

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**OLYMPIC PIPE LINE COMPANY, INC.**

**TOSCO CORPORATION'S ANSWERING POST-HEARING BRIEF**

Docket No. TO-011472

Prepared by:

Edward A. Finklea  
Chad M. Stokes  
Energy Advocates, LLP  
526 NW 18<sup>th</sup> Avenue  
Portland, OR 97209-2220  
Tel: 503/721-9118  
Fax: 503/721-9121  
Email: [mail@energyadvocates.com](mailto:mail@energyadvocates.com)

Dated: August 28, 2002

## TABLE OF CONTENTS

I.	INTRODUCTION .....	1
II.	LEGAL STANDARDS AND GOVERNING PRINCIPLES .....	5
	A. Burden of Proof [n/a] .....	5
	B. Fair, Just, Reasonable and Sufficient Rates .....	5
	i. General Considerations [n/a] .....	5
	ii. End Result Test .....	5
	iii. Public Interest Standard .....	6
	iv. Commission’s Dual Role .....	7
	C. Federal / State Jurisdictional Legal Issues .....	7
	D. Retroactive Ratemaking.....	9
III.	STATUS OF COMPANY BOOKS AND RECORDS .....	9
IV.	RATEMAKING METHODOLOGY [n/a] .....	10
	A. Investor Expectations; Right to Methodology [n/a].....	10
	B. FERC Methodology [n/a] .....	10
	i. Nature of Oil Pipelines and History of Regulation [n/a] .....	10
	ii. Rationale for FERC Methodology [n/a] .....	10
	1. Potential for Underinvestment [n/a].....	10
	iii. Elements of The FERC Methodology [n/a] .....	10
	iv. Commission Discretion in Choosing Methodology [n/a] .....	10
	1. Consistency with Interstate Rates [n/a].....	10
	2. Past Practices [n/a].....	10
	C. DOC Methodology [n/a] .....	11
V.	TEST YEAR AND JURISDICTIONAL SEPARATIONS [n/a] .....	11
VI.	OPERATING EXPENSES .....	11
	A. Results Per Books [n/a].....	11
	B. Whatcom Creek Expenses [n/a].....	11
	C. Restating and Pro Forma Adjustments [n/a].....	11
	D. One-time Maintenance Costs [n/a] .....	11
	E. Major Maintenance Costs [n/a].....	11
	F. Regulatory Costs.....	11
	G. Transitional Costs [n/a].....	12
	H. Fuel and Power Costs.....	12
	I. Federal Income Taxes [n/a].....	12
VII.	RATE BASE.....	12
	A. Rate Base Methodology [n/a] .....	12
	B. Starting Rate Base (calculation) .....	12
	C. Deferred Return (calculation) [n/a].....	12
	D. Bayview .....	12
	E. Average v. End-of-Period [n/a].....	14

F.	CWIP [n/a] .....	14
G.	AFUDC [n/a].....	14
VIII.	CAPITAL STRUCTURE .....	14
A.	Actual Capital Structure [n/a] .....	14
B.	Hypothetical Capital Structure [n/a] .....	14
i.	Historical Capital Structure [n/a] .....	14
ii.	Use of Parents' Capital Structure (excluding FERC rationale) ....	14
IX.	RATE OF RETURN .....	16
A.	Cost of Debt .....	16
B.	Return on Equity [n/a].....	16
i.	General Principles [n/a] .....	16
ii.	Analysis, Including Review of Testimony if Desired [n/a] .....	16
1.	The Median Cost of Equity is More Representative Than the Mean In This Case [n/a].....	16
2.	Olympic's Use of the Risk Premium Adder is Unjustified..	16
a.	Competition [n/a] .....	16
b.	Risk of Financial Failure [n/a] .....	17
C.	Overall Cost of Capital [n/a] .....	17
X.	REVENUES [n/a] .....	17
A.	Test Year Revenues [n/a] .....	17
B.	Throughput [n/a] .....	17
i.	Role of Throughput in Determining Revenues [n/a] .....	17
ii.	Calculation of Appropriate Throughput for Ratemaking Purposes [n/a] .....	17
iii.	Adjustment Mechanism Based on Throughput [n/a] .....	17
XI.	CALCULATION OF REVENUE DEFICIENCY OR SURPLUS .....	17
XII.	REFUNDS [n/a] .....	18

BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

OLYMPIC PIPE LINE COMPANY, INC.,

Respondent.

