BEFORE THE WASHINGTON UTILITIES AND

TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)Docket No. TO-011472
TRANSPORTATION COMMISSION,)Volume XLI
Complainant,)Pages 5246-5290
)
v.)
)
OLYMPIC PIPE LINE COMPANY,)
INC.,)
Respondent.)
___________________________________)

A hearing in the above matter was held on July 12, 2002, at 3:58 p.m., at 1300 S. Evergreen Park Drive Southwest, Olympia, Washington, before Administrative Law Judge ROBERT WALLIS, Chairwoman MARILYN SHOWALTER, and Commissioner PATRICK OSHIE.

The parties were present as follows:

OLYMPIC PIPE LINE COMPANY, INC., by Steve Marshall, Attorney at Law, One Bellevue Center, Suite 1800, 411 108th Avenue, N.E., Bellevue, Washington 98004, and William H. Beaver, Attorney at Law, 1201 Third Avenue, Suite 2900, Seattle, Washington 98101.

TESORO, by Robin Brena, Attorney at Law, 310 K Street, Suite 601, Anchorage, Alaska 99501.

Barbara L. Nelson, CCR
Court Reporter

TOSCO CORPORATION, by Chad Stokes, Attorney at Law, 526 N.W. 18th Avenue, Portland, Oregon, 97209.

THE COMMISSION, by Donald Trotter and Lisa Watson, Assistant Attorneys General, 1400 Evergreen Park Drive, S.W., P.O. Box 40128, Olympia, Washington 98504-0128.

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JUDGE WALLIS: Let's be back on the record, please, following our afternoon recess. An administrative matter. I believe we have Exhibits 2312 and 13 for Mr. Brown, and 2414 through 20 for Mr. Grasso that have not yet been received in evidence. Is there any objection to receiving these documents?

MR. MARSHALL: No.

MR. TROTTER: Which are they?

JUDGE WALLIS: 2312 and 13 and 2412 through 20.

MR. TROTTER: No objection.

JUDGE WALLIS: Those documents are received in evidence. At this time, Tesoro has recalled to the stand its witness Frank J. Hanley. Mr. Hanley, I'll merely remind you that you have previously been sworn in this docket.

During off-the-record discussions amongst counsel, I understand that there are no further questions from counsel prior to Commissioner questions; is that correct?

MR. MARSHALL: Correct.

MR. STOKES: Yes, Your Honor.

JUDGE WALLIS: Very well. We are prepared to proceed at this time with Commissioner questions.

Whereupon,

FRANK J. HANLEY,

having been previously duly sworn, was called as a witness herein and was examined and testified as follows:

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Mr. Hanley, first of all, thank you for returning. We realize you got interrupted on the stand the last time you were here, which seems like a long time ago.

A. You're welcome. I'm glad to be back.

Q. And since you were here some time ago, or at least a lot has occurred since you were last here, it's hard for me to remember the context of my questions, so I'm going to ask a couple not recollecting quite why I'm asking them. So could you turn to Exhibit 422?

A. Okay.

Q. And go to page two.

A. Yes.

Q. Now, as I recall, this exhibit discusses spot prices for barging rates; is that correct?

A. Yes.

Q. And my question is do spot prices vary much from longer term prices, and if so, both up and down or only up?

A. I would say that conceivably it could be both ways, but as a greater likelihood, probably spot prices would tend to be somewhat -- somewhat greater.

Q. The reason I ask is really experience in the electricity market in which easily the spot prices can be much higher than long-term prices, but they can also be lower, and it has to do with supply and demand, but also the extent to which customers engage in long-term contracts. If you have enough long-term contracts, then you tend to have excess capacity and the spot market goes down, versus if you don't have enough to cover yourself and you have to scramble, the spot price goes up. And I'm just wondering if that dynamic is similar for barging or not?

A. I believe that that's probably true. That's why I said I think it can work both ways.

Q. And in the given instance, it would seem to me that since there was a sudden loss of pipeline capacity, that suddenness would necessarily mean that the spot market prices would be quite a bit higher in the post Whatcom time period, but that those spot prices would probably not be representative of a general spot price dynamic. I don't know one way or the other.

A. Well, I think there's general logic to your suggestion contained in the question, although I don't think, in reality, that that really happened. And since my last appearance here, I became -- have become, by word of mouth and by reading transcripts of things that occurred during my absence, became aware, surprisingly, that Olympic had indeed done a survey, unknownst to all including its own witness, on cost of capital, and shockingly, their rates they came up with were considerably higher than these. So --

Q. Now, which rates and which are those? I mean, could you identify what you mean?

A. Well, those were the rates, I believe, Chairwoman, that were discussed during witness -- I'm trying to recall his name now. I read the transcript. It's either Cummings or Peck.

MR. BRENA: Cummings.

THE WITNESS: Cummings, thank you. Witness Cummings revealed that indeed there had been a survey done in the spring, early spring, I believe, and indicated that the rates that -- the barge rates they came up with were -- well, just by comparison to these, were higher.

