounting recognition of revenue. However, an exchange transaction is viewed in a broader sense than the legal concept of a sale. Whenever an exchange of rights and privileges takes place, an exchange transaction is deemed to have occurred. For example, interest revenue and interest expense are earned or incurred ratably over a period without a discrete transaction taking place. Accruals are recorded periodically in order to reflect the interest realized by the passage of time. In a like manner, the percentage-of-completion method recognizes revenue based upon the measure of progress on a long-term construction project. The earnings process is considered to occur simultaneously with the measure of progress (e.g., the incurrence of costs).

The timing of revenue recognition also varies based on the realizability of the future cash flows. For example, the production of certain commodities takes place in an environment in which the ultimate realization of revenue is so assured that revenue can be recognized upon the completion of the production process. At the opposite extreme is the situation in which an exchange transaction has taken place, but significant uncertainty exists as to the ultimate collectibility of the amount. For example, in certain sales of real estate, where the down payment percentage is extremely small and the security for the buyer's notes is minimal, revenue is often not recognized until the time collections are actually received.

Chapter 8, Special Revenue Recognition Areas, provides more information about revenue recognition under special circumstances.

Expenses. Expenses represent actual or expected cash outflows that result from an entity's central operations. Expenses are generally recognized when an asset either is consumed in an entity's central operations or is no longer expected to provide the level of future benefits expected when that asset was recognized.

Expenses are different from losses for three reasons. Expenses result from an entity's central operations; losses result from incidental or peripheral activities of the entity. Expenses are often incurred during the earnings process; losses often result from nonreciprocal transactions (such as thefts or fines) or other economic events unrelated to an earnings process. Expenses are reported gross, losses are reported net.

Although many cash outflows are recognized directly as expenses, that is done for expediency; most expenses are first assets, if only for a moment. Measuring the consumption of assets is done by one of three pervasive measurement principles: associating cause and effect, systematic and rational allocation, or immediate recognition.

Some costs, such as materials and direct labor consumed in the manufacturing process, are relatively easy to identify with the related revenue elements. The matching principle requires that all expenses incurred in the generation of revenue should be recognized in the same accounting period as the related revenues are recognized. Thus, those cost elements are included in inventory and expensed as cost of sales when a product is sold and revenue from the sale is recognized. That process is associating cause and effect.

Other costs are more closely associated with specific accounting periods. In the absence of a cause and effect relationship, the asset's cost should be allocated to the accounting periods benefited in a systematic and rational manner. This form of expense recognition involves assumptions about the expected length of benefit and the relationship between benefit and cost of each period. Depreciation of fixed assets, amortization of intangibles, and allocation of rent and insurance are examples of costs that are recognized by the use of a systematic and rational method.

All other costs are normally expensed in the period in which they are incurred. This includes costs for which no clear-cut future benefits can be identified, costs that were recorded as assets in prior periods but for which no remaining future benefits can be identified, and costs for which no rational allocation scheme can be devised.

The general approach for recognizing expenses is first to attempt to match costs with the related revenues. Next, a method of systematic and rational allocation should be attempted. If neither of those measurement principles is beneficial, the cost should be immediately expensed.

Expenses do not include distributions to owners. Expenses of a corporation are easily identified and separated from distributions to stockholders. In both the sole proprietorship and partnership form of entity, the identification process can be more difficult. Items such as interest or salaries paid to partners or owners may be thought of as distributions of profits rather than expenses. However, many entities adopt the philosophy that financial reporting should be the same regardless of legal form (economic substance takes precedence over legal form). Under the corporate form of business, interest on stockholder loans and salaries paid to stockholders are clearly classified as expenses and not as distributions. Accordingly, these items may be treated as expenses for both partnerships and sole proprietorships. However, full disclosure and consistency of financial reporting treatment would be required. Circumstances may involve treating certain payments, such as guaranteed salaries, as expenses while classifying other "salaries" as profit distributions.

Olympic Pipe Line Co. - Exhibits 07-08-2002		
Number	**Witness**	**Description**
	Kermode	Williams Pipe Line Co., 33 F.E.R.C. P 61,327, 1985 FERC LEXIS 357 (1985) (5 pages) (Olympic)

Exhibit No. ___
Olympic Pipe Line Co.
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Service: **Get by LEXSEE®**
Citation: **33 ferc 61327**

*33 F.E.R.C. P61,327, *; 1985 FERC LEXIS 357, ***

Williams Pipe Line Company

Docket Nos. OR79-1-026, -027, -028, -029, -030 and -031

FEDERAL ENERGY REGULATORY COMMISSION - Commission

33 F.E.R.C. P61,327; 1985 FERC LEXIS 357

Opinion No. 154-C; Order Denying Rehearing in Part, Modifying Opinion No. 154-B in Part, Clarifying That Opinion, and Denying Stay

December 5, 1985

SYLLABUS:
[1]**

[Note: Opinion No. 154-B, issued June 28, 1985, appears at 31 FERC P61,377.]