Docket No. TO-011472

**TOSCO CORPORATION'S  
ANSWERING POST-HEARING  
BRIEF**

**I. INTRODUCTION**

1 Pursuant to the Fifteenth, Seventeenth, and Nineteenth Supplemental Orders issued by  
Administrative Law Judge (“ALJ”) Wallis on July 19, 2002, July 30, 2002, and August 26, 2002,  
respectively, and WAC § 480-09-420, Tosco Corporation (“Tosco”) hereby submits this  
Answering Post-Hearing Brief.

2 Olympic Pipe Line Company, Inc., (“Olympic” or “the Company”) continues to argue  
that its “dire financial straits” and the need to make future safety improvements warrants its  
requested 59.5 percent rate increase, without any cost-based justification. *See* Olympic Opening  
Post-Hearing Brief (“Olympic”) at ¶ 1. However, as discussed in Tosco’s Opening Post-Hearing  
Brief, any dire financial situation is at least partially attributable to Olympic’s owners’ previous  
business strategy. Tosco Opening Post-Hearing Brief (“Tosco”) at ¶ 23. Shippers should not  
bear responsibility for these past business decisions. Furthermore, Tosco agrees that safety is  
important, and will pay for prudently incurred safety related improvements when they are made,  
but *this* rate case cannot be about future investment needs. Finally, reliance on the public interest  
standard, end result test or the Commission’s dual role to regulate the rates and safety of oil

pipelines does not abrogate the Company's burden of proof to demonstrate the rate increase it seeks would result in just and reasonable rates.

3           This rate proceeding differs in tone from many of the recent proceedings before the Washington Utilities and Transportation Commission ("WUTC" or "Commission"), because the public service company has linked its need for revenue with its willingness to make investments in safety improvements. Olympic infers that the dual role of the WUTC to regulate safety and rates should lead the Commission to grant the Company a higher rate increase than would otherwise be warranted. *See* Olympic at ¶ 21.

4           In deciding this case, the Commission should resist Olympic's implied threat, and instead determine through standard accounting practices and regulatory principles a rate level that will yield just, fair, reasonable and sufficient rates. Fortunately for the Commission, the WUTC Staff has done a commendable job of analyzing Olympic's filing to determine a fair, just, reasonable and sufficient rate level. Additionally, Olympic's two largest non-affiliated shippers have expended their resources to bring in experts to assist in the task. It has been a long and arduous task, largely because Olympic was, at a minimum, ill-prepared to prosecute a full rate case, or unwilling to be as forthcoming as this Commission expects a public service company to be when it seeks a significant rate increase. *See generally* Re Olympic Pipe Line Co., WUTC Docket No. TO-011472, Sixteenth Supplemental Order (July 23, 2002).

5           The WUTC Staff was left with trying to audit Olympic's books and records utilizing the standard normally imposed on utilities regulated by this Commission. The Staff put on a very carefully reasoned case based on its close analysis of Olympic's books and records. The Staff concluded, using a test year ending December 31, 2001, that Olympic justified only a 1.12

percent rate increase. Ex. 1901T at pg. 2 line 20. How can the WUTC Staff, which has no reason to take other than a fair and reasoned approach to this case, be recommending only a fraction of the Company's 59.5 percent request? For all the complexity of the case, the answer is simple: the WUTC Staff took a traditional and responsible approach to measuring Olympic's need for revenue, and Olympic took the most aggressive position possible on each and every issue in an attempt to inflate its revenue requirement. Olympic did so for a simple reason: it wants money from its shippers now to fund future improvements, instead of borrowing the money or having its owners infuse capital into the Company. The Commission should send Olympic a strong message that it will not be allowed to manipulate the standards governing ratemaking in Washington in order to improve its short-term financial situation.

6           Nothing in Olympic's Opening Post-Hearing Brief seriously challenges the reasoning and support underlying the cases of WUTC Staff and Intervenors Tosco and Tesoro Refining and Marketing Company ("Tesoro"). All three parties have approached the issues differently, but when all is said and done, each concludes that Olympic has not made a case for anything more than a very modest increase. The Commission has a certain degree of latitude in deciding some of the accounting issues, and there is a certain range on return and capital structure that are within a zone of reasonableness. But the Commission would have to depart from its own precedent and standards to grant Olympic anything more than a modest rate increase based on the record in this proceeding.

7           Does such an outcome present a dilemma for the Commission or Olympic's shippers? Tosco respectfully submits that it does not. Tosco's witness Dr. Means explained that as part of the regulatory compact, as Olympic invests money, it will have the ability to justify higher rates. Tr. at pg. 3661 line 25 through pg. 3662 line 10. However, prudent, economically justified

investments need to be made *first* in facilities that then become used and are useful. That is a fundamental aspect of rate regulation. Tosco and other shippers cannot be lawfully required to front the money to fund needed investments. The proper response of a regulated public service company is to invest first. After prudent investments have been made, the public service company can file for another rate increase, unless as volumes materialize the additional revenue offsets the need for a future rate increase.