Q. I see.

A. So clearly they do vary, but I think the important point, from my perspective, is that they're consistently higher than the pipeline rates, even -- even under the extreme scenario of the full requested increase, had it been granted, or if indeed it were granted.

Q. All right, thank you. Could you now turn to Exhibit 402?

A. Okay.

Q. Page two. Sorry not to give you more clues, but my question is what did you say about averaging models on this page?

A. I think I remember, Chairwoman. So if I may, I'll --

Q. You can provide the context.

A. I'll take it from that cue. When I addressed averaging, it was really in response to some questions that I was receiving relative to a prior appearance before this Commission, where the Commission said that they used the models other than the discounted cash flow model as checks, not as primary tools. And what I said was, well, it is true that I, again, averaged all four results of the different -- the four methods listed on Exhibit 402, page two, to arrive at my recommended 13 percent common equity cost rate.

However, had I utilized the models other than the discounted cash flow as checks, I would have observed that they ranged between 11.6 percent and 13 percent as the upper end of those three other methods, and the average of all four -- I'm sorry, of all three methods, that is, specifically the risk premium model shown on line two, and these references, for transcript clarity, are all Exhibit 402, page two. So on line two, 13 percent for the risk premium model; line three, 11.6 percent capital asset pricing model; and line four, 12.7 percent for the comparable earnings analysis. So they range from 11.6 to 13, and the average of those three, that is, lines two, three and four, is 12.4 percent.

Now, looking at that 12.4 percent average of those three methods vis-a-vis the discounted cash flow result on line one tells me that, in fact, reliance in this instance on the discounted cash flow method utilizing prior precedent of this Commission, using them as checks, reality, if you will, says that in this instance, at least, the discounted cash flow model relied upon solely produces a result that is inordinately high, and that, to me, is an additional way of confirming the reasonableness of my recommendation of 13 percent shown on line five, page two of Exhibit 402.

Q. Okay, thank you. Could you comment, if you have a comment, on the Staff's proposal of the 20 percent equity capital structure recommendation?

A. Sure. I'd like to do it this way, by contrasting to my -- what I'll call my stated observable recommendation shown on page one of Exhibit 402. That recommendation of mine is contingent upon that level of equity actually occurring in reality. In other words, within the body of my testimony in Exhibit 401-T, I clearly state there that there should not be a reward of an equity return on equity that does not exist. I previously have stated that there is capital at risk, but they're different kinds of capital and they're different levels of risk. And yet risk of being a debt holder is very different than being -- or associated with the risks of being a common shareholder. And so that reward should not be there, and certainly should not be that great as between a zero equity and 46.4 percent equity, okay.

So just having that as a prologue, if you will, to, you know, to respond to your question. So in my mind, how does the public interest really be served if this Commission does not have -- and I don't know -- I don't profess to know what authority, how far you can go, but I'll make the assumption that you cannot order them to -- them being the owners of Olympic -- to put in equity capital or some combination or convert or forgive debt and create equity.

So from my viewpoint, there's a dilemma. How do you incent -- what incentive can you create for them to do that, to put in equity capital, okay.

Now, to the Staff's recommendation. Conceivably, that's a good compromise, and I say this for two ways. My position is, after all the reasonable costs in developing cost of service, you get to the line -- the rate base times the rate of return is to afford a reasonable opportunity to earn on capital that's actually invested. Capital that's actually invested is debt. There's no equity. Now -- and so that would be to allow just a debt return which affords them a return on their capital -- that's all that's invested -- as debt. It's not associated, the same risk, as equity capital.

Now, for a compromise position -- and that would be the most incentive. That would be a clear message.

Q. What's that?

A. To give only a debt return, because there is no equity. Frankly, even I will admit, having read precedents and even cite the American Water Resources case, for example, where you had a similar situation for a water company, wanted to create incentive, and so went to a 20 percent hypothetical equity ratio in that case, which is consistent, totally consistent with the Staff recommendation in this case.

I think, in that kind of a scenario, there is not such a vast difference between the reality of no equity and rewarding with, you know, considerable equity that doesn't exist, a small percentage such as 20 percent could be a reasonable situation. It goes towards helping, if you will, without any comic intent or whatever, a sad situation, but at the same time creating an incentive to put equity in.

And so I think that the Staff recommendation in that regard is a good one. Something like a 7.4 percent overall rate of return, I think would send a message, it would be doing something helping them, it would be still be sending a message and saying, Look, if you want a higher return on equity in the absolute percentage sense and show us, then, could be your message, to put in, cough up this equity, and when the equity gets up to a reasonable level, then we'll revisit the rate of return, including the rate of earnings on the equity, okay.

So I think that's a -- that kind of a scenario would very much be, in my view, in the public interest, because it would not be so opposed to public interest by rewarding -- I heard the term earlier today -- rewarding owners who are holding equity capital hostage, certainly not excessively, anyway. And it would also be in the public interest to try and get -- to incent the owners to increase the equity capital, because it's in the public interest to have a utility that has a balanced and reasonable healthy capital structure. So in short, I think the Staff proposal is -- is a good one.

