BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

OLYMPIC PIPE LINE COMPANY, INC.

TOSCO CORPORATION'S OPENING POST-HEARING BRIEF

Docket No. TO-011472

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I. INTRODUCTION

1 Pursuant to the Fifteenth and Seventeenth Supplemental Orders issued by Administrative Law Judge Wallis on July 19, 2002, and July 30, 2002, respectively, and WAC § 480-09-420, Tosco Corporation ("Tosco") hereby submits this Opening Post-Hearing Brief. Olympic Pipe Line Company, Inc., ("Olympic" or "the Company") has requested a 59.5 percent rate increase through its rebuttal case, reduced from its previously requested 62 percent increase. Ex. 701T at pg. 1 lines 14-16. Olympic derived this proposed rate increase from a total cost of service of approximately $56.5 million and a severely constrained throughput estimate. Ex. 701T at pg. 1 lines 11-13. Olympic has not produced evidence to support this substantial rate increase in either its direct or rebuttal case, despite 14.5 days of hearings, 12 witnesses and offering five different cost of service presentations over the past year.[1]

2 Olympic has tried to justify its extreme rate request by posturing that the revenue is needed to enable Olympic to attract $66 million in capital over the next three years to make

[1] 1) Olympic filed its May 2001 rate filing, later withdrawn; 2) its July 2001 rate filing; 3) Direct Case 1; 4) Direct Case 2; and 5) its Rebuttal case.

safety improvements and enable it to return to 100 percent operating pressure. Ex. 1601T at pg. 2 lines 2-4. However, the plea for revenue has not been supported by a demonstration that the rates Olympic seeks to charge would be just and reasonable, under any proper measure of the standard employed by the Washington Utilities and Transportation Commission ("WUTC" or "Commission"). On the facts, Olympic has simply failed to justify much of an increase at all.

3 Tosco recognizes the importance of safety improvements on the Olympic system, and as a major shipper, is willing to pay for prudently incurred costs to ensure the safe operation of this oil pipeline. However, Olympic must justify its proposed rates using traditional accounting and ratemaking principles that govern all public service companies in the state. Asserting the need to make future investments does not relieve Olympic of its burden to justify the proposed rate increase.

4 A careful analysis of Olympic's filing demonstrates that Olympic has distorted its analysis to justify this rate increase by: 1) improperly setting rates with a severely restricted throughput estimate; 2) using a capital structure grossly out of proportion to its actual capital structure of 100 percent debt; 3) using an overstated return on equity with a premium for market risk when none is justified; 4) using an improper ratemaking methodology to set Olympic's Washington intrastate rates; 5) misstating and improperly characterizing expenses; and 6) improperly focusing on future investments to justify this rate increase.

5 Tosco has not advanced a total cost of service for Olympic, but through the testimony of Dr. Robert Means, has recommended specific, well founded adjustments to Olympic's case.

Dr. Means' recommendations apply traditional ratemaking principles to Olympic.[2] Dr. Means' analysis demonstrates that even when a few major issues are considered, Olympic has not supported the need for any substantial rate increase. Dr. Means' recommendations, applied to the traditional Washington methodology for public service companies, result in a rate increase for Olympic of approximately 2 percent. Tr. at pg. 3681 lines 18-19. The resulting per barrel cost at Dr. Means' design throughput is $ 0.3554. Tr. at pg. 3681 lines 15-18. Without even making all the well-founded adjustments proposed by WUTC Staff and Tesoro Refining & Marketing Company ("Tesoro"), there is little justification for more than a slight rate increase.

6 A major issue in this proceeding is the design throughput that should be used to determine Olympic's permanent rates because the pipeline is currently severely constrained. Tosco has forwarded a well-reasoned solution to resolve this contentious issue. Dr. Means has proposed an adjustment mechanism as a solution that ignores the cause of and does not place blame for the current pressure restriction. Dr. Means' adjustment mechanism is neutral to both Olympic and its shippers and is preferable to other proposed mechanisms in that it gives the Company an incentive to operate efficiently and return to normal operating pressure. Dr. Means sets Olympic's permanent rates using 130 million barrels per year and allows Olympic to retain the benefits of lower costs or higher volumes, but also places the burden of higher costs or lower volumes on Olympic. Ex. 2201T at pg. 36 lines 1-6. When Dr. Means' proposed adjustment mechanism is coupled with his other recommendations, the rate increase for the five years, including the surcharge, would be approximately 10 percent. Tr. at pg. 3681 lines 20-22. When Dr. Means' adjustments are made and combined with other necessary adjustments proposed by

[2] Dr. Means' recommendation regarding starting rate base is linked to the federal TOC methodology and is not applicable to this proceeding where the traditional Washington methodology for public service companies should be used.

Commission Staff and Tesoro, it becomes apparent that Olympic has not justified the need for any significant rate increase.

EXECUTIVE SUMMARY

7

- **Olympic has failed to justify anything more than a slight increase in its rates for transporting oil products in the State of Washington. Although the company needs to make significant investments to improve its system, it has not met the burden of proving that a 59.5 percent rate increase would result in just and reasonable rates. Asserting the need to make future investments does not relieve Olympic of its burden to justify any level of rate increase.**

8

- **Tosco has made very reasonable recommendations to Olympic's cost of service presentation that should be adopted. When just those adjustments are made, Olympic's need for a rate increase is drastically reduced to approximately a 2 percent increase. With the addition of a surcharge mechanism to address the uncertainty regarding throughput, the rate increase would be approximately 10 percent.**

9

- **Olympic's allowed return on equity ("ROE") should be based on the median return of the oil pipeline proxy group and include no premium for market risk. Dr. Means recommends that the Commission adopt a 13 percent ROE for Olympic.**

10

- **Olympic's capital structure should be set equal to the median 2001 capital structure of the oil pipeline proxy group, despite actually having a capital structure of 100 percent debt. The oil pipeline proxy group has a capital structure that consists of 47.4 percent equity and 52.6 percent debt.**

11

- **Olympic's income tax allowance should be consistent with, and driven by, the appropriate allowed ROE, which is in turn driven by the appropriate rate base, capital structure, and cost of equity. Olympic's income tax allowance should be set a $2,333,000 based on the depreciated original cost ("DOC") methodology.**

12

- **Olympic's cost per barrel for fuel and power should be based on its costs and volumes for the second half of 2001. At Olympic's proposed rate design throughput, this would change fuel and power costs from the filed level of $10.7 million in its direct case and $8.9 million in its rebuttal case to $8.4 million. For the higher design throughput Dr. Means recommends with his proposed adjustment mechanism, it would change those costs to $10.3 million.**

13

- **Olympic's rates should be based on an annual throughput of 130 million barrels. This is the throughput it should be able to achieve when it returns to full operating pressure and the operating efficiencies permitted by the Bayview Terminal are included. Olympic should also be allowed to levy a temporary surcharge to recover**

the expected net revenue shortfall caused by the current operating pressure restriction.

14 • **Dr. Means' recommended adjustments should all be made and applied to the traditional ratemaking methodology utilized by this Commission to set rates for public service companies in the State of Washington. Tosco concurs with the recommendations of the WUTC Staff and Tesoro on using the DOC methodology for setting Olympic's intrastate rates.**

15 • **Tosco concurs with the WUTC Staff and Tesoro regarding several other cost of service adjustments. If the Commission adopts those recommendations, the size of any increase in Olympic's rates should be further minimized.**

II. LEGAL STANDARDS AND GOVERNING PRINCIPALS

A. Burden of Proof

16 It is undisputed that Olympic has the burden to demonstrate that any proposed rate increase is just and reasonable. That burden has not been met. RCW § 81.04.130 provides that:

> At any hearing involving any change in any schedule, classification, rule, or regulation the effect of which is to increase any rate, fare, charge, rental, or toll theretofore charged, the burden of proof to show that such increase is just and reasonable is upon the public service company.

Olympic has requested an extraordinary 59.5 percent rate increase. Ex. 701T at pg. 1 lines 14-16. However, Olympic's requested rate increase is simply unsupported despite the enormous and thorough record in this proceeding. Instead of presenting a defensible rate increase based on a well supported cost of service, Olympic argues that if its proposed rate increase is denied, virtually all of the $66 million in capital projects scheduled and anticipated for the next three years will not be funded and therefore would have to be postponed pending a further rate proceeding. Ex. 1601T at pg. 2 lines 2-7. Olympic's argument on the need to make future investments does not eliminate Olympic's burden in this proceeding. As Dr. Means explains, Olympic, as a regulated public service company in Washington, needs to believe it is going to

get a reasonable return on new investments, but that assurance cannot come from inflating the current cost of providing service, or artificially suppressing throughput estimates. *See generally* Tr. at pg. 3663 lines 4-7. Olympic cannot justify the level of rate increase it has requested in this proceeding. It has no reason to doubt, however, that the WUTC will take proper account of any future investments when they are made and the higher operating costs are being incurred. *See* Tr. at pg. 3663 lines 7-10. In the instant proceeding, however, when proper adjustments to Olympic's cost of service are made, as proposed by Dr. Means, Staff and Tesoro, the rate increase proposed by the Company simply cannot be justified. Thus, Olympic has failed to satisfy its burden to prove that its proposed rate increase is just and reasonable. RCW § 81.04.130.

B. Fair, Just, Reasonable and Sufficient Rates

i. General Considerations

17 The Commission has broad authority to regulate, in the public interest, the rates charged by Olympic to ensure that they are consistent with the statutory standard that rates must be fair, just, reasonable, and sufficient. RCW §§ 80.28.010, 81.28.230. Olympic's proposed 59.5 percent rate increase is not justified by Olympic's cost of service using a reasonable throughput estimate, thus, would not yield fair, just, and reasonable rates. Olympic tortures its costs in this proceeding to support its rate increase, while at the same time implying that the public interest standard and the end result test mandate lesser scrutiny of its filing. Dr. Means, as well as Staff and Tesoro, have identified significant errors in Olympic's evidence used to support its cost of service and throughput volume. The voluminous record in this proceeding does not support Olympic's requested rate increase. Anything more than a modest increase in current rates would

result in rates that are not fair, just, reasonable, and sufficient. Reliance on the end result test or the public interest standard does not change this result based on the record in this case.

18 The Washington Legislature delegated the authority to set rates for public service companies to the WUTC. *See* Raymond Lumber Co. v. Raymond Light & Water Co., 92 Wash. 330, 335, 159 P. 133 (1916); RCW § 80.01.040 (General Powers and Duties of Commission).[3] The statutory mandate to the WUTC is to set fair, reasonable, and sufficient rates. RCW §§ 80.28.010, 81.28.230. Washington courts have also observed that the paramount objective of the Legislature in creating the Commission "was to secure for the public safe, adequate, and sufficient utility services at just, fair, reasonable, and sufficient rates." *See, e.g.*, State ex rel. PUD 1 v. Department of Pub. Service, 21 Wash.2d 201, 209, 150 P.2d 709 (1944).

19 Following this standard and the regulatory compact, the Commission must strike the appropriate balance between the right of the public to be served at a reasonable charge, and the right of the utility to a fair return on the value of its property used in the service. *See* Federal Power Comm. v. Hope Natural Gas Co., 320 U.S. 591 (1944); State ex rel. Puget Sound Power & Light Co. v. Department of Pub. Works, 179 Wash. 461, 466, 38 P.2d 350 (1934). Washington courts have held:

> "[a] public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under

[3] The provisions of RCW § 80.01 apply equally to Titles 80 and 81. *See* RCW § 81.01.010.

> efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties…."

State ex rel. Pac. Tel. & Tel. Co. v. Department of Pub. Serv., 19 Wash.2d 200, 266, 142 P.2d 498 (1943) *quoting with approval from* Bluefield Water Works & Imp. Co. v. Public Serv. Comm'n, 262 U.S. 679, 692 (1923)); *see also* Duquesne Light Company v. Barasch, 488 U.S. 299, 310, 312 (1989) (utility entitled to the opportunity to earn a rate of return sufficient to maintain its financial integrity, attract capital on reasonable terms, and receive a return comparable to other enterprises of corresponding risk). Each of these interests is as important in the eyes of the law as the other. Puget Sound Power & Light Co., 179 Wash. at 466.

