

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Complainant,

v.

OLYMPIC PIPE LINE COMPANY, INC.,

Respondent.

DOCKET NO. TO-011472

OLYMPIC PIPE LINE COMPANY'S
FINDINGS OF FACT AND
CONCLUSIONS OF LAW [PROPOSED]

FINDINGS OF FACT

1. The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute to regulate rates, rules, regulations, practices, and accounts of public service companies, including pipeline companies. *RCW 80.01 RCW*.

2. Olympic Pipe Line Company ("Olympic" "OPL" or the "Company") is a "public service company" as that term is defined in RCW 81.04.010, and a common carrier pipeline under RCW 81.88.030, and as those terms may otherwise be used in Title 81 RCW. Olympic engages in interstate commerce and commerce in Washington State by providing the transportation of refined petroleum products by pipeline for compensation.

3. Olympic owns and operates approximately 400 miles of oil pipelines and related facilities that ship petroleum products from four refineries located in Whatcom and Skagit Counties to various terminals in western Washington and Oregon. Ex. 611 at 3-4. Olympic's pipeline system transports petroleum products in both interstate (59%) and intrastate (41%) commerce. Ex. 703 at 64, ll. 31-33.

4. Oil pipelines are an efficient and cost-effective means of transporting petroleum products. Third Supplemental Order; Order Granting Interim Relief in Part, Docket No. TO-011472 ("Interim Order") at 3. Oil pipelines are safer than transportation by barge and tanker truck. Ex. 1401T at 18-19.

5. In April of 2000, BP purchased ARCO, which then owned 37.45% of Olympic's shares; Equilon owned 37.45%; and GATX Terminal Corporation owned 25.10%. Ex. 611 at 3.

6. In June 2000, BP Pipelines (North America) Inc. won the bid to manage and operate Olympic and began operating in July 2000. All officers and employees of Olympic are employees of BP Pipelines. Olympic pays BP a fee for management services. Interim Order at 3; Ex. 611 at 3.

7. In September 2000, ARCO purchased GATX shares and now owns 62.55% of

Olympic's shares. Ex. 611 at 3.

8. Sixty-five individual shippers use Olympic's pipeline from time to time. Interim Order at 4. Two of Olympic's shippers, Tosco and Tesoro, who ship a combined total of 23% of the total petroleum shipments on Olympic's pipeline, have intervened in this proceeding. Interim Order at 4. No other shipper has intervened. Public counsel has not intervened.

9. On June 10, 1999, a segment of Olympic's 16-inch pipeline within the city limits of Bellingham, Washington, ruptured. "Because of circumstances that are not here at issue, the pipeline developed a leak during the summer of 1999; a large volume of product (gasoline at the time) escaped and flowed into Whatcom Creek. Fumes from the gasoline exploded in a city park surrounding the creek, resulting in three deaths. In the aftermath of the explosion, the northern portion of the pipeline was shut down. Safety improvements have been mandated and many have been made. The federal Office of Pipeline Safety (OPS) is involved in inspections of the line and has required certain safety-related improvements to be made as a condition of putting the line back in service." Interim Order at 5.

10. On June 18, 1999, OPS issued a Corrective Action Order (CAO) to Equilon, Olympic's operator at the time, placing restrictions on Olympic's 16-inch line. Ex. 611 at 3.

11. In September 1999 Olympic performed a hydrotest of its pipeline within the City of Bellingham. During this hydrotest, a portion of the pipeline manufactured using an Electrostatic Resistance Weld (ERW) process ruptured. OPS then amended the CAO to limit the entire Olympic system to no more than 80 percent of its maximum allowable operating pressure (MAOP). Ex. 611 at 7-8. The CAO also required Olympic to test its entire pipeline system prior to being permitted to return to 100% MAOP. Ex. 1619 at 6; Ex. 618.

12. In a letter to the Mayor of Renton, the United States Department of Transportation said that the cause of the Whatcom Creek incident was third-party excavation damage. Ex. 618 at 5. It is undisputed that a seam failure of ERW pipe was not the cause of the Whatcom Creek incident.

13. BP Pipelines was not the operator of Olympic at the time of the Whatcom Creek incident. Ex. 611 at 6. BP Pipelines' operation of the pipeline since it took over management has emphasized safety, as is reflected by its philosophy, "No accidents, no harm to people, no damage to the environment." Interim Order at 5; Ex. 665 at 3.

14. "[I]t is . . . clear that safety must continue to be a top priority for this Company." Interim Order at 3.

15. "It is essential that the Company have the means to buttress its ability to operate safely, to support public confidence that it will operate safely, and to avoid the occurrence of a major event that could precipitate complete financial meltdown and deprive the shippers and the region of an efficient and cost-effective means of transportation." Interim Order at 3.