Q. You -- in your answer, you were talking about signals this Commission should send to the Commission -- to the company, and you used the phrase -- I think you said that we should signal we would grant an increase if they came back to us having put in more equity, and you said including the rate of earnings on the equity. But what did you mean by that?

A. Well, the -- without commenting or, you know, creating combat between sides -- that was not my purpose in this thing. Clearly, my testimony doesn't indicate a nine percent return on equity, which is implicit in Dr. Wilson's testimony. And so there could be -- you would be allowing 20 percent equity at a nine percent return if you adopted the Staff proposal, but with the idea is that you want a higher return on a greater percentage of equity, then show us, increase the equity ratio up to where we think it ought to be.

And now, changing from the we, having meant in my comment just then the Commission, speaking now for myself, that I think a proper equity ratio is 46.4 percent, could be 50 percent or somewhere certainly in that range, but 46.4 is a minimum, in my view, of where it ought to be on a reasonable -- reasonable basis.

Q. Why does a greater share of equity call for a greater return on that equity, a greater rate of return on the equity?

A. Good question. All things being equal, it wouldn't. I think that the rate should be higher than nine percent, but frankly, I would be reluctant to say if they don't put in equity, because my position is that you ought to just give them a debt cost rate, and I'm saying if you look somewhere, you want to give them something, you have evidence in the record from Dr. Wilson. He believes that nine percent is the right rate relative to that 20 percent equity ratio. I don't. But, by the same token, you want to create an incentive. So by going from the actual zero percent that they have to a 20 percent hypothetical, that's -- that would be giving them -- again, I don't mean this in a derogatory sense -- but giving the dog a bone, but then you want an additional bone. You want some good favor on it, you want the bone -- make it taste a little better. Well, if you want something higher than a nine percent, show me, you know, show me the money, cough the money up.

Q. Well, is another rationale that the rate of return on phantom equity or pretend equity, if it's not really there, justifiably might be lower than the rate of return on equity that is actually there? In other words, the Staff recommendation is to assume 20 percent equity, but there isn't 20 percent equity.

So I guess, to put it simply, is there a difference between an assumed 20 percent equity that's not actual there and a real 20 percent equity that really is there in terms of the rate of return that we should recognize?

A. Sure, yes, absolutely, and that's why -- that's why I say that I don't have a problem with the Staff position, because, in a sense, it's more generous than mine, because I'm saying absent equity being there, my view is give them nothing, just a debt return. But if you want to do something that is reasonable, it's somewhat consistent with a past decision of this body, this Commission, and at the same time be very much aware and concerned of public interest that you want to get them -- do something and give them incentive to get the equity ratio in reality, not just hypothetically for ratemaking, but in reality get it up there to where it ought be, then I think that the Staff proposal is, in fact, you know, would be a good -- a good middle ground, possibly, as opposed to my position, which is, sure, 13 percent on 46.4, but only if it's really 46.4, not 46.4 hypothetically, when in reality is zero.

CHAIRWOMAN SHOWLATER: Okay. Thank you.

COMMISSIONER OSHIE: No questions.

JUDGE WALLIS: Are there follow-up questions?

MR. MARSHALL: I just have one on this barge rate issue.

R E C R O S S - E X A M I N A T I O N

BY MR. MARSHALL:

Q. When Mr. Cummings testified, did you hear him testify that that was a figure from a data response to the intervenors?

A. I didn't hear him. I wasn't here. I read the transcript.

MR. MARSHALL: Okay. That's all.

MR. BRENA: Could I have a moment?

JUDGE WALLIS: Redirect.

MR. BRENA: I think I have a question.

R E D I R E C T E X A M I N A T I O N

BY MR. BRENA:

Q. Mr. Hanley, just following up on your conversation with the Chairwoman, would a reasoned response to try and incent actual equity investment be for the Commission to adopt the Staff's capital structure rates of return on equity and debt, given the current situation, but to offer that if they bring the equity up to the level that you've recommended, that the rate of return on equity that you've recommended would also be adopted?

A. Well, yes, I suggested as much, I thought. But, clearly, yes, which is why I say I think that, based on my testimony and my experience, 13 percent, if it got up to the 46 to 50 percent range, would be a reasonable -- and that would be even additional incentive, I believe.

Q. And looking at the parent company's current cost of debt, the parent company's cost of debt is in the five percent range currently; correct?

A. Yes, I believe that Dr. Schink introduced evidence in his rebuttal, a 5.26 percent, I believe was the rate that it is currently.

Q. So I mean, in practical terms, what we're discussing here is is that the debt that's associated with prior losses that's currently burdening this pipeline company could be forgiven and the result of that could be that they could increase their return -- their actual debt costs are five, but they would get a 13 percent return by simply forgiving that debt?