20 To that end, Tosco has analyzed six specific contentious issues – throughput, capital structure, rate of return, fuel and power costs, amortization period for starting rate base, and interest expense – and made reasonable and responsible recommendations. The recommendation regarding starting rate base is linked to the federal trended original cost ("TOC") methodology. However, Dr. Means does not endorse the use of the federal methodology for Washington oil pipeline ratemaking. Dr. Means presented his analysis based on the federal TOC methodology simply because that was the only methodology Olympic used in this proceeding. Dr. Means' other five adjustments to Olympic's case should all be made, and applied to the traditional Washington ratemaking methodology for public service companies; the DOC methodology. Applying Dr. Means' recommendations to the traditional Washington ratemaking methodology, in addition to adjustments recommended by Commission Staff and Tesoro, will lead this Commission to a rate that is fair, just, reasonable, and sufficient. Only a very modest increase can be justified if the Commission applies its normal standards for determining the proper rates of a public service company.

ii. End Result Test

21 Olympic postures that the so called "end result" test derived from Hope Natural Gas, 320 U.S. 591 (1944), justifies, given the alleged very high risk situation for Olympic, a higher equity share in its capital structure than a typical oil pipeline company, and a higher return on equity capital based solely on the desire of the Commission to provide an incentive for the regulated company to invest in socially-desirable projects. Ex. 201T at pg. 7 line 23 through pg. 8 line 7. Dr. Schink argues that the end result test focuses on whether the result is just and reasonable, and that the methodology used by a regulatory commission to determine the rate of return is essentially irrelevant.[4] Ex. 201T at pg. 10 lines 1-22. Olympic continues:

> The relevance of the "end result" test to this matter is that the oil pipeline industry is different from other regulated industries, and Olympic's circumstances are different from those of a typical oil pipeline company. The oil pipeline industry is much more competitive than the electricity or gas distribution industries and also more competitive than the natural gas pipeline industry. *Olympic, because of its exposure to waterborne competition and to the severe negative financial impacts that have followed in the wake of the June 10, 1999, accident in Bellingham, Washington, has much higher risks than are faced by a typical oil pipeline company. I believe that it is essential for the Commission to take these factors into account in reaching its decision regarding Olympic's return on equity if the Commission is to satisfy Hope and the "end result" test.* Ex. 201T at pg. 11 lines 1-12 (emphasis added).

In this proceeding, the Commission is not concerned with the oil pipeline industry in general. It is concerned with the rates of one pipeline, Olympic. Dr. Means has demonstrated that both the steady increase in Olympic's volume and revenue in the past and the rate increase it now has

[4] Tosco notes Olympic's inconsistent arguments on the methodology issue. On the one hand, Olympic advocates that the methodology is irrelevant when it justifies an equity rich capital structure and higher rate of return. But in the same breath, Olympic argues that only the federal TOC methodology should be applied in this proceeding.

requested indicate that it faces little threat from waterborne competition. That conclusion was confirmed by Mr. Peck during the evidentiary hearing.

Mr. Trotter	Q.	…If pipeline capacity is available, water-borne transportation is not an effective alternative?
Mr. Peck	A.	That's not your first line; you would rather use the pipeline.
Mr. Trotter	Q.	That's because it is substantially cheaper?
Mr. Peck	A.	Correct.

Tr. at pg. 2785 line 24 through pg. 2786 line 18.

22 Olympic's reliance on the end result test is misplaced. Despite arguments made by Olympic, the Commission should not have to induce the Company with an unjustified ROE or an equity rich capital structure as an incentive for Olympic's owners to make the investments necessary to ensure the long-term reliability of the pipeline and to restore the pipeline to its full operating capacity. Olympic is correct that the small or non-existent equity component of Olympic's capital structure does create financial risk. However, it is a risk that has in part been created by Olympic's past policies, including paying dividends to its owners despite an alarmingly low actual equity ratio. For example, between 1990 and 1997, Olympic's equity ratio ranged between 11.06 and 16.09 percent. Ex. 401T at pg. 3 lines 18-19. During that same time period, Olympic paid out $51.6 million in dividends to its parent owners. Ex. 401T at pg. 3 lines 14-20. Absent payment of these dividends, Olympic would have maintained a capital structure with an equity ratio of approximately 31.81 to 64.98 percent. Ex. 401T at pg. 4 lines 3-6. Chairwoman Showalter used an appropriate metaphor during the evidentiary hearing, describing

Olympic's situation like "parents who starve the child of equity, and then go to the State for more food that may not go to the child." Tr. at pg. 3760 lines 12-17.

23 There is, in addition, a fundamental inconsistency in basing Olympic's general argument for generosity on that equity-poor capital structure while at the same time basing the specific cost of service calculations on a capital structure that consists almost entirely of equity. Simply put, the end result test does not mandate special treatment for Olympic, or eliminate its burden to justify its rates are fair, just, reasonable, and sufficient. Any financial risk faced by Olympic is due at least in part to its own business strategy, and shippers should not bear the financial responsibility for this decision.

iii. Public Interest Standard

24 See Section II(B)(i)

iv. Commission's Dual Role

25 Olympic argues that this is the first time the Commission's dual role to regulate and balance both rates and pipeline safety has been placed directly at issue. Olympic Prehearing Memorandum at pg. 7. As previously discussed, Tosco supports and is willing to pay for all prudently incurred safety related expenses. However, the mere need for future safety investment does not abrogate the Commission's obligation to set just and reasonable rates. Furthermore, in many respects Olympic is no different than other regulated entities. All regulated entities have safety concerns, and the burden to prove just and reasonable rates. In fact, the WUTC has safety jurisdiction over gas local distribution companies for whom they also regulate rates.

26 Olympic postures that if its rate increase is not granted, $66 million in capital projects will have to be cancelled or postponed. Olympic's arguments are misplaced at best. In response to Olympic's need to make future investments, Dr. Means explains that Olympic has all the assurance it needs in what is known as the regulatory compact. Tr. at pg. 3662 lines 1-9. The regulatory compact gives the public service company assurance that if a new investment is made, then in a rate case in which that investment and the operating costs can be reflected, rates will be established that will give return not just on the old investment, but the new investment as well. Tr. at pg. 3662 lines 4-10. Thus, the end result in this case should focus on the proper determination of just and reasonable rates for investment already in service, and on a proper throughput estimate. Cost based regulation rests on being able to make a reasonably accurate assessment of costs and revenues. Tr. at pg. 3662 lines 13-15. The determination of whether a rate is just and reasonable generally involves an examination of a utility's prudently incurred cost of providing service. Farmers Union Cent. Exch., Inc. v FERC, 734 F.2d 1486, 1502, *cert. denied sub nom.* Williams Pipeline Co. v. Farmers Union Cent. Exch., Inc., 469 U.S. 1034 (1984); People's Org. for Wash. Energy Resources v. WUTC, 104 Wash.2d 798, 810 (1985). No party in this proceeding has disputed the importance of safety related expenditures. However, expenditures are properly included in Olympic's rates once the investment has been made in used and useful facilities. Olympic is trying through this proceeding to have rates set high enough to fund the investments before they are made. That is simply not how this Commission sets rates for public service companies.

C. Federal / State Jurisdictional Legal Issues

27 The WUTC has exclusive authority over Olympic's intrastate rates. Those rates are lawful as long as the result is fair, just, reasonable, and sufficient. The United States Supreme

Court has squarely held that the power over intrastate rates is exclusively reserved for the states, absent a violation of Section 13(4) of the Interstate Commerce Act. North Carolina v. United States, 325 U.S. 507, 511 (1945). There is simply no requirement that intrastate rates for Olympic be set in parity with interstate rates.

28 Olympic previously argued that the WUTC should grant interim rates consistent with the FERC in order to "avoid constitutional issues." Olympic Motion at ¶¶18-22. This argument was dismissed by the WUTC. Re Olympic Pipe Line Co., WUTC Docket No. TO-011472, Eighth Supplemental Order (Mar. 29, 2002). It is clear that, as originally enacted, the Interstate Commerce Act was not intended to intrude on the power of the states to regulate intrastate commerce. Simpson v. Shepard, 230 U.S. 352 (1913). Thus, there are distinct roles of federal and state regulators, and this Commission must set intrastate rates for Olympic without regard to Olympic's unsupported claims of "constitutional issues" raised by a difference between intrastate and interstate rates.

D. Retroactive Ratemaking

29 Tosco will not address this issue in this Opening Brief, but reserves the right to address arguments raised by other parties in its Answering Brief.

III. STATUS OF COMPANY BOOKS AND RECORDS

30 The integrity of Olympic's financial books and records, and the financial information Olympic has advanced to support its proposed 59.5 percent rate increase, are suspect. As previously discussed, Olympic has filed 5 different cost of service presentations with this Commission in the past year. *See* Section I. The very ability of Olympic to file substantially different cost of service presentations demonstrates that its books and records are not reliable.

Strikingly, Olympic did not have audited financial information to support its rate filing.[5] This placed the parties and the Commission in a difficult position, because without an unqualified auditor's letter, Olympic could not verify that the financial information it advanced accurately and fully represents its actual financial position. Ex. 2401T at pg. 7 lines 12-14.

31 Olympic has been unable to obtain an unqualified audit of its financial books and records since 1999. Ex. 2101T at pg. 11 lines 18-19. The state of Olympic's books and records is at least partially attributable to the fact that: 1) Olympic changed operators, changed auditors, and changed accounting systems three separate times; 2) there is little to no cooperation between Olympic's former operator and its current operator or between Olympic's two owners; and 3) there are outstanding accounting disputes in litigation between Olympic and one of its owners. Ex. 2401T at pg. 7 lines 14-18. Furthermore, the Company will likely have difficulty obtaining unqualified audited financial statements until its balance sheet reflects liabilities that more closely match assets, and until prior operating losses are no longer financed with debt. Ex. 2101T at pg. 12 lines 15-17. For example, the short-term debt on Olympic's balance sheet, to the extent it was issued to fund prior period operating losses, should no longer be carried on Olympic's balance sheet. Ex. 2101T at pg. 11 lines 8-10. WUTC Staff witness Elgin instead urges that the short-term debt be written off.

32 The Company has made several different commitments regarding when it will have unqualified audited financial statements. At the January 24, 2002, interim hearing, the Company committed to having audited financial statements "in the next couple weeks certainly before, much before the end of the general rate case, before I think, the Commission Staff has to put on

[5] On August 12, 2002, Olympic offered into the record, after close of the evidentiary hearing, an audited financial statement for 2001. At the evidentiary hearing, Intervenors objected to the late filed financial statement and the Commission took the matter of whether to allow the statement into the record under advisement.

their rate case…." WUTC Interim Hearing Tr. at pg. 1304 lines 17-21. Later, the Company committed to having unqualified audited financial statements "by the end of the year, or perhaps the first quarter of 2003." Ex. 603 at pg. 14 lines 20-21. Finally, at the hearing, the Company requested to leave the record open until August 15 to submit audited financial statements only for the most recent year. Tr. at pg. 5280 lines 16-22. Although the Company did eventually offer this statement, it is arguably unreliable because the preceding two years have yet to be audited. The submission of this audited financial statement raises more issues than it was intended to resolve. Thus, Olympic's financial books and records cannot be relied upon to accurately reflect its actual financial position.

33 The absence of audited financial statements for the proceeding years is not merely a formal deficiency. The Commission's regulation of oil pipeline rates, like its regulation of the rates of other companies within its jurisdiction, is based on costs. It is of vital importance that the costs used to justify those rates be accurate.

34 The lack of audited financial statements is justification for rejection of the rate filing outright, but Tosco stopped short of making this argument. However, the lack of audited financial statements is an additional reason for approaching Olympic's request for an extraordinarily large rate increase with care and skepticism.

IV. RATEMAKING METHODOLOGY

35 As discussed above, Olympic's total cost of service for intrastate service should be determined utilizing the traditional ratemaking methodology for public service companies in

Washington State, the DOC methodology.[6] Despite arguments made by Olympic, there is no entitlement to any particular rate setting methodology, and the Commission may use any standard, formula, method or theory of valuation reasonably calculated to result in just, fair, reasonable, and sufficient rates. *See* RCW § 81.04.250. Olympic has the burden to justify use of the federal methodology. RCW § 81.04.130. However, Olympic has not provided compelling justification, or any justification for that matter, to utilize the federal ratemaking methodology for oil pipelines to set intrastate rates.