CORE TERMS: pipeline, capital structure, rate base, oil, interest expense deduction, rate of return, clarification, methodology, starting, case-by-case, depreciated, valuation, allowance, interest expense, depreciation, weighted, write-up, earnings, ratio, subject to refund, usual method, income tax, cost-of-service, modification, multiplying, calculating, subsidiary, inflation, discovery, investors

PANEL:
Before Commissioners: Raymond J. O'Connor, Chairman; A. G. Sousa, Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

OPINION:
[*61,638]

[Opinion No. 154-C Text]

On June 28, 1985, the Commission issued Opinion No. 154-B. n1 In that Opinion, the Commission established principles pursuant to which it will test the reasonableness of oil pipeline rates. On July 26, 1985, Marathon Pipe Line Company (Marathon) filed a request for rehearing. On July 29, 1985, the Association of Oil Pipe Lines (AOPL), n2 ARCO Pipe Line Company (ARCO), and the United States Department of Justice (Justice) filed requests for rehearing. Justice also asked for clarification of the order. n3 On July 29, 1985, the Mid-Continent Shippers petitioned for reconsideration. Most of the arguments raised by the petitioners are not new and have been fully addressed in Opinion No. 154-B. Except for those matters dealt with herein, the Commission finds **[*61,639]** that no facts or principles of law have been presented which warrant modification of Opinion No. 154-B.

n1 *Williams Pipe Line Co.*, 31 FERC P61,377 (1985).

n2 The AOPL included in its filing verified statements of certain individuals as matters relied upon in its request for rehearing. **[**2]**

n3 The AOPL and Phillips Pipe Line Company filed responses in opposition to the motion for clarification by Justice.

Summary of Opinion No. 154-B

In Opinion No. 154-B, the Commission:

(1) adopted net depreciated trended original cost (TOC) as the form of rate base and stated that only the equity portion thereof would be trended;

(2) concluded that rate of return should be determined on a case-by-case basis by the usual approach of using embedded debt costs and setting a risk-related equity rate of return;

(3) stated that as a general policy the proper capital structure to use was the pipeline's or its parent's actual capital structure, depending on how capital was raised n4;

n4 If a parent guarantees debt issued by its pipeline subsidiary, the parent may be considered to be the issuer of the debt.

(4) adopted a starting rate base for existing assets consisting of the sum of a pipeline's debt ratio times book net depreciated original cost and the equity ratio times the reproduction cost portion of the valuation rate base depreciated by the same percentage as the book original cost rate base has been depreciated;

(5) ruled that oil pipelines should use their actual interest **[**3]** expense in computing their income tax allowance in their cost-of-service;

(6) adopted normalization as the proper treatment for book and tax timing differences in the recognition of certain expenses and noted that oil pipelines must exclude all deferred tax amounts from their rate bases; and

(7) removed the previously imposed limitations on the suspension of unprotested oil pipeline rate filings and on the participation of Commission staff in oil pipeline rate cases.

Interest Expense Deduction

ARCO and Justice object to the method adopted in Opinion No. 154-B for determining the interest expense deduction in calculating a pipeline's income tax allowance.

In Opinion No. 154-B, the Commission held: [One] . . . tax issue is the determination of the interest expense deduction to use in calculating a pipeline's tax allowance. The usual method is to multiply the company's weighted cost of debt times its rate base. This will not work for oil pipelines. This is so because under the TOC [Trended Original Cost] methodology adopted in this opinion the rate base includes an equity write-up. The Commission holds, therefore, that oil pipelines should use their actual interest expense. n5

n5 31 FERC at p. 61,837. **[**4]**

Both ARCO and Justice argue that the interest expense deduction for determining the tax allowance should be the same as the interest produced by the capital structure adopted for rate of return purposes. The Commission agrees that, as a general rule, tax and return interest should be the same. The problem here, as stated in Opinion No. 154-B and as recognized by ARCO, is that the TOC methodology adopted in Opinion No. 154-B includes an equity write-up. Hence, the usual method of multiplying the company's weighted cost of debt times its rate base will not produce a proper interest expense deduction. The Commission's solution to this problem was to require the use of **[*61,640]** a pipeline's actual interest expense. The Commission is now persuaded that the better solution is to use the same actual capital structure for both the interest expense deduction and the allowed interest return. This

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is in accord with our decision in *Arkansas Louisiana Gas Company, a Division of Arkla, Inc.*, n6 in which we expressed a general preference for using actual capital structures rather than hypothetical capital structures when determining gas pipelines' rates of return. That decision assumed that the interest **[**5]** expense deduction would be the same as the debt return produced by the capital structure. We see no reason why this should not also be the case for oil pipelines, if the equity write-up can be eliminated. At this time, therefore, subject to re-examination on a case-by-case basis, it appears appropriate for an oil pipeline to determine its interest expense deduction by multiplying its weighted cost of debt times its net depreciated original cost rate base.

n6 31 FERC P61,318 (1985).