A. That's right. It would be easy enough to do. All they have to do is presumably get approval of the board of directors and, with a stroke of a pen -- wouldn't create cash, mind you. At this point, it would be an accounting entry, but the debt goes away under such a scenario, the equity ratio is where it is. They're still going to need cash and at some point they're going to still have to think about coughing up some good solid cash equity, but certainly it would bolster the balance sheet, the capital structure of Olympic.

And you know, keep in mind, I said in my previous appearance here that, you know, prior to the Whatcom Creek, they did -- they have the ability to borrow directly on its own, and that was with actually a substandard equity ratio, albeit not negative, but low compared to industry averages. So it is quite doable. Very much so.

Q. Would such a step be a substantial step forward for this company and, in your opinion, in the public interest?

A. Well, it would clearly be in the public interest, because the issue of a healthy capital structure is very critical. It's critical to the financial well-being of the enterprise and its continued financial well-being, because a healthy balanced capital structure will give it the wherewithal to raise additional external capital from other sources and then hopefully there would be enough incentive under the scenario that I've laid out whereby the owners would not be reluctant to put in additional equity capital as required to keep the capital structure balanced on a going forward basis as far as the eye can see.

CHAIRWOMAN SHOWALTER: All right. Let's assume that we have an order where there's a sliding scale of rate of return going from 20 percent assumed equity through a real amount, and then up to your 46 percent. Do you know how much debt Olympic would have to convert to equity in order to achieve, say, 20 percent real equity or your 46 percent real equity, and don't you also have to take into account some kind of tax effect or not?

THE WITNESS: I don't believe so, not for this purpose, Chairwoman. I think it would be simply a matter of just forgiving the debt and they're just going to transfer and I believe they would -- it would shift to equity once the debt is forgiven on the books of Olympic.

CHAIRWOMAN SHOWALTER: All right.

THE WITNESS: Okay. It would then be contributed capital.

CHAIRWOMAN SHOWALTER: If Olympic were looking at this proposition, realizing that if it converted debt to equity, it would begin to get more return, wouldn't it also offset against that benefit some loss of tax benefit from having debt?

THE WITNESS: It, you mean Olympic?

CHAIRWOMAN SHOWALTER: Yes.

THE WITNESS: Well --

CHAIRWOMAN SHOWALTER: That's a good point. I realized where you're going.

THE WITNESS: Yeah. Well, clearly, I mean, there's always -- there's the tradeoff, but the whole notion of utilities in general having greater debt than most nonutility, non-price regulated enterprises, it was presumably a greater stability, the blanket, if you will, of regulation presumed greater stability of revenue stream and so forth. But there's always that tradeoff between what the marketplace finds acceptable and what is needed for safety and to attract new external debt capital on a reasonable basis, you know, in competition with other seekers of capital.

So sure, is equity capital more expensive, but look at all the time that we're spending here and all the concern that is obviously apparent to all parties, everybody in this room, about there not being any equity and even, prior to that, one looks back and greatly substandard equity as a percentage of total capital, and look at the dilemma we're facing. And I've heard discussions sitting in here the last couple of days, yesterday and today, of possibilities of bankruptcy and what that might entail and what would it mean or not mean and so forth. Well, we ought not be thinking about or having to talk about those kinds of things and probably wouldn't if indeed this company had maintained over the years a balanced capital structure.

CHAIRWOMAN SHOWALTER: Thank you. Oh, it wasn't my question. It was yours, I think.

MR. BRENA: You're doing a great job. I just thought I'd remain silent.

Q. In analyzing the tax impacts of equity and debt, if they were to strike that pen and go up to 46 percent equity, they would get the 13 percent equity. They would also get a tax allowance on their equity return; correct?

A. Sure.

Q. So in terms of a total -- I'm sorry. So would you discuss the total impact of them -- of real equity being there, how much additional cash that would bring them, not only in equity return, but also in tax allowance?

A. Sure. Well, clearly, under the ratemaking paradigm that's used, cost based ratemaking, rate based rate of return paradigm, there's no equity, there is no income tax provision. If it's just all debt, there are no taxes to be paid. So as we increase the equity, we're going to have taxes, because there's going to be bottom line, you know, to the common shareholders and there will be taxes due.

So those taxes, if you just assume, say, a 35 percent federal income tax rate, are going to be fairly substantial, which are going to be built into the cost of service, so not only will they get a higher rate of return, but the -- you know, and in order to do that, to accomplish that, effectuate, say, for discussion -- of course, the ultimate is up to this body, but assuming for discussion purposes 13 percent or whatever other one that would be decided as a higher incentive rate, what would imply the need for higher cost of service and therefore some given amount of throughput's going to relate to a higher tariff rate per barrel, and so that would go a long way towards helping the whole situation in terms of cash flow and everything else.

Q. So in terms of cash flow, do you have in mind, if you have a 13 percent rate of return plus a tax allowance, what percentage that turns into in terms of a cash flow percentage of equity versus debt?