36 Olympic does not have a witness to support the use of the 154-B methodology. The Commission struck Christie Omohundro's testimony, Olympic's primary witness on this issue, because she demonstrated a woeful lack of understanding of the mechanics of the 154-B methodology and the policy considerations behind it. *See generally* Tr. at pgs. 3879-3928. Olympic witness Mr. Smith claims that he is not making any specific recommendations with regard to methodology, but rather merely is giving background. Tr. at pg. 4255 lines 8-11. Ms. Hammer continuously defers to Mr. Collins on the most basic aspects of the 154-B calculation. Ex. 802 at pg. 21 line 1 through pg. 22 line 7. Mr. Batch only makes passing reference to methodology in his testimony in the context of introducing Ms. Omohundro. Ex. 610 at pgs. 6-7. He also admits that he is not a rate expert nor has any knowledge of the methodology used in Olympic's prior rate filings, but then claims that "switching" would disadvantage the company. Tr. at pgs. 3070-3075. Mr. Collins does not advocate the use of a particular methodology. Ex. 1914 at pg. 83 lines 4-8. Dr. Schink claims that all prior tariff filings to the Commission have been justified in the FERC framework. Ex. 201T at pg. 13 lines 18-21. He then admits on the

[6] Dr. Means conducted the analysis for his testimony within the framework of the TOC methodology because that was the case presented by Olympic. Ex. 2201T at pg. 6 lines 14-15. However, Dr. Means does not endorse the federal oil pipeline methodology for Olympic's intrastate rates in Washington. On the contrary, Tosco agrees with Staff and Tesoro that the use of the DOC methodology is the proper methodology for Olympic.

stand that his knowledge of the Company's filings is not first hand, but based on something Company counsel may have told him. Tr. at pg. 2258 lines 8-22. Thus, Olympic has not presented any witness able to justify the use of the TOC methodology over the DOC methodology.

37 Furthermore, Olympic's so-called reliance on the TOC methodology is unjustified. Olympic cites no precedent where the WUTC has adopted the TOC methodology. It is undisputed that the WUTC uses the DOC rate base methodology for setting rates for public service companies in Washington. Ex. 1901T at pg. 11 lines 11-19. It is this methodology that the Commission has determined results in just and reasonable rates, as it is required by law to determine. Olympic has made an unreasonable assumption that the WUTC would blindly follow the FERC's ratemaking policies with respect to oil pipelines, despite the fact that many of the justifications for using the Federal TOC methodology are not present in this case.

A. Investor Expectations; Right to Methodology

38 There is no justifiable investor-backed expectation in any particular ratemaking methodology. Olympic asserts that investor-backed expectations warrant the application of the federal oil pipeline ratemaking methodology. *See*, *e.g.*, Tr. at pg. 4272 lines 18-24. However, the U.S. Supreme Court has held that an otherwise reasonable rate is not subject to attack "by questioning the theoretical consistency of the method that produced it." Duquesne Light Co. v. Barasch, 488 U.S. 299, 314 (1989). Notably, counsel for Olympic even admitted that the Company has no vested right to any particular methodology. Tr. at pg. 3911 lines 17-20. Thus, any argument that the owners/investors of Olympic have an expectation or a right to a particular methodology is simply not persuasive.

1. The Company's Arguments Are Inconsistent with Olympic's Past Practices

39 Olympic's case contains a fundamental inconsistency. While claiming that a "switch" from the 154-B methodology by this Commission would harm the Company and undermine the Company's and investors' expectations, Olympic has set rates with the FERC according to something other than the 154-B methodology until just recently. In 1985, the FERC's Opinion 154-B methodology was used to establish rates for pipeline carriers with open rate cases, but FERC did not require pipeline carriers with existing final rates to file new rates based on its new methodology. Ex. 2301T at pg. 33 lines 8-10. In Olympic's case, at the time FERC adopted the 154-B methodology, Olympic had interstate rates in effect set pursuant to the ICC's valuation methodology. Ex. 2301T at pg. 33 lines 10-11. Olympic did not file rates with the FERC under the 154-B methodology until 1996. Ex. 2301T at pg. 33 lines 11-12; *see also* Tr. at pg. 5055 line 8 through pg. 5056 line 1. Thus, there is no evidence that Olympic or its owners/investors placed any reliance on the 154-B methodology until 1996. This is buttressed by Mr. Collins' admission that even certain rate filings *with this Commission*, involving the Sea-Tac Terminal, were not based on the FERC methodology. Tr. at pg. 3117 lines 13-21.

40 Furthermore, after 1995, the TOC methodology was no longer FERC's primary ratemaking tool. As discussed below in Section IV(B)(i), after passage of the Energy Policy Act of 1992, and in an effort to do away with the particularly complicated TOC filings, the FERC adopted indexing as the method by which it would establish just and reasonable rates for oil pipelines. Order No. 561, Revisions to Oil Pipeline Regulation Pursuant to the Energy Policy Act of 1992, III FERC STATS. & REGS. ¶30,985, 58 Fed. Reg. 58,753 (1993), *modified on reh'g*, Order No. 561-A, III FERC STATS. & REGS. ¶31,012 (1994), 60 Fed. Reg. 356 (1995). FERC's 154-B methodology was only available if the pipeline could make certain affirmative

showings. 18 C.F.R § 342.4; *see also* Section IV(B)(i). Since then, Olympic has made multiple filings using the indexing methodology at FERC without a similar filing with the WUTC. Tr. at pg. 5064 lines 1-12. Thus, the Company's position that investor expectations warrant the use of the TOC methodology is undermined in that it has, even recently, relied on methodologies it does not now advocate here.

B. FERC Methodology

i. Nature of Oil Pipelines and History of Regulation

41 In 1906, the Hepburn Act amended the Interstate Commerce Act ("ICA") to include within its reach "common carriers engaged in…the transportation of oil…by pipeline." 49 U.S.C. app. § 1(1)(b) (1988). The ICA subjected oil pipelines to many of the same standards of operation common to regulation today: they were required to post tariffs, charge only just and reasonable rates, and avoid unjust discrimination or undue preferences. Id. §§ 1(5), 2, 3(1), 6.

42 From a regulatory perspective, the next thirty or so years were uneventful. Then in 1940, the Interstate Commerce Commission ("ICC") for the first time articulated a standard by which the reasonableness of oil pipeline rates was to be measured. The ICC employed a "fair value" methodology, which gave significant weight both to the depreciated original cost value of the pipeline's assets and to a calculation of the cost of reproduction new ("CRN"). *See* Atlantic Pipe Line Co., 47 ICC Valuation Rep. 541, 584-98 (1937); Ajax Pipe Line Co., 50 ICC Valuation Rep. 1, 24-36 (1949). These factors were weighted together to produce a valuation that served as the basis for calculation of the revenue requirement. Atlantic Pipeline Co., 47 ICC Valuation Rep. at 584-98; Ajax Pipe Line Co., 50 ICC Valuation Rep. at 24-36. Allowable revenues for a pipeline were ultimately determined by applying a fixed rate of return (set by the ICC at 8 percent for crude oil pipelines and 10 percent for petroleum products pipelines) to the valuation

base. Atlantic Pipeline Co., 47 ICC Valuation Rep. at 584-98; Ajax Pipe Line Co., 50 ICC Valuation Rep. at 24-36.

43 For three decades, the valuation methodology remained generally unchanged until the Williams Brothers Pipe Line rate case was initiated by shipper complaint in 1972. The ICC upheld the reasonableness of the pipeline's rates using the valuation methodology. Williams Bros. Pipe Line Co., 351 ICC 102, *aff'd on recons.*, 355 ICC 479 (1976). The shippers then appealed to the D.C. Circuit. While that appeal was pending, the ICC's jurisdiction over oil pipeline ratemaking was transferred to the Federal Energy Regulatory Commission ("FERC"). Instead of deciding the appeal, the D.C. Circuit remanded the case to the FERC to give it an opportunity to create its own ratemaking policy. Farmer's Union Central Exchange v. FERC, 584 F.2d 408 (D.C. Cir.), *cert. denied*, 439 U.S. 995 (1978) (Farmer's Union I). With minor changes, the FERC adopted the ICC's valuation methodology and applied to that base a generous rate of return that included a "'real,' entrepreneurial" return on equity. Williams Pipe Line Co., 21 FERC ¶61,260 (1982) (Opinion No. 154).

44 The shippers again appealed, and the D.C. Circuit summarily rejected the FERC methodology, reasoning that the method must be a cost-based approach and if it was not, the FERC needed to justify the use of this non-traditional approach. Farmer's Union Central Exchange v. FERC, 734 F.2d 1486 (D.C. Cir. 1984) (Farmer's Union II). The Court held that FERC's rejection of a cost-based approach was unsupported and remanded aspects of the case with certain instructions to the FERC based on the Court's interpretation of FERC's mandate under the ICA.

45 On remand, the FERC abandoned the ICC valuation method and instead issued an opinion that promulgated a relatively concise set of principles intended to govern oil pipeline ratemaking for the future. Williams Pipe Line Co., 31 FERC ¶61,377 (June 28, 1985) (Opinion 154-B). Specifically, Opinion 154-B established a new approach for the determination of rate base and rate of return that was, and is, unique to oil pipeline regulation. This included the trended original cost and starting rate base concepts.

46 Today, the federal ratemaking methodology enunciated in Opinion No. 154-B is among several alternatives available to oil pipelines for establishing rates. After passage of the Energy Policy Act of 1992 and a substantial rulemaking process, the FERC again changed the primary ratemaking methodology applicable to oil pipelines. Order No. 561 established indexing as the new federal ratemaking methodology. Order No. 561, Revisions to Oil Pipeline Regulation Pursuant to the Energy Policy Act of 1992, III FERC STATS. & REGS. ¶30,985, 58 Fed. Reg. 58,753 (1993), *modified on reh'g*, Order No. 561-A, III FERC STATS. & REGS. ¶31,012 (1994), 60 Fed. Reg. 356 (1995). In short, this methodology allows rate changes that do not exceed indexed rate ceilings based upon the annual percentage change in the Producer Price Index for Finished Goods less one percentage point. Ex. 1101T at pg. 7 lines 8-11; *see also* 18 C.F.R § 342.

47 Cost of service rates based on the 154-B methodology are merely an alternative to indexing, which are available only under certain conditions. 18 C.F.R § 342.4(a). A pipeline may justify a rate in excess of the index ceiling based on the cost of service methodology *only* if it can show that there is a substantial divergence between the actual costs experienced by the carrier and the rate resulting from the application of the index, such that the rates at the ceiling

level would preclude the carrier from charging a just and reasonable rate within the meaning of the ICA. Id.

48 Market-based rates are another alternative to indexing. Id. § 342.4(b). Pipelines may seek market-based rates on the basis of a showing that they do not possess significant market power in the relevant markets. Order No. 561 at ¶30,957-59. Finally, pipelines are permitted to set rates based on negotiations directly with shippers. 18 C.F.R § 342.4(c).

ii. Rationale for FERC Methodology

49 Adopting the TOC methodology for Olympic is not in the public interest nor is it justified by Olympic's particular situation or the policy justifications that inspired FERC to adopt 154-B. The primary rationale for FERC's approach was to aid new pipelines in their efforts to compete with older more fully depreciated pipelines and with other alternative forms of transportation. Ex. 2301T at pg. 27 lines 17-20. In other words, 154-B levels the playing field and prevents underinvestment. The FERC's Opinion 154-B, devising generic principles for setting interstate oil pipeline rates, is a mere twelve pages long. *See* Williams Pipe Line Co., 31 FERC ¶61,377 (June 28, 1985). In the opinion, the FERC clearly stated that its primary rationale for adopting TOC over DOC was "because it is a theoretically acceptable alternative that after the switch from valuation will help newer pipelines with higher rate bases to compete with older pipelines with lower rate bases and will help them compete with other modes of transport and so will tend to foster competition generally. This is so because TOC mitigates the front-end load problem for new pipelines." Williams, 31 FERC at ¶61,834. However, the facts which inspired the FERC's 154-B opinion are not present in Olympic's case. Olympic faces no competition from other oil pipelines. Olympic is the only pipeline which can serve the four refineries manufacturing petroleum products within the state of Washington. Ex. 2301T at pg. 28 lines 4-5. Olympic's

own witness Mr. Peck even admits that there is "little chance of another pipeline being built to serve the function that Olympic is serving." Tr. at pg. 2860 line 15-17. Furthermore, Mr. Peck admits that pipeline transportation is economically preferable to waterborne transportation, thus contradicting allegations of competitive risks from waterborne transportation. Tr. at pg. 2785 line 24 through pg. 2786 line 18.

50 In Chairwoman Showalter's colloquy with Mr. Smith, she explored the rationale, or lack thereof, for the TOC methodology in this proceeding. *See* Tr. at pgs. 4267-4274. Olympic's witness Mr. Smith admitted that where there is little or no competition, the rationale for applying TOC is weaker. Tr. at pg. 4269 line 1 through pg. 4272 line 7. Mr. Smith also explained that since Washington is not a state that guarantees franchises to pipelines, the rationale for employing TOC in this case is further weakened. Tr. at pg. 4272 lines 12-16. He further admitted that Olympic is not a new, under-depreciated pipeline competing against an older depreciated pipeline. Tr. at pg. 4273 line 21 through pg. 4274 line 2. Thus, Olympic demonstrated that the circumstances which warrant the application of the TOC methodology, are not present in this case. Mr. Collins made similar admissions. Tr. at pg. 3344 line 24 through pg. 3345 line 2.