Capital Structure, Rate of Return and Depreciation

Justice asks for clarification or modification of several aspects of the capital structure principles established by Opinion No. 154-B. The first clarification concerns the date to be used in determining the capital structure. For pipelines whose rates are not currently under investigation by the Commission or whose rates may have been set for investigation after issuance of Opinion No. 154-B, the capital structure to be used in determining the starting base is as of the date of Opinion No. 154-B (June 28, 1985). If a pipeline has a case pending before the Commission in which rates are being collected subject to refund, the capital structure to **[**6]** be used is that in existence on the date the rates under investigation became effective. n7

n7 31 FERC at p. 61,839, nn. 43 and 45. The reason the Commission referenced 1983 valuations is that the only cases in which rates are currently subject to refund concern pipelines whose tariff filings were made prior to 1983.

The second issue raised by Justice is whether the parent's actual capital structure includes or excludes non-guaranteed debt issued by subsidiaries. We believe this question should be resolved on a case-by-case basis. n8

n8 *See Tennessee* Gas Pipeline Co., a Division of Tenneco Inc., 33 FERC P61,005 (1985).

Third, Justice argues that the capital structure used to determine the starting rate base should be permanent for the service life of the property. If changes to the debt-equity ratios are permitted, states Justice, pipelines will be able to manipulate their returns. We disagree. The starting rate base freezes only the dollars in that base. As with other regulated companies, capital structure may change from time to time.

Fourth, Justice asks whether the Commission intended that a real rate of return, once determined, would be used without change unless altered **[**7]** in a later rate case. Justice is correct. Our reference to changes in the real rate was meant to indicate that the risks of the pipeline could be reexamined. One mechanism for doing this would be to derive a new nominal rate and subtract therefrom the inflation rate using whatever inflation index is finally established.

Fifth, Justice requests clarification on how equity depreciation for existing pipelines will be treated. While it is true, as stated by Justice, that under TOC, the original cost of equity is not a component of the starting rate base, we intend that the equity, as well as the debt, depreciation component for cost-of-service purposes will be based on original cost. n9

n9 *Id.* n. 41.

Last, Justice asks us to place on pipelines the burden of going forward with evidence that a pipeline's investors had relied on the future recovery of deferred earnings under the valuation

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methodology. Opinion No. 154-B permitted participants challenging the starting rate base to prove that investors had not relied upon the previous rate base method. Justice states that participants raising such challenge would have to engage in years of discovery to prove that there was no reliance. **[*61,641]** **[**8]** However, Justice then implicitly contradicts itself when it argues that *prima facie* evidence of earnings in past years, higher than those allowed under valuation, should be sufficient to require the pipeline to come forward with evidence of its reliance. Evidence of such earnings obviously does not take years of discovery to obtain and is clearly one avenue for participants to pursue in showing that a pipeline was not relying on future earnings under the valuation methodology.

The other issues raised by Justice, such as the appropriate inflation index, are better addressed and resolved in the context of particular cases.

This is also true for the question raised by the Mid-Continent Shippers of whether a parent should be compensated for its guarantees of a pipeline's debt when the parent's capital structure is used for rate of return purposes. n10 Opinion No. 154- B has provided the basic framework for oil pipeline ratemaking; certain matters, however, are more appropriately fleshed-out in a specific pipeline setting.

n10 *See, id.* n. 50.

Request for Stay

The AOPL asks that the Commission stay the effectiveness of Opinion No. 154-B pending judicial review. The AOPL **[**9]** states that it has made a strong showing that it is likely to prevail on the merits of its appeal and is concerned about the potential waste of resources if the court of appeals vacates Opinion No. 154-B. The Mid-Continent Shippers oppose the AOPL's request. They state that under the criteria established in *Washington Metropolitan Area Transit Commission v. Holiday Tours, Inc.*, 559 F.2d 841 (D.C. Cir. 1977), the petitioner for stay is required to show that without such relief, it will be irreparably injured. They state that the AOPL has not identified the nature or extent of any injury. Hence, the AOPL has not shown irreparable injury. The Mid-Continent Shippers also observe that the Commission has left some matters to a case-by-case determination. Thus, application of the principles of Opinion No. 154-B will clarify and elaborate those principles. Furthermore, since Opinion No. 154-C provides guidance as to the methodology the Commission intends to apply in all pending and future rate cases, but allows changes to this methodology on a case-by-case basis, the members of AOPL will not be harmed if the stay is denied.

The Commission agrees with the Mid-Continent Shippers. Although **[**10]** the Commission will grant a stay when "justice so requires," n11 here the public interest is best served by letting the oil pipeline industry begin the business of applying the generic principles enumerated in Opinion No. 154- B without further delay. Moreover, the Commission believes that moving forward in those cases will have the salutary effect of enabling the Commission to fine-tune those principles.

n11 Administrative Procedures Act, 5 U.S.C. § 705 (1982).

The Commission orders:

(A) All requests for rehearing and clarification are denied except as described in the body of this order.

(B) AOPL's request for a stay is denied.

Exhibit No. ___
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