A. No, not just off the top of the head, but certainly with a 46 percent equity ratio and a healthy income tax provision built in, I mean, I don't know absolute dollars, because I don't know what -- if indeed you make a finding, what you would find the rate base to be and so forth, there's so many variables in there. But, clearly, it would go a long way to certainly ameliorating, if not eliminating the supposed cash flow problem of, you know, all this mounting debt and so forth, because much of it would go away.

CHAIRWOMAN SHOWALTER: Just so I'm clear as to what you're saying, are you saying that, in this scenario, if the company did achieve an actual equity structure of 46 percent, that that then has iterative effects that would increase rate base and therefore justify on return to this Commission, I presume, an increased rate? Is that what you were saying?

THE WITNESS: No, it wouldn't necessarily change the rate base under my scenarios. One quick way they can do it, bring that capital structure into balance, is just by forgiving, if you will, a lot of that debt that's payable to the parent companies, the owners.

Illustratively, if you had a rate base, and this is -- I don't profess these numbers to have any semblance to, you know, the record, so I don't want anyone to be upset. It's just illustratively. If you had a rate base of a hundred million dollars and you have no equity in it and you had, whatever, $90 million of debt, or it were a $110 million of debt, let's just say, if it was even greater than a rate base value, then if you wanted, say, a 46 percent debt -- well, 46 percent of 110 million, whatever that works out to be, they could just -- that much debt would go away and it would create 46 percent of that rate base, if you will, suddenly would be represented by equity. In other words, that like amount of debt suddenly goes away. It's not debt. There's no more interest.

CHAIRWOMAN SHOWALTER: All right. But I guess what I thought I heard you saying is that, but, then, once you have that much equity, it increases maybe expenses in terms of taxes, which then has an effect on the rate, at least I thought I was understanding a kind of iterative effect.

THE WITNESS: Yes, you did. That's exactly right. So under the paradigm, then, for ratemaking at that point, if there were some mechanism to, you know, as the incentive to come back and revisit, then you take into account the fact that the equity now, that, you know, certain things really happened and there really is, say, 46 percent equity, now you take into account the taxes and whatnot and you then adjust the cost of service and the resultant tariff rate.

CHAIRWOMAN SHOWALTER: Okay. Thank you. I get it.

Q. Would you accept, subject to check, that the tax allowance in your capital structure with your rates of return would be an additional $2 million?

A. Sure, I would accept that subject to check, yes.

Q. Would you also accept, subject to check, that a 13 percent rate factored up for a tax allowance would translate into 18.5 percent on equity?

MR. MARSHALL: You know, I have two objections. Not only is it leading, but there's absolutely no foundation that this expert -- this person has any tax expertise whatsoever. And I listened very carefully to what he's had to say, and he's wrong in many instances, so I have to object that it's a leading question of a witness who has no tax background whatsoever.

There has been plenty of tax testimony here already about the effect of taxes from people who do know a lot more than this witness, including what the IRS would do with a 100 percent debt situation. In fact, Mr. Fox testified as to the analysis that was done by BP, and that the IRS will --

MR. BRENA: If there is an objection, I would appreciate he not go through and recharacterize all the other witnesses' testimony. If he has an objection, I'd like him to state it so I can respond to it.

MR. MARSHALL: But my objection is this is making the record very muddy from a witness who has no tax background. And this being compounded now by a leading question, asking the witness to make certain assumptions subject to check. I don't know what this expert would check, not being an expert.

MR. TROTTER: Your Honor, I will join the objection just to the extent that it was very obviously leading. This does seem like a calculation that could be provided with detail in a brief based on the record, based on a hypothetical of facts that we're talking about, and so I think that's the proper place for it.

JUDGE WALLIS: Mr. Brena.

MR. BRENA: Well, this is purely calculational. Take 13 percent and you got a 35 percent tax structure, and it's just a matter of inverting the number and calculating it.

JUDGE WALLIS: Then would it be proper on brief?

MR. BRENA: I'd be happy to do it on brief. I just wanted to make this record clear what that 13 percent would translate into. Anybody here can sit and do that calculation if they choose to, but just for the clarity of the conversation.

JUDGE WALLIS: The objection is sustained.

MR. BRENA: Okay. That's all I have.

MR. MARSHALL: I have to have a couple of clarifying questions on this interest issue.

JUDGE WALLIS: I have one or possibly two questions in clarification, also.

MR. MARSHALL: You may be able to clarify the same issue, so please go ahead.

JUDGE WALLIS: Well --

E X A M I N A T I O N

BY JUDGE WALLIS:

Q. Mr. Hanley, just, again, hypothetically, in no relation to any real company, if a company has a rate base of a hundred million and debt of 150 million, does that mean that the company has a zero percent equity or a 50 percent negative -- or a $50 million negative equity?

A. Well, we say ratio-wise that it's zero. We just don't do negative equities, because total capital is a hundred percent, so that --

Q. So if the company were then to put in $50 million in equity or convert 50 million of the 150 to equity, would it have a zero percent equity or a 33 percent equity ratio?