1. Potential for Underinvestment

51 See Section IV(B)(ii)

iii. Elements of The FERC Methodology

52 Tosco will not address this topic in the Opening Brief, but reserves the right to address arguments raised by other parties in its Answering Brief.

iv. Commission Discretion in Choosing Methodology

53 Assuming *arguendo* that this Commission has used or adopted the FERC methodology for oil pipelines in the past, the WUTC has discretion to utilize any ratemaking methodology it deems appropriate to produce fair, just, reasonable, and sufficient rates. RCW § 81.04.250. Thus, the WUTC is not bound by its past actions. However, as discussed below, the WUTC has never adopted a specific ratemaking methodology for oil pipelines.

54 The language of the Commission's enabling statutes gives the Commission discretion to choose the proper methodology in order to guarantee that rates will be fair, just, reasonable, and sufficient for public service companies in Washington. RCW § 81.04.250. The language used in the statutes directing the Commission to set rates for public service companies is indicative of the deference afforded the WUTC in this area. RCW § 81.04.250 states that in determining rates "the Commission has the power…to prescribe and authorize just and reasonable rates…." "In exercising that power, the Commission may use *any* standard, formula, method, or theory of valuation reasonably calculated to arrive at the objective of prescribing and authorizing just and reasonable rates." Id. (emphasis added).

1. Consistency with Interstate Rates

55 See Section II(C)

2. Past Practices

a. Tariffs Do Not Have the Legal Effect of an Order

56 Olympic has raised various arguments in this proceeding inferring that this Commission should be bound by what Olympic interprets to be the Commission's past practices. However,

Olympic's argument is misplaced and ignores the Commission's discretion in choosing the proper methodology discussed in Section VI(vi).

57 Olympic infers that approval of its previous tariff filings by operation of law merits the application of the FERC Opinion No. 154-B methodology in this proceeding. Ex. 721C at pgs. 1-2; Ex. 201T at pg. 9 lines 1-2; Ex. 201T at pg. 13 lines 17-26; Ex. 1201T at pg. 30 lines 17-25; Ex. 701T pg. 3 lines 9-13; Tr. at pg. 4524 lines 1-8; Tr. at pg. 4209 lines 13-18. Through this tenuous argument, Olympic asserts that the Commission has adopted the FERC ratemaking methodology. Olympic's argument is based on unsupported and strained reading of the applicable statutes. It is clear that an approved tariff allowed to go into effect by operation of law does not have the legal effect of an Order by this Commission, which finally determines the legal rights, duties, privileges and immunities of Olympic. RCW § 34.05.010(11)(a).

58 The Company cannot give effect to revised tariff sheets until the Commission approves a tariff filing by issuing an order or the new or changed provisions become effective by operation of law. WAC § 480-80-105(5). A tariff approved by operation of law requires no affirmative action by the Commission. On the other hand, the Administrative Procedures Act ("APA"), applicable to the duties of this Commission, defines Order, without further qualification, as "a written statement of particular applicability that finally determines the legal rights, duties, privileges, immunities, or other legal interests of a specific person or persons." RCW § 34.05.010(11)(a). Presumably, a written statement from the party itself allowed to go into effect by operation of law, would not satisfy this definition, and the "Approved" stamp on the tariffs at issue hardly constitutes a "written statement." *See, e.g.*, Ex. 721C at pg. 5. However, any ambiguity in this statutory provision is resolved by looking at RCW § 34.05.461(3) discussed below.

59 The APA further qualifies what constitutes an initial or final Order. Provisions in the APA relating to the entry of initial and final orders are applicable to the Commission by reference in WAC § 480-09-780. Section 34.05.461(3) of the APA explains that

> "initial and final orders shall include a statement of findings and conclusions, and the reasons and basis therefore, on all the material issues of fact, law or discretion presented on the record, including the remedy or sanction and, if applicable, the action taken on a petition for a stay of effectiveness….The order shall also include a statement of the available procedures and time limits for seeking reconsideration or other administrative relief. An initial order shall include a statement of any circumstances under which the initial order, without further notice, may become a final order."

Olympic's tariff filings allowed to go into effect by operation of law contain no findings of fact or conclusions of law, implicit or explicit, regarding the particular methodology underlying the approved rates. Indeed, a tariff, by definition, merely contains "terms and conditions of regulated service, including rates, charges, tolls, rentals, rules, and equipment and facilities, and the manner in which rates and charges are assessed for regulated services provided to customers, and rules and conditions associated with offering service." WAC § 480-80-030. Clearly, the tariff filings relied upon by Olympic fail to satisfy the definition of an Order as provided by Washington law, and are not dispositive of the Commission's alleged adoption of the federal ratemaking methodology for oil pipelines.

b. Staff Memos Do Not Constitute Agency Action

60 Olympic also infers that a series of dated Staff memoranda demonstrate that the FERC methodology was adopted to determine Olympic's rates. Ex. 721C at pg. 2-3. However, this is a red herring. Staff memoranda do not constitute agency action. First, Commission Staff is not an

"agency," where agency is defined as "any state board, commission department, institution of higher education, or officer, authorized by law to make rules or to conduct adjudicative proceedings…." RCW § 34.05.010(2). The Commission Staff is not authorized by law to make rules or conduct adjudicative proceedings and is therefore not an "agency."

61 Furthermore, the analyses contained in the memoranda do not constitute agency action. "Agency action" means "licensing, the implementation or enforcement of a statute, the adopting or application of an agency rule or order, the imposition of sanctions, or the granting or withholding of benefits." RCW § 34.05.010(3). The Staff memos do not license anything; they do not implement any statute, nor apply an agency order, impose sanctions, or grant any benefit. They simply provide to the Company an analysis of their tariff filings. Mr. Colbo even advised the Company "the Staff feels [the adoption of FERC guidelines] should be a policy determination of the Commission itself." Ex. 721C at pg. 27.

C. DOC Methodology

62 This Commission should set rates for Olympic based on the traditional methodology used to set rates for public service companies in Washington State. The WUTC uses restated, pro forma results of operations, including a return on rate base calculated based on historical cost less depreciation, known as the depreciated original cost ("DOC") methodology. Ex. 1901T pg. 11 lines 18-19. This methodology requires the Commission to set rates that will provide the Company the opportunity to earn revenues sufficient to recover: 1) a reasonable level of operating expenses and taxes; 2) a return of the investment used to provide the regulated service; and 3) a return on investment used to provide the regulated service. The DOC methodology will result in just, reasonable, and sufficient rates for Olympic. Tosco commends the Commission

Staff for its careful analysis on the methodology issue, and urges the WUTC to adopt Staff's position on use of the DOC methodology for Olympic.

V. TEST YEAR AND JURISDICTIONAL SEPARATIONS

63 WUTC Staff has properly calculated the jurisdictional allocation between interstate and intrastate rates. *See* Ex. 1901T at pg. 37 lines 4 through pg. 38 lines 5; *See also* Ex. 1903. Mr. Twitchell's cost of service calculation fairly separates Olympic's results of operations between jurisdictions, as is common practice in the regulation of multi-jurisdictional companies. Therefore, Tosco supports the use of the WUTC Staff's calculation of jurisdictional allocation.

64 Tosco uses the Company's test year as presented in its Direct case simply because that was the case presented by Olympic.[7] Ex. 1101T at pg. 27 lines 12-16. In Case 2 of the FERC filing, Olympic describes its base period (test year) as being October 1, 2000 through September 30, 2001, and its Test Period (rate year) as being the nine months subsequent to the Base Period (test year), that is, through June 30, 2002.[8] Id. For our analysis, we therefore used a July 1, 2002 through June 30, 2002 test period (rate year). From this standpoint, the problems with its rebuttal presentation were (1) it still used two months of budget data for the test period and (2) it tried to include estimates for three months beyond the end of that test period.

65 The Company presented its test year affirmatively to the Commission, and Intervenors relied upon it in conducting their subsequent analyses. However, in its rebuttal case, Olympic completely changed its test year to include 7 months of actual data, 2 months of budgeted, and 3 months of averaged data through September 2002. Ex. 727. The Company should not be

[7] In FERC terminology, Base Period refers to the most recent 12 months of actual data used as a starting point, and to that data adjustments are made that reflect a perspective looking period as the basis for which to evaluate rates, the latter period is defined as the Test Period. In WUTC terminology, the first period is called the test year and the latter the rate year.

[8] Washington methodology is indicated in (parenthesis).

rewarded for presenting a moving target. The Commission should reject Olympic's rebuttal case and revised test year. As demonstrated in the evidentiary hearing, the Company's rebuttal case test year is unreliable and adds a level of unnecessary complexity to this proceeding. Thus, Olympic's rebuttal case test year is a poor choice compared to the period presented in the Direct case.

66 As an alternative to the Company's Direct case test year, Staff has used a test year ending December 31, 2001. Ex. 2001T at pg. 2 lines 1-2. Staff should be commended for analyzing Olympic's actual results of operation for this period, fully restating the results and making proper pro forma adjustments. While deriving a test year is normally a routine exercise in the regulatory process, the state of Olympic's accounting records made this an exceedingly difficult task. Staff's test year is thus a reliable and informed alternative to the Company's direct case test year. Tosco would support this as an alternative to the Company's direct case. However, use of Olympic's revised test year, presented in its rebuttal case, should be rejected as unreliable and prejudicial to the shipper's right to just and reasonable rates from this public service company.

VI. OPERATING EXPENSES

A. Results Per Books

67 Olympic has not provided actual results of operations per books, or any fully restated actual and proforma results of operations in this proceeding. Ex. 1901T at pg. 6 lines 1-2. Olympic has also not provided revenues per books, restated and with proper pro forma adjustments, nor has Olympic provided the rate base per books, restated and with proper pro forma adjustments. Ex. 1901T at pg. 6 lines 4-5.

68 Instead of making a proper rate filing, Olympic simply provides its total cost of service calculation, assuming the Commission will accept all adjustments to expenses, restated revenues, restated rate base, rate of return, and the FERC methodology. Notably, the parties and Commission have had to contend with a moving target, because even the cost of service presentation has significantly changed numerous times. The data supporting Olympic's filing is insufficient for the Commission to determine whether Olympic's earnings are fair, just reasonable and sufficient because most of Olympic's information reflects budgeted results. Ex. 1901T at pg. 6 lines 9-11. Budgeted results are not known and measurable and are not appropriate to support adjustments using objective and rational ratemaking methodology. Ex. 1901T at pg. 6 lines 12-14. Despite these challenges, Staff and Intervenors have analyzed Olympic's case and made reasonable and responsible recommendations. Anything more than a modest increase simply cannot be justified.

B. Whatcom Creek Expenses

69 Olympic has represented that the direct costs associated with the Whatcom Creek accident are not included in its cost of service. Ex. 803 at pg. 5 line 18. This appears in fact to be the case. However, at least in Olympic's direct case, there appears to be indirect costs related to this accident which should be removed from Outside Services costs.

70 Olympic accrued $6.4 million for remediation by December 2000 and stated that of this $6.4 million, $1.2 million would be spent for remediation in 2001. Ex. 2301T at pg. 42 lines 16-17. The Commission should exclude the $1.2 million for rate setting purposes. As Mr. Brown explains, there is no support that Olympic actually spent or will spend any remediation funds during either the base or test period, and Olympic has not demonstrated that it has or will incur any actual costs associated with this estimated remediation. Ex. 2301T at pg. 42 lines 18 through

pg. 43 line 1. Furthermore, it appears that Olympic's $6.4 million included estimated remediation expenses for both Bellingham and Sea-Tac. Ex. 2301T at pg. 43 lines 1-2. The Bellingham estimate is related to the Whatcom Creek accident and Sea-Tac is related to a facility that Olympic no longer owns. Ex. 2301T at pg. 43 lines 2-4. These indirect costs associated with the Whatcom Creek accident and the Sea-Tac facility should not be included in rates. Accordingly, Tosco supports Tesoro's recommendation of removing Olympic's estimated $1.2 million in remediation costs from Outside Services costs contained in Olympic's Direct case.

71 Olympic has properly removed the remediation costs associated with Bellingham in its rebuttal case. Ex. 801T at pg. 6 lines 13-17. Olympic updated for actual costs incurred for the period July 2001 through April 2002, and used revised estimates for May and June. This results in a decrease of approximately $.5 million in remediation expenses to reflect removal of the remediation costs for Bellingham, but still retains remediation costs for the Sea-Tac Terminal. Ex. 801T at pg. 13 lines 7-9. However, remediation costs for the Sea-Tac Terminal should also be excluded, resulting in a $1.2 million decrease in remediation costs from Outside Services Costs.