16. BP Pipelines has made substantial efforts to restore public confidence. Ex. 5; Ex. 601T at 7. BP Pipe Lines' management takes pride in its ability to operate safely and has proposed additional

improvements aimed at enhancing safety. Interim Order at 5. The safety measures being implemented by BP Pipelines anticipated and will meet or exceed new federal safety regulations. Tr. 4024.

17. On October 31, 2001, the Company filed with the Commission a new Tariff WUTC No. 23, canceling and replacing WUTC No. 21. Olympic's proposed tariff did not include any direct costs associated with the Whatcom Creek incident. Ex. 801T at 13. Olympic's tariff revisions sought an increase of \$8,742,426 (a 62% rate increase) for Olympic's intrastate rates. Ex. 703, at 66, ll. 33; Ex. 703, at 64, ll. 33; Ex. 703 at 67, ll. 33; Ex. 703 at 65. In its rebuttal case, Olympic revised its request to seek an 59.5% increase.

18. On October 31, 2001, Olympic also filed (i) a Petition for a Policy Statement and Order Clarifying Oil Pipeline Rate Methodology, and (ii) a Petition for an Order Authorizing an Immediate Rate Increase.

19. By order dated November 19, 2001, the Commission suspended Tariff No. 23 and denied the Petition for a Policy Statement, stating that it "had committed to address the issue of methodology in the context of the general rate proceeding . . ." Interim Order at 2.

20. On January 31, 2002, the Commission issued an Interim Order. The Commission found that "it is clear that the Company is in dire financial straits, in large part due to the need for safety improvements" and that it "has seen its throughput plummet because of mandated closure." Interim Order at 3.

21. "[Olympic's] only means to acquire funding for its operations and needed capital projects are loans or capital investments from its owners, or revenues from transportation rates." Interim Order at 3.

22. "The Company is not financially sound and it needs funds." Interim Order at 3.

23. The appropriate test period is the most recent 12-month period for which income statements and balance sheets are available. The test period is used for investigation of the Company's operations for the purposes of this proceeding. Olympic used a test period in this proceeding from October 2000 through and including September 2001. Staff used a test period of calendar year 2001.

24. The rate year is the twelve month period following the order on final rates, which will be October 1, 2002 through and including September 30, 2003.

25. Olympic requires new capital spending in the amount of \$66 million over the next three years. 1601T at 5.

26. New federal pipeline safety laws, effective in January 2002, affect all major pipelines in the United States. Olympic has spent and will continue to spend at significantly higher levels than prior to 1999 to meet new federal and state safety standards. Ex. 1401T at 8.

27. In light of these continuing costs, the Company's cost of service for the rate year (test

period cost of service adjusted for unusual events and for known and measurable events) is \$56,535,000. OPL Posthearing Brief, paragraph 156.

28. Olympic has not requested recovery of direct costs associated with the Whatcom Creek incident. Ex. 611 at 15-17.

29. Since 1965 the WUTC and its predecessors had not adopted a separate oil pipeline rate methodology for general rates. Since at least 1983, the Company has submitted tariff sheets for its general intrastate rates based on the same methodology employed by the Federal Energy Regulatory Commission for its interstate rates. In 1996, Olympic submitted a tariff for its general rates that was based on the trended original cost methodology employed by FERC, which was allowed to go into effect without suspension. From 1983 to 2001, Staff analyzed Olympic's proposed general tariffs and found that use of the federal methodology produced a higher rate. Staff did not challenge the justness, fairness, reasonableness or sufficiency of such rates.

30. Based on consistency with the general rate methodology for interstate shippers and this Commission's past practice, it was reasonable for Olympic and its investors to expect continued use for state shippers of the federal methodology used for interstate shippers.

31. Shifting midway to the use of a depreciated original cost methodology from a TOC/starting rate base would deny Olympic the opportunity to recover a fair return on its existing assets, would discourage future investments, and would result in insufficient rates.

32. Olympic's rate base should be based on end of rate period balances, including end of period construction work in progress. Ex. 1901T at 53-54. The rate base represents the net book value of assets which are provided by investors' funds and which are used and useful in providing pipeline services.

33. During the test period, the Bayview Terminal Facility was used and useful in providing pipeline services, such as hydro-pressure testing, facility electro-mechanical testing, over-pressure protection, storing petroleum products, and storing line fills. Interim Order at 6; Ex. 1601T at 13.

34. Consistent with the trended original cost methodology, the Commission finds Olympic's average starting rate base write-up to be \$5,709,000. Ex. 703 at 6. The Commission finds the Company's average deferred return for the test period to be \$23,753,000. Ex. 703 at 3.