A. Well, I see your point. It would -- under your -- you did say 150?

Q. The question I'm getting to is in the case of either the Staff's 20 percent or your 46 percent, how much would have to be converted in order to yield that and, either in a hypothetical basis or in terms of real numbers, just what are we talking about here?

A. I believe that I addressed this in my testimony. Could you give me a moment, please, Your Honor --

Q. Yes.

A. -- to see if I can find it? Hopefully, I'm not mistaken. Okay. I don't think I did in 401-T. I must have been thinking about something else. But in any event, if I may, I'll continue. I think your point is certainly well-taken, that in order to -- as far as the balance sheet is concerned, the amount forgiven would be -- would have to be of such magnitude as to offset the existing negative equity, and the additional amount would have to be such that, when combined, the positive new equity figure would equal 46 percent of the total capital. My response, I think, to -- I think it was to the Chairwoman, really centered around, was focusing around 50 percent or 46 percent of the rate base.

Q. Yes.

A. But you're correct when it comes to the balance sheet.

CHAIRWOMAN SHOWALTER: I just want to follow up. Is another way to put this that if your rate base is a hundred million and you want to get to 46 percent equity, that you just have to convert -- keep converting debt to equity until you only have

$54 million left in debt?

THE WITNESS: That's right relative to the rate base, but to the extent that there's already actually existing negative equity on the books or the balance sheet, in order to actually change the balance sheet to 46 percent equity, because the difference between the rate base and the actual book equity would have to be equal to an amount equal to what is necessary to offset the negative dollars and an additional amount, whatever that works out to be mathematically, so that the new positive total equity is then 46 percent of the total and the debt would be 54 percent.

JUDGE WALLIS: Mr. Marshall, did we hit your question?

MR. MARSHALL: No, not even a glancing blow, I'm sorry to say, but I'll keep it very short.

JUDGE WALLIS: Please proceed.

R E C R O S S - E X A M I N A T I O N

BY MR. MARSHALL:

Q. There was comment here about Dr. Wilson's 20 percent equity, 80 percent debt, and at the 80 percent debt, Dr. Wilson used the 5.56 percent rate of actual debt that the parents got their money at;

is that right?

A. No, I don't believe it is. My recollection is is that Dr. Wilson used a seven percent debt cost rate, which was to a weighted debt cost of 5.6 percent and 20 percent equity at a nine percent cost rate, which was 1.4 -- 1.8, I'm sorry, 1.8 percent weighted, and the sum of the two is 7.4.

Q. Let me ask this. The debt portion of Dr. Wilson's testimony, he used the interest rate that the parents actually were paying, their weighted cost of debt; right?

A. No.

Q. The 5.56 percent, where does that come from?

A. I don't know.

Q. From Dr. Wilson, you don't know where it comes from?

A. No. Only place I know it's coming from right now are your lips. I really don't -- it's unknown to me, 5.56. I know Dr. Schink produced a number of 5.26 percent in his rebuttal testimony, but I don't know -- to the best of my knowledge, Dr. Wilson did not alter his recommendation. His recommendation of a seven percent debt cost rate was independent of Dr. Schink's testimony.

Q. You have a hypothetical debt cost of 7.54 percent; is that correct?
A. Yes, sir.
Q. And that's a market rate?
A. Yes, it's -- it was derived from the five proxy companies and is consistent, I believe, with the recommended capital structure.
Q. If one of the costs of capital witnesses used the actual debt cost to the parents in the range of five percent and didn't use their capital structure or their cost to them of their equity, would that be inconsistent, in your view?
MR. TROTTER: I'm going to object to the question, Your Honor. This is not related to his testimony and if Mr. Marshall wanted to ask other witnesses that question, he should have asked it.
MR. MARSHALL: I did. I just wanted to clarify that that lower -- let me withdraw the question and try to do it in a very direct way. We can wrap this up quickly.
Q. The lower five percent debt rate that you talked about, was that only produced because of the financial strength of the parents and their capital structure, or do you know?
A. I wouldn't think so. I wouldn't think that

it changed that dramatically, because the financial strength of the parent companies didn't change that dramatically in a matter of months. I suspect that it was more attributable to the change in the mix of the debt level of the kinds of debt, as well as resultant market changes and interest rates.

Q. I think I may see the mismatch here. Dr. Wilson used the original direct testimony interest rate for the parents of Olympic in coming to his debt percentage, or his debt cost; is that right?

A. Honestly, sir, to my knowledge, no, it -- I don't believe that it is right. To my knowledge, Dr. Wilson arrived at a seven percent debt cost rate and it was completely independent of the debt cost rate of the parent companies. That's to the best of my knowledge.

Q. Do you know what the debt cost rate of Olympic's parents is, their weighted cost debt, given their capital structure and their equity arrangements?

A. That is purported by Dr. Schink to be the last -- that's the last I know -- as 5.26 percent.

MR. MARSHALL: Thank you. No further questions.