C. Restating and Pro Forma Adjustments

72 See Section VI(A)

D. One-time Maintenance Costs

73 Tesoro has corrected errors with regard to Olympic's one-time maintenance costs. Mr. Grasso eliminated $5.615 million in one-time maintenance costs from the Outside Services category because Olympic inappropriately included them in its cost of service. Ex. 2401T at pg. 13 line 15. Olympic has improperly included this $5.6 million worth of one-time project

expenses, the bulk of which relate to a carryover of budgeted amounts not actually spent in the year 2001, on an on-going basis. Ex. 2401T at pg. 26 lines 8-11; *see also* Ex. 2305. However, one-time maintenance costs should not be included in Olympic's cost of service for recurring expenses on a continuing basis. Tr. at pg. 4974 lines 2-4. Olympic argues that the $5.6 million in major maintenance expense reflects the normal maintenance costs projected by Olympic and that this level of spending is expected to continue for some time. Ex. 801T at pg. 12 lines 15-23. Olympic has provided no support for its categorization of these projects. Tr. at pg. 4975 lines 6-15. Furthermore, Olympic has not properly demonstrated that these non-recurring expenses are actually recurring.

74 Mr. Brown explained that it is improper to include the $5.6 million in one-time expenses because future rates should not include one-time maintenance items from either the base period or the test period. Ex. 2301T at pg. 41 lines 18-19. Simply put, base period actual costs may not be adjusted upward based on a future budget for one-time expenses. Ex. 2301T at pg. 41 lines 19-21. As Mr. Brown testified, "by their very nature, one-time expenses may not be expected to recur during the future periods in which the future rates are to be collected." Ex. 2301T at pg. 41 line 21 through pg. 42 line 2.

75 Portions of the $5.6 million also should be excluded from Olympic's cost of service on other grounds. Specifically, $4.3 million of that figure is included in the Company's books as a carry-over expense. Ex. 2301T at pg. 42 lines 2-4. So the expense is both a one-time expense and an expense for an item which should have already been completed. Ex. 2301T at pg. 42 lines 4-5. In addition, the $5.6 million figure includes $455,000 for lowering pipeline over the East Creek. Ex. 2301T at pg. 42 lines 9-11. Ms. Hammer explained that this item was expensed, not capitalized, because the line itself was not changed, rather, "you just lower it." Ex. 1804 at

pg. 71 line 4. However, as Staff witness Mr. Kermode explained, this treatment does not conform with GAAP. Ex. 1801T at pg. 11 line 27. Under GAAP, a cost is capitalized when it provides a benefit exceeding a one-year operating cycle. Ex. 1801T at pg. 11 lines 27-29. Mr. Kermode correctly points out that line lowering improves the asset over its remaining life because the line is protected from further hazardous exposure. Ex. 180T at pg. 11 lines 29-30. Thus, the $5.6 million figure is improper for the additional reason that certain aspects of it, under GAAP, should have been capitalized and not expensed. For these reasons, the $5.6 million one-time maintenance expense included in Olympic's Case 2 cost of service should be excluded.

76 Furthermore, Olympic's expense figures presented in its rebuttal case are unreliable because two months are budgeted estimates and three months are simply an average derived from actual and budgeted estimates. The Company has presented no justification for using budgeted estimates, and averaged numbers derived from a combination of actual and budgeted projections. *See* Tr. at pg. 4980 lines 9-21.

E. Major Maintenance Costs

77 See Section VI(D) above.

F. Regulatory Costs

78 Olympic has included in its base period cost approximately $1 million in regulatory expenses for legal and consulting services in its direct case. Ex. 2301T pg. 43 lines 15-16. The inclusion of this $1 million dollars is improper, because the amount reflects unusual circumstances, and is not a valid estimate of future spending. Ex. 2301T at pg. 43 lines 17-18. Olympic has two rate cases as well as compliance requirements imposed by the Office of Pipeline Safety and the Department of Ecology, a level of activity that likely will not continue

far into the future. Olympic, through the testimony of Ms. Hammer, responds by arguing the rate litigation cost included in the $1 million is merely $0.440 million and that the total costs involved items such as audit fees, cost associated with additional security and safety related services, which are expected to remain at the same levels. Ex. 801T at pg. 14 lines 3-8. However, Mr. Collins adjusts the litigation costs upward from $0.4 million to $2.6 million, which is then normalized over a five year period in its rebuttal case. As a result, Olympic includes $0.5 million in its rebuttal case to reflect litigation costs. Ex. 701T at pg. 8 lines 9-13.

79 Olympic's arguments are not persuasive as there is no showing that $2.6 million in litigation costs is a prudent amount to include for ratemaking purposes. It is questionable whether it was prudent or necessary to have three different law firms involved in the presentation of Olympic's case. Tosco supports Tesoro's recommendation of amortizing the $1 million contained in its direct case over a five year period to normalize the expense. This is a reasonable and responsible allowance for regulatory costs to be paid by shippers.

G. Transitional Costs

80 Olympic has improperly included $455,000 in costs for changing operators, based on a five year amortization of $2.3 million in total transitional costs charged to Olympic by BP for becoming Olympic's new operator on July 1, 2000. Ex. 2301T at pg. 44 lines 5-8. Inclusion of this cost is improper because: 1) this expense is related to an event which occurred prior to Olympic's base period (test year) of October 1, 2000, through September 30, 2001; 2) a change from one operator to another is not related to the service provided to the shippers; and 3) the change in operators seems to have arisen as a direct result of a change in the majority ownership of Olympic. Ex. 2301T at pg. 44 lines 8-21. Tosco concurs with Tesoro's recommendation of removing the $455,000 from Outside Services Costs.

H. Fuel and Power Costs

81 Olympic has proposed to use $10.7 million in its direct case and $8.9 million in its rebuttal case for fuel and power expense. *See* Ex. 2201T pg. 27 lines 20-22; *see also* Ex. 801T pg. 5 line 21 through pg. 6 line 1. This includes the cost of both electric power and drag reducing agent. At its proposed design throughput in its original case, this is equivalent to $0.101 per barrel. Ex. 2201T pg. 27 lines 15-16. However, it should be noted that Olympic's total fuel and power expense is depressed due to the improper use of restricted throughput to set rates. Olympic used 105.9 million barrels in its direct case and 103.2 million barrels in its rebuttal case compared with Tosco's recommended 130 million barrels. Because Tosco uses a higher level of throughput, the fuel and power costs must properly reflect the increase in electricity needed as compared to Olympic's improperly depressed fuel and power figures and throughput estimate.

82 Dr. Means has no recommendation with respect to the DRA component of these costs. Dr. Means does however recommend a reduction in the cost of electric power to reduce the total fuel and power cost per barrel to $.079. Ex. 2201T at pg. 27 lines 18-20. Dr. Means' recommendation is based on Olympic's actual fuel and power costs for the last six months of 2001 (the most recent data available to Dr. Means) while Olympic based its recommendation on one month of data.[9] Ex. 2201T at pg. 28 lines 1-5. *See also* Ex. 803 at pg. 7 lines 12-13. At the design throughput Dr. Means recommends, 130 million barrels annually, this would reduce the total fuel and power costs from $10.7 million to $10.3 million. Ex. 2201T at pg. 27 lines 20-22.

[9] Olympic's rebuttal case abandons the direct testimony methodology used to estimate electricity costs and attempts to utilize the most recent 10 months of data available for electricity costs coupled with two months of estimated data. This methodology used by Olympic arrives at a per-barrel electricity cost slightly higher that Dr. Means estimate. Ex. 201T at pg. 102 lines 12-22.

At the lower design throughput proposed by Olympic, fuel and power costs would be $8.4 million. Ex. 2201T at pg. 27 lines 22-23.

I. Federal Income Taxes

83 Olympic's income tax allowance is a calculation driven in large part by the size of the equity component of the Company's capital structure and the authorized return. Accordingly, the income tax allowance will be overstated to the degree the equity portion of the return is overstated. Ex. 2401T pg. 29 lines 15-16. In its original filing, Olympic proposed using an extraordinary 82.92 percent equity component in its capital structure, despite actually having a capital structure comprised of 100 percent debt, and an ROE of 13.23 percent. Then in its rebuttal case, Olympic revised its capital structure to reflect an 86.85 percent equity component, and a ROE of 14.15 percent. Olympic included an income tax allowance of $7.4 million in its direct case and $6.9 million in its Rebuttal case. Ex. 1704. Olympic's income tax allowance should be consistent with, and driven by, the appropriate allowed return on equity, which is in turn driven by the appropriate rate base, capital structure and costs of equity. Therefore, consistent with Dr. Means' recommendations for rate base, capital structure, and cost of equity, Olympic's income tax allowance should be set at $2,333,000, based on the DOC Methodology. Ex. 2212.

84 Given that Olympic's actual capital structure is 100 percent debt, Olympic has deductible interest expenses far above what is realized under the rate case, and thus will pay significantly lower income taxes. *See* Tr. at pg. 4407 line 21 through pg. 4413 line 7. Dr. Means has recommended a capital structure that is 47.4 percent equity, instead of 86.85 percent equity. Simply adjusting the equity portion of the capital structure down to 47.4 percent and using an authorized return of 13 percent, lowers Olympic's income tax expense from $6.9 million to $2.3

million. The nearly $4.6 million difference would be a windfall profit to Olympic, as the added tax expense is not actual, but instead are phantom taxes that are assumed to be paid for ratemaking purposes, but in reality would never be paid. The windfall associated with phantom taxes is yet another reason to reject Olympic's aggressive position on capital structure and ROE, and instead adopt Dr. Means' recommendations.

J. Other – Improper Inclusion of Sea-Tac Remediation Costs in Outside Services

85 See Section VI(B)

VII. RATE BASE

A. Rate Base Methodology

86 See Section IV

B. Starting Rate Base (calculation)

87 Starting rate base is linked to the federal TOC methodology and has no place in this proceeding where the traditional Washington methodology for setting rates for public service companies should be utilized. However, Tosco reserves the right to address arguments made by other parties in its Answering Brief.

C. Deferred Return (calculation)

88 Olympic has improperly included amortization of deferred return in its cost of service. This is not properly included in a DOC methodology filing because there is no deferral of any return from the past. Furthermore, even if it was part of a DOC filing, Olympic did not actually defer any of the underlying return, nor is there any accounting order issued by the WUTC that permits Olympic to defer any portion of its return. Ex. 1901T at pg. 19 lines 21 through pg. 20

line 4. Without an accounting order, the Company is not legally entitled to defer any portions of its return. Id.

89 Consistent with WUTC Staff's recommendations, the Commission should remove the $848,000 of amortized deferred return from Olympic's calculation of revenue requirement, in addition to other adjustments, to comport with the traditional Washington ratemaking methodology. This $848,000 is the amount Olympic used to calculate the total cost of service per Exhibit 819, Schedule 1, line 6. This is the amortization of net deferred return included in the FERC rate base. However, this amortized deferred return is not an operating expense or tax that is necessary to provide service, nor is it a return on the investment used to provide the regulated service. Ex. 1901T at pg. 18 lines 20-22. Therefore, as WUTC Staff has recommended, this item should be removed from Olympic's cost of service.

D. Bayview

90 The controversy surrounding Bayview is simple to resolve: either it is included in rate base and its potential throughput is included to set rates, or it is excluded from rate base and no volume is added for its potential throughput. Tosco advocates including Bayview in Olympic's results of operations and including the added throughput made possible by Bayview's existence. Olympic's proposal of including Bayview in results of operations, without the resulting throughput, is untenable.

91 In 1998, Olympic projected that the Bayview Terminal would allow an increase in throughput by 35,000 to 40,000 barrels per day. Ex. 2201T at pg. 29 line 5-7. This significant increase in throughput justified the substantial investment in the Bayview facility. However, the Bayview Terminal is now in limited operation and is not currently being used for its intended

purpose. Olympic claims that Bayview is useful in the provision of the pipeline services in the test year for testing, for emergency pressure relief for storage and as a major staging area for work done during the test year. Ex. 1601T at pg. 11 lines 8-14. This limited use does not justify the substantial $24 million investment in facilities without the proposed increase in throughput.