35. Since 2000, Olympic has received \$53 million in loans from BP and approximately \$45 million from Equilon. Ex. 604. Olympic has not paid its shareholders any interest or principal on these loans. Ex. 501T at 4.

36. It is common oil pipeline industry practice for the parents of oil pipelines to finance the pipeline entirely with direct loans or loan guarantees. Ex. 1701T at 9; Ex. 201T at 36.

37. Olympic has not paid a dividend to its shareholders since 1997. Ex. 501T at 4.

38. The Company's actual capital structure is 100% debt. Interim Order at 7. A hypothetical capital structure of 86.85% equity and 13.15% debt should be adopted based on the weighted average of the capital structure of Olympic's two shareholders. Ex. 201T at 92, 96.

39. There are five companies in the oil pipeline company proxy group. Ex. 220. Olympic is much smaller financially than any of the five companies in the proxy group, has fewer miles of pipeline than the proxy group, has higher earthquake risks, and higher regulatory risks due to safety and environmental regulations. Olympic is a small, non-diversified company, which sells one product, petroleum transportation, to shippers with alternatives available to them. Olympic Posthearing brief at paragraph 130 and paragraph 130, n. 316.

40. Given the level of risk Olympic faces, Olympic's ROE should be set at the upper range for the oil pipeline proxy group. Ex. 221 at 21. Olympic is at least as risky as Kinder Morgan Pipeline, which has a 17.94% return on equity. Tr. 3702.

41. Olympic's cost of equity, based on a discounted cash flow analysis performed on the oil pipeline proxy group and Olympic's above normal risk, should be at least 15.65%. Ex. 201T at 4. This rate of return will allow the Company to attract sufficient new capital to both perform its service responsibilities and accomplish the \$66 million in safety- and pressure-restoration-related capital expenditures Olympic must perform over the next three years.

42. Olympic's adjusted cost of debt is 5.26%. Ex. 201T at 96. This cost of debt is derived from the cost of debt of Olympic's parents and would only apply if Olympic's parents' capital structure is used. Ex. 201T at 96.

43. Olympic's after-tax overall cost of capital is 14.28% and its before-tax overall cost of capital is 21.60%. Olympic Posthearing Brief at paragraph 155; Ex. 201T at 96.

44. Olympic presented un rebutted testimony that maximum operating pressure on its intrastate facilities will remain at 80% beyond the rate year. A representative level of throughput under similar conditions should therefore be used to set throughput levels. Use of ten months of actuals and two months annualized data, as suggested by Olympic, is the best evidence available to the Commission to set throughput levels during the rate year. An adjustment to test year throughput of 103.2 million barrels is therefore appropriate. Ex. 1601T at 21; Ex. 801T at 8.

45. The Commission held four weeks of hearings regarding Olympic's request for general rate relief throughout June and July, 2002. The Company waived the statutory suspension date to October 1, 2002.

46. The Company's books and records were of sufficient quality for the Commission to make an accurate determination of the Company's results of operations and rate base and were adequate to meet the Commission's needs in performing its regulatory oversight functions on an ongoing basis.

47. Using a throughput adjustment of 103.2 million barrels per year, the Commission finds that a deficiency exists in the adjusted test period gross annual revenues in the amount of \$21,078,000 when compared to the rates allowed to go into effect pursuant to Olympic's last general rate filing. Ex. 703 at 1. An increase in revenue of \$21,078,000 is therefore appropriate in this case.

48. Because Olympic's interim rates were not sufficient to cover the amount of the revenue deficiency experienced by Olympic during the pendency of its general rate case, no refunds of interim rates collected are appropriate.

49. Olympic agreed to convene a collaborative with its shippers with the goal of establishing an automatic throughput adjustment mechanism. Ex. 1601T at 22.

CONCLUSIONS OF LAW

50. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, this proceeding. *Titles 80 and 81 RCW.*

51. It is in the public interest for oil pipelines to continue to operate in western Washington. It is in the public interest that such pipelines be operated by companies with a proven commitment to safety and to preventing harm to the environment.

52. The rates for service in Olympic's tariff established in the last general rate tariff permitted to go into effect are insufficient to yield reasonable compensation for service rendered in the state of Washington by Olympic. Revisions of rates and charges to its tariffs made in accordance with the findings herein will yield a fair rate of return on Olympic's rate base and will be fair, just, reasonable and sufficient.

53. The trended original cost methodology is the appropriate method for setting rates for Olympic's intrastate operations.

54. The rates proposed by tariff revisions filed by Olympic Pipe Line Company on October 31, 2002, and suspended by prior Commission order, are just, fair, reasonable and sufficient. *RCW 81.04.250.* These rates are hereby put into effect as of October 1, 2002, in accordance with the terms of this Order.

55. The rates that result from this Order are neither unduly preferential nor discriminatory.