JUDGE WALLIS: Is there anything further of the witness? It appears that there is not. Mr. Hanley, thank you for returning.

THE WITNESS: You're welcome, Your Honor.

JUDGE WALLIS: We appreciate your presence. You're excused from the stand at this time.

THE WITNESS: Thank you.

JUDGE WALLIS: Is there anything further of an evidentiary nature? Let the record show that there's no response.

MR. BEAVER: Excuse me, excuse me. Sorry.

JUDGE WALLIS: There was no response.

MR. BEAVER: Three things.

MR. BRENA: Now would be the right time to bring up the three additional witnesses Tesoro would like to add.

MR. BEAVER: The first issue that I would like to address, at least on behalf of Olympic, is a request that the record, the evidentiary record be allowed to remain open until August 15 for us to submit to this Commission what I expect to have by then, which is our audited financial statement by Ernst & Young. The --

MR. BRENA: Are we going to do these one at a time?

JUDGE WALLIS: Why don't we let Mr. Beaver

tell us what they are, and then we can discuss them.
MR. BEAVER: Second one is probably a lot easier, which is, and maybe we already have this, a request for a list through today of the exhibits that have actually been admitted.
JUDGE WALLIS: We will be working on that and we will provide it.
MR. BEAVER: Okay, great. And the final one, and this is not a motion by Olympic to add a new witness, but I believe that the Commission has the ability to actually, through a data request or other order, request that a party make a person available for questioning. And based on some questions that Commissioners have asked, we just wanted to indicate that if the Commissioners do have a desire for Bernadette Zabransky to actually testify and they make that request, we will certainly make sure that she is provided. And that was it.
JUDGE WALLIS: Thank you. The second one we've taken care of. I believe we indicated earlier that as soon as an updated list is available, we will provide it to parties. We will do that next week, prior to the administrative conference. And I believe that I've asked parties to examine that very carefully and bring any corrections to our attention

at that conference.

As to the other two, do any of the other parties have any comments?

MR. TROTTER: I'm just taking the last one first. I guess we'll just cross that bridge when we come to it on Ms. Zabransky. The Commission does have the right to make bench requests, and they do, but since there isn't one pending, I don't think it will be productive to get into the details.

JUDGE WALLIS: Very well.

MR. TROTTER: With respect to the audited --

JUDGE WALLIS: Why don't we go around on that one and see if others have comments.

MR. BRENA: Yeah, I strongly oppose any suggestion that the record be left open for them to bring in additional witnesses. They have the burden to put their case forward. They put a case forward. The fact that their case lacks certain type of testimony or certain types of witnesses is not something that should be resolved through bench requests. Bench requests are to resolve, you know, technical points like detailed points, not to backfill the insufficiency of a filing party's case. So she was not offered as a witness, she was available for a witness, they put their case forward. I don't think that's an appropriate use of the concept or of the bench request, so --

JUDGE WALLIS: Very well.

MR. BRENA: -- I oppose that strongly.

JUDGE WALLIS: We have your argument in mind. Mr. Stokes, do you have anything to add?

MR. STOKES: We would also oppose leaving the record open at this time, Your Honor.

JUDGE WALLIS: Very well. Let's move to the first item, the request to keep the evidentiary record open to receive an audited financial statement. Mr. Trotter.

MR. TROTTER: Yes, as you may recall, we indicated earlier we would have no objection to a late-filed exhibit containing the auditor's certification, and I assume that would include all notes. I think at that point, perhaps the entire statement might as well be in, so we don't object to that. I will note that there may be significant issues raised by that, and I'm not quite sure how to deal with it, since the briefs would be due six days later.

I also observe that the company, through time, has made different estimates of when this would be available. I think Mr. Fox's testimony was the end of July, and no later, for sure by the end of July, and now it's August 15th, so that uncertainty seems to be continuing. But we would not object to a late-filed exhibit, but -- for that form of document, but it does raise some issues about if there are notes and if it's qualified, it may raise significant issues.

JUDGE WALLIS: Mr. Stokes.

MR. STOKES: Your Honor, we also have an issue with the close proximity to the brief. If there are issues raised in the audited financial statements, there's no time in which to address that before the briefs are due, so --

JUDGE WALLIS: Mr. Brena.

MR. BRENA: I have an ongoing concern with the target changing in this case, with their case evolving and changing and moving, particularly when there's no opportunity for us to respond to those changes. I think the Commission was extremely lenient in allowing the rebuttal case to be considered in the record. I think that they've had an opportunity for three and a half years to provide audited financial statements and failed to.

I think this is an issue that came up at the very first of this case over a year ago. I think the time has ended long ago for them to now come forward with that after there's no opportunity for Tesoro to explore the meaning behind it, so -- and they shouldn't be able to change the target again after we can't respond in any way at all. So I strongly oppose leaving that open, and I would note that we have testimony in the record. I don't know how they can get an unqualified opinion on a balance sheet when they have two open years that they're not even auditing and they're auditing the next one. So I don't think -- I mean, I have, well, more than a little bit of accounting, and I don't see how it's possible for them to produce the document that they've said, and if they do, then I would like an opportunity to depose the auditor that came up with it and I'd like to take a look at his work papers and I'd like to know what he considered and what he didn't consider.