92 Olympic's current throughput presumably includes whatever impact Bayview's limited operation may have. Ex. 2201T at pg. 29 lines 13-15. However, Bayview was not in operation in 1998; thus Olympic's 1998 throughput is a volume it can achieve without the terminal. Ex. 2201T at pg. 29 lines 15-18. It follows that the additional throughput permitted by the Bayview Terminal should be added to Olympic's 1998 volume. Thus, Olympic's permanent rates should be based on a design throughput volume of 130 million barrels per year. As Dr. Means explains, this represents Olympic's 1998 throughput as increased by the projected full operation of the Bayview Terminal. Ex. 2201T at pg. 29 lines 15-18. Arguments that Bayview only adds 37,500 million barrels per day in capacity to the pipeline, and not necessarily throughput, ignores the fact that Olympic is over nominated, meaning that there is more demand than available capacity. It is likely that this added capacity will be utilized. Finally, Olympic represented to the FERC and the WUTC that Bayview would increase capacity by between 35,000-40,000 barrels per day in order to justify the investment. If Olympic believed that the capacity would not be used, then the representation was misleading.

93 If the Commission does not adopt Dr. Means' approach, Staff's proposal of removing Bayview-related test year expenses and rate base amounts from results of operations should be adopted. Ex. 2001T at pg. 33 lines 8-9. However, Staff has recommended that Olympic should accrue Allowance for Funds Used During Construction ("AFUDC") on its net investment in Bayview until the facility becomes used and useful for providing pipeline service. Ex. 2001T at

pg. 33 lines 9-11. Olympic, on the other hand, seeks to have it both ways by including Bayview in results of operations without the added throughput. The Company's proposal should be rejected outright.

E. Average v. End-of-Period

94 Staff has proposed to use the end of period rate base level, despite clear precedent in favor of using average rate base. Ex. 1901T at pg. 44 lines 13-18. Staff "strongly supports the Average Monthly Average ("AMA") method of calculating rate base unless extenuating circumstances exist." Ex. 1901T at pg. 44 lines 9-10. Staff has determined that Olympic's current situation warrants extraordinary measures. Staff argues that using end of period rate base is appropriate because: 1) There is abnormal growth in plant; 2) End of period rate base is a means to mitigate regulatory lag; and 3) Olympic has failed to earn its authorized rate of return since the Whatcom Creek explosion. Ex. 1901T at pg. 44 line 13 through pg. 45 line 14. Tosco supports Staff's recommendation that the end of period be used in this case as a means of mitigating regulatory lag and the need for Olympic to file another rate case, so long as the test period ends no later than December 31, 2001. Tosco supports the WUTC Staff position because it is a proper response to the need to minimize regulatory lag as Olympic makes the needed safety improvements. In contrast to the overreaching found in Olympic's request to use a test period that includes budgeted estimates and averages derived from budgeted and unaudited actuals, using end of period rate base is an extraordinary, yet well-founded response to the facts presented by Olympic.

F. CWIP

95 Tosco will not address CWIP in its Opening Brief. However, Tosco reserves the right to address arguments raised by other parties in its Answering Brief.

G. AFUDC

96 Olympic has improperly calculated the amortization of AFUDC included in operating expenses and the amount of AFUDC included in rate base. The inclusion of AFUDC in a company's cost of service allows it to earn a return of investment while it builds a facility that will be used and useful. Ex. 1901T at pg. 23 lines 20-22. Staff witness Mr. Twitchell explains that Olympic's calculation of AFUDC is incorrect because Olympic uses the risk related equity rate of return and capital structure of BP and the cost of equity is assumed to be the same as the cost of equity the Company is proposing for use for the test period in this case. Ex. 1901T at pg. 23 line 22 through pg. 24 line 2. This miscalculation improperly increases Olympic's revenue requirement. Mr. Twitchell explains that the resulting AFUDC included as an expense and in rate base is overstated. Ex. 1901T at pg. 24 lines 26-27. This causes a mismatching of revenues, expenses, taxes and rate base inconsistent with generally accepted accounting principals. Ex. 1901T at pg. 24 line 27 through pg. 25 line 1. Mr. Twitchell correctly notes that this shifts risk away from the Company and places it squarely on ratepayers. Mr. Twitchell reduces the amortization of AFUDC included in operating expenses from $204,000 to $79,399. Ex. 1902 line 22. He also reduces the AFUDC included in rate base from $8,802,500 to $5,062,309. Ex. 1902 line 29. Tosco supports Staff's recommendation regarding AFUDC.

VIII. CAPITAL STRUCTURE

A. Actual Capital Structure

97 Olympic's business strategy has systematically drained equity away from Olympic in favor of its parent owners. Between 1990 and 1997, Olympic's equity ratio ranged between 11.06 percent and 16.09 percent, while during the same time period Olympic paid out $51.6 million in dividends to its parent owners. Ex. 401T at pg. 3 lines 18-20. Mr. Hanley estimates

that without payment of these dividends Olympic would have maintained an equity ratio between 31.87 percent and 64.98 percent. Ex. 401T at pg. 4 lines 3-6. Olympic's actual capital structure consisted of far too much debt to provide any measure of safety against unexpected events. As a result of the Whatcom Creek accident, the equity component of Olympic's capital structure is now negative, with its obligations exceeding the net book value of its assets. Ex. 2201T at pg. 19 lines 7-10.

98 Despite its actual capital structure, Olympic proposes using a capital structure consisting of 86.85 percent equity and 13.15 percent debt for purposes of setting rates. Ex. 701T at pg. 8 lines 19-20. Incredibly, the equity position has been revised upward from Olympic's Direct case, which proposed a capital structure comprised of 82.92 percent equity. Ex. 201T at pg. 92 lines 4-6.

99 Olympic should be required to bear the consequences of its past decisions on financing and dividends. It should not be allowed a higher return on equity because of the financial risk caused by those decisions. It also should not be allowed to burden its cost of service with a capital structure that assumes its owners have been willing to maintain a large equity stake in the company.

B. Hypothetical Capital Structure

i. Historical Capital Structure

100 See Section VIII(A)

ii. Use of Parents Capital Structure (excluding FERC rationale)

101 The Commission should adopt a hypothetical capital structure based on the median capital structure of the oil pipeline proxy group. Ex. 2201T at pg. 2 lines 15-16. As discussed

above, Olympic's actual capital structure is 100 percent debt. Use of Olympic's corporate parents' capital structure is not justified because: 1) it is far too costly for ratepayers; 2) the corporate parents are riskier operations; 3) the parent's actual capital structure is not the result of actual market signals; and 4) use of an exceedingly high equity ratio would create a windfall for Olympic to the detriment of its shippers.

102 Given the link between Olympic's financial difficulty and its parents failure to provide a larger share of their investment in the form of equity, it would be appropriate to use Olympic's actual capital structure comprised of 100 percent debt for purposes of setting rates. Ex. 2201T at pg. 21 lines 7-10. Use of Olympic's cost of debt, provided in its Rebuttal case, of 5.26 percent, would drastically reduce Olympic's cost of service. However, Tosco takes a reasonable and conventional approach of recommending a hypothetical capital structure based on the capital structure of the oil pipeline proxy group. Ex. 2201T at pg. 21 lines 10-13. As explained by Dr. Means, the Commission should consider the Company in this proceeding, not as if it were a subsidiary of two large corporate parents, rather like a stand-alone company, out in the market trying to attract capital. Tr. at pg. 3676 lines 8-14. The Commission should then determine a reasonable capital structure for a company in that position by deriving a specific, non-arbitrary capital structure from an identifiable source, which neither favors the Company nor the shippers. Tr. at pg. 3676 lines 15-21. That is precisely the role that the oil pipeline proxy group plays for ratemaking purposes. It is upon this basis that Tosco recommends the Company's capital structure be set consisting of 47.4 percent equity and 52.6 percent debt. Ex. 2201T at pg. 21 lines 13-15. The proxy group is illustrated below:

Exhibit No. 2205 (RCM-5)

Capital Structure of Proxy Group Companies

Company	Debt Percentage*
Kaneb Pipe Line	54.47%
TEPPCO Partners	52.96%
Enbridge Energy	52.62%
Buckeye Partners	51.38%
Kinder Morgan Energy Partners	41.40%
Median	52.62%

*From company 10-K and annual reports

103 Olympic has included in its cost of service calculation the weighted average capital structure of its corporate parents of 86.85 percent equity and 13.15 percent debt. Ex. 201T at pg. 6 lines 9-10. Olympic's proposal of 86.85 percent equity and 13.15 percent debt is untenable for several reasons. Stating the obvious, this equity-rich recommendation is drastically different than Olympic's actual capital structure. Olympic has a negative equity ratio. Ex. 2201T at pg. 19 lines 7-10. The Commission should reject Olympic's capital structure and use the hypothetical capital structure proposed by Dr. Means.

104 In determining the appropriate capital structure for setting rates, the Commission must strike the appropriate balance between economy on the one hand and financial safety on the other. *See*, *e.g.*, WUTC v. Washington Natural Gas Company, WUTC Cause No. U-80-111, 44 P.U.R. 4th 435, (September 24, 1981). In doing so, the Commission need not use the actual capital structure if it fails to meet the criteria mentioned. Id. The Commission should recognize Olympic's corporate parents have the ability to set the Company's capital structure at whatever level best fits with its larger corporate objectives, rather than balancing both business and

ratepayer interests. The Commission should not reward the Company for its previous business strategy by setting an exceedingly high and expensive equity ratio.

105 Olympic's proposal ignores the significantly different business risks faced by Olympic's corporate parents and Olympic, a fact critical to this analysis. Ex. 2201T at pg. 19 lines 15-21. Olympic's corporate parents are subject to the fluctuations of world oil markets and greater business risks than Olympic. Ex. 2201T at pg. 19 lines 15-21. Although Olympic's rates have increased from 1982 to1998, the trend in Olympic's throughput has been steadily upwards, with only minor fluctuations around the upward trend. Ex. 2201T at pg. 19 lines 16-18. Thus, Olympic's results of operations do not represent a company that faces significant business risk. Olympic's so-called risk is further debunked by the fact that Olympic has requested an enormous rate increase, an action not illustrative of a business that faces significant market risk.

106 Perhaps in desperation, Olympic also argues that it faces materially different risks than the companies in the pipeline proxy group, and hence the median capital structure of the group is an inappropriate source from which to derive a hypothetical capital structure. Ex. 201T at pg. 95 line 13 through pg. 96 line 4; Ex. 223 at pg. 54 lines 992-994. However, Olympic has offered insufficient evidence to suggest that it faces substantially greater risk than the companies in the oil pipeline proxy group. In fact, Olympic's vertical integration gives it a layer of protection that the proxy group lacks. Tr. at pg. 2503 lines 8-19.

107 Deriving Olympic's capital structure from its parents' capital structure is also inappropriate because the parents' capital structures are not the result of actual market signals. Tr. at pg. 2536 lines 20-21. The Company represents its parents' capital structure based on book equity. Tr. at pg. 2536 lines 21-23. Such measurement relies merely on accounting entries that

have occurred over time as a result of mergers, acquisitions, and the capitalization of goodwill. The resulting capital structure has nothing to do with the relative risk of the companies involved in those transactions.[10] Thus, Olympic has mischaracterized the capital structure of its parents by comparing book equity ratios with debt in order to conclude that market forces have created or perfected the ratios. Olympic inappropriately relies on such market perfection in its argument that using the parents' capital structure is appropriate in this proceeding. Ex. 223 at pg. 54 lines 986-991.

108 Finally, the proposed capital structure is too costly to ratepayers. In determining capital structure, the Commission must strike an appropriate balance between economy and financial security. WUTC v. Pacific Power and Light Company, WUTC Cause No. U-84-65, Fourth Supplemental Order, 62 PUR 4th 557 (August 2, 1985); *see also* WUTC v. Puget Sound Power and Light Company, WUTC Cause No. U-83-54, Fourth Supplemental Order, 62 PUR 4th 557, (September 28, 1984); WUTC v. Washington Natural Gas Company, WUTC Docket No. UG-920840, Fourth Supplemental Order (September 27, 1993). The economy and efficiency of lower capital costs resulting from an increased debt ratio must be balanced against the financial security of the capital structure in the sense that the Company has no legal obligation to pay a return to the holders of its common stock: these shareholders provide "safe" capital but demand a higher return for providing that safety. In this instance, Olympic's proposed equity ratio of 86 percent is too "safe" and, consequently, too expensive. Approximately $13.9 million dollars of Olympic's requested revenue increase is tied to the difference between the Company's actual

[10] Dr. Wilson offered a compelling example of this phenomenon in his cross-examination. Tr. at pg. 2537 line 6-21. To paraphrase, if two companies, each worth $1 billion, merged as equals, the newly formed company may emerge from the transaction with $2 billion in equity. In contrast, if one of the companies acquired the other at a typical market book ratio of, two to one, the result would be $1 billion or $2 billion worth of goodwill that leads to an equity ratio of one third or one quarter.

capital structure and the imputed capital structure put forth by Olympic in this proceeding. Tr. at pg. 2426 lines 10-14. Perhaps acknowledging that Olympic's parents' capital structure is too high for a company with 100 percent debt, Dr. Schink states in his rebuttal case, that at a minimum, Olympic's capital structure for ratemaking purposes should be 60 percent equity, without any rationale for choosing this number as a minimum. Ex. 201T at pg. 7 line 10.

IX. RATE OF RETURN

A. Cost of Debt

109 The Company calculates the cost of debt in its rebuttal case, based on its parents' embedded cost of debt, 5.26 percent. Ex. 201T at pg. 89 lines 17-18. The Company explains that this is the approach that the FERC takes when "a regulated entity does not issue its own debt or when the regulated entity's debt is guaranteed by its parents." Ex. 201T at pg. 89 lines 18-20. Based on this approach, Olympic's updated proposal for the cost of debt in this case is 5.26 percent, which weighs each of the individual parents' cost of debt by their ownership share. Ex. 201T at pg. 90 lines 9-11. Tosco does not take issue with Olympic's recommendations on cost of debt, but reserves the right to address arguments made by other parties in its reply brief.

B. Return on Equity

i. General Principles

110 The Hope case suggests basic standards for determining the appropriate return on equity for a regulated entity. FPC v. Hope Natural Gas, 320 U.S. 591 (1944). In general terms, the rate of return on common equity should be "commensurate with returns on investments in other enterprises having corresponding risks" and should be "sufficient to ensure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital." Hope Natural Gas, 320 U.S. at 603. In accord with this standard, Dr. Schink utilizes the discounted cash flow

("DCF") methodology applied to the oil pipeline proxy group, which has been applied by the FERC. SFPP LP, 86 FERC ¶61,022 at ¶61,098-102 (1999). The range of results from this exercise establishes a zone of reasonableness for the cost of common equity capital for a given pipeline. Id. For an oil pipeline facing normal risk, the allowed ROE should be the median cost of equity for the proxy group. Id. The FERC has defined a broad normal risk zone and requires evidence of a substantial deviation from normal risk to warrant use of an ROE above or below that median point, commensurate with its risk under the FERC methodology. A pipeline facing above average risk should be assigned an ROE between the median value and the upper end of the zone of reasonableness. Id.

ii. Analysis, Including Review of Testimony if Desired

111 Tosco urges the Commission to adopt an ROE equal to the median value of the oil pipeline proxy group and reject a risk premium adder. In Dr. Schink's direct testimony, Olympic advocates the use of the FERC-based DCF methodology for estimating the cost of common equity capital for Olympic. Ex. 223 at pg. 1 lines 8-10. In real terms, his analysis results in an ROE for Olympic of 11.18 percent. Ex. 223 at pg. 1 line 11. That is, 11.18 percent is the median value of the range of real cost of common equity capital estimates for the proxy group contemplated by the DCF methodology. He also urges the Commission to take into account the higher-than-average risk that the Company supposedly faces by using a risk premium adder of .75 percent. Ex. 223 at pg. 1 line 15. This increases his initial proposal to an ROE of 11.93 percent. Ex. 223 at pg. 2 line 15.

112 Dr. Schink's analysis does not stop there, however. Without citing precedent from this Commission (or the FERC for that matter), Dr. Schink continues to modify the FERC methodology in this area in order to, in his words, "improve its accuracy and reliability." Ex.

223 at pg. 2 line 18. He argues that the method to determine the period-one dividend payments for each specific proxy group company should be corrected, and further that the mean, not the median, ROE for the oil pipeline proxy group is more representative of an average ROE for a pipeline. Ex. 223 at pg. 2 lines 17-24. Not surprisingly, the result of these two modifications increases his proposed ROE for Olympic to 12.48 percent in real terms, or 13.23 percent with a risk premium adder. Ex. 223 at pg. 2 lines 29-33.

113 As has been the norm for Olympic in this case, Dr. Schink presents an entirely different analysis in his rebuttal testimony. Dr. Schink changes his recommendation to the Commission from 12.48 to 13.20 percent ROE in real terms. Ex. 201T at pg. 3 lines 15-20. He further increases his suggested risk premium adder from .75 percent to .95 percent, based on the previously unconsidered factor of the purported risk of financial failure (as opposed to competitive risk) of Olympic. Ex. 201T at pg. 4 line 3. The ultimate result of Olympic's rebuttal presentation is an ROE of 14.15 percent. Ex. 201T at pg. 4 line 7.

114 On behalf of Tosco, Dr. Means accepts the analysis conducted by Dr. Schink up to a point, but recommends the Commission reject Olympic's inappropriate use of the mean ROE and its unjustified risk premium adder. For the reasons that follow, the Commission should adopt an ROE for Olympic of 13 percent, which is equal to the median value of the ROE's for the oil pipeline proxy group, exclusive of any risk premium adder.

1. The Median Cost of Equity is More Representative Than the Mean In This Case

115 The Commission should reject Olympic's recommendation to use the mean cost of equity for the proxy group. The Company argues that the mean is the best single measure of central tendency of the proxy group, which is contingent on the conclusion that there are no "outliers" in

the values and that there is not a strong skew in the distribution of the ROEs for the proxy group companies. Ex. 223 at pg. 35 line 690 through pg. 36 line 696. Dr. Schink's analysis is not persuasive.

116 First, there are indeed outliers in the proxy group ROE values. If the ROE values were symmetrically distributed about the median, the choice between median and mean would have no impact. In this case, however, the use of the mean increases the cost of equity by more than one percent. Ex. 2201T at pg. 9 line 17 through pg. 10 line 2. Specifically, the use of the mean to determine the cost of equity for the proxy group would be heavily influenced by the 17.94 percent cost of equity for Kinder Morgan. Ex. 2201T at pg. 10 lines 18-20. The Kinder Morgan cost of equity of 17.94 percent is 2.14 basis points above the next-higher value and 4.53 points above the median. In contrast, the lowest cost of equity calculated by Dr. Schink is only .50 percent below the second-lowest and only .70 percent below the median. Therefore, the numbers are represented at a higher frequency in the lower range of the proxy group, yet Dr. Schink's application of the mean pushes the numbers toward the outlier at the high end of the proxy group. Use of the median value eliminates the outlier problem because, by definition, it is the value above and below which there are an equal number of values, regardless of what those values are.[11]

117 Furthermore, that Kinder Morgan ROE is an "outlier" is buttressed by the fact that Kinder Morgan, by a wide margin, has the lowest debt ratio of the five proxy companies. Ex. 2205. This suggests that it should face the smallest financial risk. However, the market

[11] Recently in Northwest Pipeline Corp., FERC reaffirmed the use of the median ROE of the proxy group over the mean. The FERC found that the median "best represents central tendency in a skewed distribution over the mean because the latter is drawn in the direction of the skew more than the median." Northwest Pipeline Corp., 99 FERC ¶61,305 at 12 (2002). By relying on the median, the FERC was able to diminish the impact of a single proxy group company whose ROE was atypically high. The FERC found the use of the median provided consistency in the treatment of pipelines and was the most appropriate method to determine a just and reasonable rate.

apparently evaluates it as facing a much higher business risk than the other companies. Ex. 2201T at pg. 11 lines 6-7. Whether or not the higher risk qualifies Kinder Morgan as an outlier in some technical sense, it points out the advantage of beginning the analysis with the median value rather than the mean. Ex. 2201T at pg. 11 lines 7-9.

2. Olympic's Use of the Risk Premium Adder Is Unjustified

a. Competition

118 As suggested by the general principles articulated above, central to determining the proper ROE for Olympic is an analysis of the competitive risks that the Company faces. Olympic argues that it faces significant competitive risk from barge and tanker transportation of petroleum products. Ex. 223 at pg. 7 line 121 through pg. 8 line 139. In the evidentiary hearing however, Mr. Peck contradicted this assertion. Tr. at pg. 2785 line 24 through pg. 2786 line 18. In rebuttal, the Company argues that its financial risk is an additional factor that justifies, among other things, such a high ROE. Ex. 201T at pg. 4 lines 1-3. As a result of these risks, Olympic ultimately claims it is entitled to a .95 basis point risk premium adder. Ex. 201T at pg. 4 lines 1-2. These considerations are inappropriate.

119 First, because transportation cost is a minimal fraction of refined product prices, the trends and relationships in product prices cited by Dr. Schink provide no reliable evidence regarding the competitiveness of alternative transportation costs in the Portland and Seattle markets. Ex. 2201T pg. 12 line 1 through pg. 17 line 6. Furthermore, Olympic would need to establish that cost of waterborne carriage was close to cost of transportation on Olympic, and that there were no constraints that would prevent future substantial expansion in volume carried by waterborne transport. Ex. 2201T at pg. 16 line 21 through pg. 17 line 4. However, Olympic has

failed to examine the cost of waterborne carriage to see if it offers a competitive advantage. Ex. 2201T at pg. 17 lines 4-6. Rather, Olympic has only examined and compared the cost of finished product prices in various markets. Ex. 223 at pgs. 10-13. The cost of transportation is dispositive here, not the cost of the product on the market. Thus, Dr. Schink's evidence fails to show that waterborne transportation costs are competitive and Olympic's own witness contradicts this assertion. Tr. at 2785 line 24 through pg. 2786 line 18.

120 Dr. Schink claims that it should be presumed that waterborne transportation costs are an effective competitor for Olympic because Tesoro and Tosco refused to provide the cost of such services in data requests made by Olympic. Ex. 201T at pg. 5 lines 8-12. However, it should be noted that Olympic's parent company British Petroleum receives shipments from waterborne transportation but also failed to provide this information. Tr. at pg. 2465 lines 21-24. Commissioner Hemstad even noted that he found it "remarkable that the parents of [Olympic] declined to provide this information." Tr. at pg. 2465 lines 19-20. One could equally presume that BP failed to disclose this information because it reveals that waterborne transportation costs are not competitive with Olympic's costs.[12]

121 Perhaps the best evidence that Olympic faces insignificant competitive risks is its ability to demand a 59 percent rate increase without fear of losing customers to more "cost-effective" transportation alternatives. In deciding to submit this request, Olympic did not consider whether waterborne carriers had also raised their rates or might do so in the near future. The Company only considered its own device for more revenue. Ex. 2208. Thus, Olympic's own behavior suggests that it does not consider waterborne transportation to be a significant competitor.

[12] Commissioner Hemstad makes the very same inference in his cross examination of Dr. Schink. Tr. at pg. 2466 lines 4-9.

b. Risk of Financial Failure

122 Consideration of Olympic's financial risk is inappropriate because the risks that Olympic faces financially are the result of its owners' business strategy. In the Transco case cited by Dr. Schink, the FERC specifically articulated that, in considering ROE, it would "focus on the risks faced by the pipeline that are attributable to circumstances outside the control of the pipeline's management, such as factors specific to the pipeline's markets, which would include the degree and effectiveness of competition in the market." Transcontinental Pipe Line Co., 84 FERC ¶61,084 at ¶61,427 (1998). Thus, financial risk caused by Olympic's parent companies' decision to systematically drain the equity from Olympic is an improper consideration because it is not a circumstance "outside the control of the pipeline's management." Id.

123 Considering that standard, Dr. Means agrees with Dr. Schink's analysis of financial risk up to a certain point. Dr. Means is willing to grant that financial risk can affect the cost of raising money. Tr. at pg. 3663 lines 16-18. He even grants that Olympic faces some financial risk and, save the actions of its "indulgent" corporate parents, would likely be in bankruptcy. Tr. at pg. 3663 lines 22-25. However, Dr. Means believes that one of the main factors contributing to Olympic's financial risk is its actual capital structure. Tr. at pg. 3664 lines 13-14. Olympic's corporate parents have drained the equity from Olympic. As Dr. Means explained, "if that choice leads to a financial risk, because the company is very thinly capitalized, then that financial risk is not something that should be taken into account in determining the return on equity that should be allowed the company in this proceeding." Tr. at pg. 3664 line 22 through pg. 3665 line 2. That is not to suggest that the choices made by Olympic and its corporate parents are improper, only that the consequences of those choices should be placed with the Company, not the Company's customers.

C. Overall Cost of Capital

124 Based on Dr. Means' recommended changes to Olympic's direct case, Olympic's overall cost of capital should be set at 9.34 percent. However, due to changes in Olympic's rebuttal presentation, Dr. Means' adjusted the overall cost of capital to 9.79 percent.