We already know they may recommend writing off Cross-Cascades, which would be a substantial impact to their balance sheet. We already know they have two open years.

I mean, this isn't like waiting for something that just routinely would be produced.

This is -- they've changed auditors since they've started making their representations to us. I am absolutely opposed to leaving this record open to some document that cannot possibly do what it is that addresses the issues without me having an opportunity to fully explore what that is. So Tesoro opposes that outright.

JUDGE WALLIS: The Commission will take those requests under advisement and consider the arguments of parties in making a decision. I don't believe that Bench Request Number One regarding electric rates and schedules has been addressed. Let me ask if there is objection to its receipt in evidence?

MR. BEAVER: Could I -- I had told the various parties that that actually is a draft only because -- I mean, the information is accurate. I just wanted to make sure that that, in fact, addressed the question that the bench had.

JUDGE WALLIS: It did.

MR. BEAVER: Good. Then it's not a draft anymore.

MR. TROTTER: No objection.

MR. BRENA: I haven't had an opportunity, but if I could -- I won't -- I won't oppose it, but

I'd like to take a look at it before I -- before my feet are --

JUDGE WALLIS: Very well. We will reserve ruling on this until the time of the administrative conference. If the subject does not come up, we will deem it to be without objection and will receive it.

MR. TROTTER: Has it been marked for --

JUDGE WALLIS: It has not been marked, and my indication at this time is to reserve marking until I go back to the transcript and find an appropriate place to put it.

MR. BEAVER: And just so the record's clear, we did circulate to all the parties copies. I'm not sure where Tesoro's went, but --

MR. BRENA: No, no, we got it. I've just been a little busy lately. I'm sorry.

JUDGE WALLIS: Very well.

MR. TROTTER: Your Honor, I had one item. I'd offered earlier off the record to provide a list of some of the key decisions to the Commission, Order 154, 154-B. We've got a lot of these as exhibits. So I was going to just work with other counsel and try to put together a list and put that together for the bench. And we'll just see how it goes, but I think we have kind of an understanding that that's an okay thing to do. I don't think it needs to be an exhibit necessarily, unless you want it to be. But that effort will go on over the next few weeks and I'll try to get that to you, if you think it would be helpful.

JUDGE WALLIS: It may well be helpful. It would also be helpful if you were able to report, as of the time of the administrative conference next week, as to, if you have not completed it, a little bit more detail about what you're proposing.

MR. TROTTER: Okay. Just in brief, it would be the FERC orders that everyone's been talking about and the two Farmers Union cases. I think that's kind of where we were kind of in agreement in principle, but that's kind of where we are at.

JUDGE WALLIS: Very well. And I would ask that, if at all possible, you see whether there is consensus on that, that you can report at the conference next week.

In addition, there was some discussion earlier about some work papers as potential matters for official notice. Has anything further been done with regard to those?

MR. TROTTER: Yes, I sat down with Mr. Maurer for Olympic, and we've put together the documents, and I'm hoping I can get them all copied and circulated next week and then file them. There will be one -- sort of the documents that were filed by Olympic and Staff memos and so on, and then another will be I think mostly other documents found in Staff files. So I think we're getting -- made almost all the progress we needed to make on that.

JUDGE WALLIS: Very well. Again, if at all possible, if that could be done prior to the conference, then we'll be able to get closure on it and proceed. I have been unable, in the time that I've had available, to confirm facility availability, so it would be my intention to see that a notice is issued on Monday, by electronic mail and fax, to counsel regarding the exact time and place of the administrative conference. Is there anything further?

CHAIRWOMAN SHOWALTER: Oh, I have something further. I just want to thank everyone for the hard work and long hours that you put in. We're well aware that it was this Commission that decided to go ahead with the proceeding in the manner that we have, and I know that it was grueling for everyone concerned, and I feel particularly sympathetic to everyone's families and especially their children, who haven't been able to see their parents.

I think, speaking personally, I really have learned a lot in this proceeding. It doesn't -- it has no bearing on the ultimate decision or whether we -- I would have learned something in a later proceeding. I'm just saying that putting in long and concentrated hours on a subject really does add insights. And the witnesses and the attorneys have all contributed to that, and I appreciate it.

MR. BEAVER: And I would say, from Olympic's standpoint, the reciprocal is true, too. Obviously, you all had to do exactly what we were doing, and we appreciate it, because it's the first time in my legal career that I've actually been involved in an agency where you actually spend evenings doing what you've been doing, so it's much appreciated.

MR. BRENA: Thank you for your courtesy and professionalism. It's been greatly appreciated.

MR. STOKES: Thank you very much.

JUDGE WALLIS: Very well. Thank you all, and we'll be in touch regarding the administrative conference.

(Proceedings adjourned at 5:04 p.m.)