X. REVENUES

A. Test Year Revenues

125 See Section XI

B. Throughput

i. Role of Throughput in Determining Revenues

126 The determination of the proper level of throughput for Olympic is extremely important to the final determination of just and reasonable rates, and recommendations vary widely. Once a revenue requirement is determined, final rates are determined by dividing the assumed throughput. If throughput is set, and volumes exceed the level expected, the Company will over earn, and the burden to challenge rates would be foisted upon Olympic's customers and Staff in a complaint proceeding. Conversely, if throughput is set too high, and volumes do not materialize, the Company will under earn and another rate case is likely. As discussed below, Dr. Means has recommended a reasonable solution for this issue by using a throughput of 130 million barrels per year, with an adjustment mechanism, that compensates the Company for the current lower throughput caused by operating pressure restrictions, while giving the Company an incentive to return to normal operating pressure.

ii. Calculation of Appropriate Throughput for Ratemaking Purposes

127 Olympic's permanent rates should be based on a design throughput volume of 130 million barrels per year combined with Dr. Means' proposed adjustment mechanism. Throughput recommendations vary drastically in this proceeding. Staff recommends a design throughput of approximately 108.3 million barrels per year, while Tesoro recommends a design throughput of approximately 121.3 million barrels. Olympic originally proposed to use a design throughput of 105.9 million barrels, but through their rebuttal case, improperly proposed 103.2 million barrels, without support for this downward revision. In fact, Tosco demonstrated that Olympic's own data does not support a reduction in Olympic's proposed throughput. Tr. at pg. 3423 line 6 through pg. 3427 line 6. Ms. Hammer admitted that Olympic's *actual* volume has been in line with Olympic's original test year forecast of 105.9 million barrels, thus there was no need to reduce this forecast in Olympic's rebuttal case. Tr. at pg. 3423 line 6 through pg. 3427 line 6; s*ee also* Ex. 864 (demonstrating that for the seven months from November 2001 through May 2002, actual Olympic volume has been above Olympic's test period forecast). Dr. Means' proposal of using a design throughput of 130 million barrels per year, in conjunction with his proposed surcharge mechanism, is a reasonable and responsible solution to the throughput issue and the dramatic effect it has on the rates ultimately paid for shipping product on Olympic's pipeline.

128 As Dr. Means explains, a design throughput of 130 million barrels represents Olympic's 1998 throughput as increased by the projected full operation of the Bayview Terminal. Ex. 2201T at pg. 28 line 24 through pg. 29 line 4. Olympic achieved a throughput volume of 116.3 million barrels in 1998, which is the most recent year of normal operations prior to the Whatcom

Creek accident. Ex. 2201T at pg. 29 lines 5-6. The actual level of 1998 volume should reflect the effects of any typical shutdowns or seasonal variations. Ex. 2201T at pg. 30 lines 1-5.

129 In 1998, Olympic also projected that the Bayview Terminal would allow an increase in capacity by 35,000 to 40,000 barrels per day. Dr. Means used the mid-point of that range for his throughput value estimate, or 37,500 barrels per day, which is equivalent of 13.7 million barrels per year. Adding this increase to Olympic's 1998 throughput results in an annual throughput volume of 130 million barrels. Ex. 2201T at pg. 29 lines 7-10.

130 Olympic argues that Bayview only adds 37,500 million barrels per day in *capacity* to the pipeline, and not necessarily *throughput*. This argument ignores the fact that Olympic is over nominated, meaning that there is more demand than available capacity. It is likely that this added capacity will be utilized. Furthermore, Olympic represented to the FERC and the WUTC that Bayview would increase capacity by between 35,000 to 40,000 barrels per day, to justify the $24 million investment. If Olympic believed that the capacity would not be used, then the representation was misleading.

iii. Adjustment Mechanism Based on Throughput

131 Dr. Means has put forth a reasonable and responsible recommendation for the difficult problem of setting the proper throughput for determination of Olympic's permanent rates. In order to allow Olympic to recover its cost of service during the period in which throughput volume is temporarily constrained by pressure restrictions, Dr. Means recommends the use of a temporary five-year surcharge in conjunction with his proposed design throughput of 130 million barrels per year. Ex. 2201T at pg. 28 line 6 through pg. 38 line 9. Dr. Means' mechanism is preferable to other proposed mechanisms because it would provide an incentive for Olympic to

return to full operating pressure, while also entitling Olympic to recover part of the revenue shortfall resulting from the current restriction on its maximum operating pressure. Ex. 2201T at pg. 28 lines 14-17. Other proposed mechanisms merely track the changes in throughput and fail to provide an incentive. Dr. Means' surcharge would be based on a prediction of when the operating pressure will be lifted and the throughput that Olympic will then be able to achieve. Ex. 2201T at pg. 31 lines 18-19. If the restriction is lifted sooner, Olympic can keep all of the additional revenue; if it fails to have the restriction lifted by the predicted date, it bears all of the resulting loss. Ex. 2201T at pg. 31 lines 20-22.

132 In its rebuttal case, Olympic proposes throughput be set at 103.2 million barrels for ratemaking purposes, improperly reduced from Olympic's prior recommendation of 105.9 million barrels. *See* Section X(B)(ii). Olympic argues such throughput is reasonable because "all that is known and measurable with reasonable certainty today is Olympic's throughput capability at 80 % operating pressure. Further, this throughput capacity is best measured by the actual throughput at 80 % operating pressure." Ex. 201T at pg. 108 lines 12-15. Olympic's proposed throughput is not appropriate for rate setting purposes, and would result in a windfall to Olympic when additional volumes materialize. In other words, if Olympic's rates were determined on the basis of the throughput that it can achieve while subject to the operating pressure restriction, those rates would become excessive when the restriction was lifted. Ex. 2201T at pg. 30 lines 13-15. Conversely, if its rates were determined solely on the basis of the throughput it will be able to achieve when operating at full pressure, it would not have reasonable opportunity to recover its costs. Ex. 2201T at pg. 30 lines 15-18.

133 Olympic claims that Dr. Means' recommendation assumes that restoring Olympic to 100 percent operating pressure is completely under Olympic's control. Ex. 201T at pg. 110 lines 12-

14. However, Dr. Means testified that the "incentive is particularly important where the event – restoring the pipeline to full operating pressure – is one over which the pipeline is able to exercise *some degree of control*." Ex. 2201T at pg. 32 lines 19-21 (emphasis added). Olympic does exercise some control over its own destiny and should be both held accountable and encouraged to exercise that control in restoring the pipeline to full operating pressure. Olympic admits that it is in the Company's interest to restore operating pressure as soon as possible. Ex. 201T at pg. 110 lines 16-18.

134 Dr. Means' surcharge mechanisms rests on Olympic's *own* prediction of when full pressure will be achieved. Ex. 2201T at pg. 36 lines 7-12; *see also* Ex. 2210. The surcharge mechanism would be determined in two steps. The first step would determine the gross revenue shortfall, that is, the difference between Olympic's revenue at full operating pressure and its revenue subject to the operating pressure restriction:

Gross shortfall = (Permanent design throughput – intervening throughput)

x Permanent rate

135 However, not all the gross shortfall is a financial loss to Olympic. A lower throughput brings lower revenues, but it also lowers costs. The second step therefore would be to determine the net revenue shortfall:

Net shortfall = (Gross shortfall – reduction in fuel and power costs)

Ex. 2201T at pg. 37 lines 9-20.

XI. CALCULATION OF REVENUE DEFICIENCY OR SURPLUS

136 Tosco has not advanced a total cost of service for Olympic, but has made reasonable and responsible recommendations to Olympic's case. The impact of Dr. Means' proposed

adjustments is illustrated below, with the first column representing the impacts based on the TOC methodology, and the second column representing his impacts based on the DOC methodology. However, Dr. Means' adjustments should be combined with other recommendations proposed by Commission Staff and Tesoro. Thus, Tosco is providing the Commission with the following table as a substitute for providing a complete revenue deficiency or surplus calculation.

Tosco's Oral Rebuttal Exhibit No. 2212:

IMPACT OF MEANS' RECOMMENDATIONS*			
	($000's) Exhibit BAC-8C (Trended Original Cost) with Recommendations	**Exhibit BAC-11C (Original Cost) with Recommendations**	**Difference**
Permanent Rate			
Cost of Equity (real)	13.00%	13.00%	Unchanged
Allowed Return on Equity	$6,277	$4,282	-$1,995
Cost of Debt	5.26%	5.26%	Unchanged
Allowed Return on Debt	$1,803	$1,727	-$76
Income Tax	$3,706	$2,333	-$1,373
Fuel & Power (including DRA)**	$10,284	$10,284	Unchanged
Other Operating Expenses	$24,560	$24,560	Unchanged
Depreciation	$2,798	$2,798	Unchanged
Amortization of AFUDC	$203	$203	Unchanged
Amortization of deferred return	$628	$0	-$628
Total Cost of Service ***	$50,259	$46,187	-$4,072
Design Throughput (thousand bbl)	129,953	129,953	Unchanged
Cost per barrel at Design Throughput	$0.3867	$0.3554	-$0.0313
Olympic Recommended Throughput (thousand bbl)	103,165	103,165	Unchanged
Cost per barrel at Olympic Throughput	$0.4872	$0.4477	-$0.0395
*Assumes no other changes in Olympic's filing.			
**Fuel and power cost assumes recommended design throughput.			
***Does not include revenue shortfall to be recovered through surcharge.			

XII. REFUNDS

137 Olympic's interim rates, set at 24.3 percent, far exceed a proper just and reasonable permanent rate. Merely taking into account Dr. Means' proposed recommendations to set permanent rates, result in a rate increase of 2 percent, and with his proposed adjustment mechanism, result in a rate increase of 10 percent. Tr. at pg. 3681 lines 11-22. Dr. Means' adjustments should be combined with additional adjustments proposed by Commission Staff and Tesoro.

138 Olympic's customers are entitled to a refund to the extent that the Commission determines Olympic's permanent rates should be set at a level below that granted in the Interim proceeding. The Commission's obligation to grant such refund is clear in Washington statute, case law and this Commission's past practices.

139 First, Washington courts have been clear that the Commission is vested with the authority to direct payment of refunds when charges are found to be excessive. *See, e.g.*, State ex rel. Puget Sound Navigation v. Dept. of Transportation, 206 P.2d 456, 483 (1949). To establish a foundation for a proper refund, the permanent rates are used as an indication of what is fair, reasonable and sufficient. For example, in WUTC v. Puget Sound Energy, the Commission noted that as the "investigation of a company's proposed permanent rate proceeds in a case where a temporary rate is established subject to a refund condition, the Commission simultaneously undertakes its judicial function to establish a benchmark against which to judge whether the temporary rate was excessive from and after the date it was authorized." WUTC v. Puget Sound Energy, WUTC Docket No. UE-981238, 1999 Wash. UTC Lexis 127, at *13 (April 5, 1999). Thus, only permanent rates represent what is ultimately fair, just, reasonable

and sufficient. To the extent that interim rates exceed the permanent rates, they become unjust and unreasonable upon setting permanent rates.

140 Second, the Commission was clear in its Interim Order that the interim rates were set subject to refund. The Commission stated that "any revenues collected under this tariff sheet *are collected subject to refund,* based on the level of permanent rates found to be appropriate in the review of the Company's general rate proceeding…." WUTC v. Olympic Pipe Line Co., WUTC Docket No. TO-011472 (January 31, 2002) (emphasis added). Thus, the Commission contemplated that refund is the appropriate recourse for Olympic's customers in the event that the interim rate exceeded the permanent one.

141 Finally, it would be inconsistent with this Commission's statutory obligation, to regulate in the public interest, if it allows Olympic to retain funds received in excess of just and reasonable rates. *See* RCW § 80.01.040. In accord with that standard, the proper measure of a refund is the difference between the permanent rates as ordered by the Commission and the rates actually collected in the Interim. WUTC v. Pacific Northwest Bell Telephone Co., WUTC Cause No. U-82-19, 1986 Wash. UTC Lexis 8, at *18 (September 18, 1986) ("PNB"). In PNB, the Commission concluded "[t]he ratepayers were deprived of the use of their funds overpaid during the period, and should be compensated for that use; the company received the benefit of those funds, and should be required to pay for that benefit." Id. at *21. To that end, the Commission may also require interest be paid on the excess sums collected. Tacoma v. Sperry & Hutchinson Co., 144 P. 544 (1914). Therefore, the revenues produced by the interim rates, in excess of the just and reasonable permanent rates, should be refunded to shippers over the same number of months they were collected.

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Respectfully submitted by:

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