8 Dr. Means acknowledged that this phenomenon imposes a regulatory lag, with the utility spending money first and then receiving the return later. Tr. at pg. 3661 line 4 through pg. 3662 line 10. Of course, as the record in this case demonstrates, regulatory lag goes both ways. For years, the owners of Olympic saw tremendous returns on their investments. Tr. at pg. 4806 line 10 through pg. 4807 line 15. Notably, no case was brought by the company to lower rates or return any of that money to shippers.

9 If the Commission decides the case on the merits and only gives Olympic a slight increase, what will happen? Olympic will receive revenues that cover its O & M, depreciation, and a fair return on its investment in used and useful facilities. It should be a viable operation with this level of revenue.

10 In the balance of this Answering Brief, Tosco will address specific issues which it feels requires specific technical responses, but most issues have been thoroughly addressed in Tosco's Opening Post-Hearing Brief. Tosco has put forth responsible recommendations throughout this case and continues to support a modest rate increase, based on the careful recommendations of Dr. Means, WUTC Staff and Tesoro. If the Commission decides the case based on the extensive record in this proceeding, only a modest increase should be allowed.

## **II. LEGAL STANDARDS AND GOVERNING PRINCIPLES**

### **A. Burden of Proof [n/a]**

### **B. Fair, Just, Reasonable and Sufficient Rates**

#### **i. General Considerations [n/a]**

#### **ii. End Result Test**

11 The end result test and the public interest standard do not support use of the TOC methodology, nor has Olympic provided a single witness to justify use of the TOC methodology. *See* Tosco at ¶ 36. Olympic argues that “unlike Staff’s and Tesoro’s proposed application of the DOC methodology, Olympic’s proposed methodology and risk adjusted rate of return fully satisfy the end result test as they will enable Olympic to attract capital necessary to achieve 100 percent operating pressure and make additional safety improvements, and thereby also further the public’s interest.” Olympic at ¶ 11. Olympic’s reliance on the end test result does nothing to bolster Olympic’s position. Tosco at ¶¶ 21-23. The DOC methodology is a well established methodology that has been proven to attract capital, to result in fair, just, reasonable and sufficient rates, and is utilized by this and many other jurisdictions. Olympic has not provided any reasonable evidence for its assertion that the DOC methodology will not allow it to attract capital, especially since its parent owners are its main source of funding. *See* Ex. 501T at pg. 1 lines 19-22. Thus, Olympic has failed to support its argument that the TOC methodology, and not the DOC methodology, will satisfy the end result test. *See* Tosco at ¶ 36.

12 The DOC methodology is used in this jurisdiction to set rates for public service companies, and there has been absolutely no demonstration that using the traditional Washington ratemaking methodology for public service companies has failed to produce fair, just, reasonable and sufficient rates for regulated entities. Olympic had the burden to prove otherwise. Based on



the exhaustive record in this proceeding, the Commission should reject Olympic's proffered use of the TOC methodology and unjustified reliance on the end result test.

### iii. Public Interest Standard

13 Olympic attempts to justify its proposed rate increase by relying on the alleged minimal impact it perceives the general public and ratepayers will experience if the 59.5 percent increase is approved. Without any factual support, Olympic simply asserts that the general public will not realize an actual increase in gasoline prices if the entire increase is granted. Olympic at ¶¶ 12-16. Olympic also trivializes the effect of the increase on ratepayers arguing that the shippers are large corporations and the rates will only effect a small share of their revenues. Id. The Commission should ignore these unfounded arguments.

14 Proper rate regulation of a monopoly service provider is driven by the ultimate costs of providing service. Olympic's arguments ignore basic ratemaking principles and seem to imply that Olympic's requested relief should be granted because the public may not notice and its shippers are large corporations. However, these arguments are completely irrelevant in cost-based regulation and have no place in this proceeding. Ultimately, rates must be set according to the utility's prudently incurred costs to provide service. RCW § 81.28.250(3). People's Org. For Wash. Energy Resources v. WUTC, 104 Wash.2d 798, 810 (1985). *See also* 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). Accordingly, this Commission should not allow Olympic to set rates based on non-cost factors such as what the market will bear or based on the size of the revenues of its customers.

### iii. Commission's Dual Role

15 See Tosco Corporation's Answering Post-Hearing Brief at ¶¶ 2-4.

#### C. Federal / State Jurisdictional Legal Issues

16 In its Opening Post-Hearing Brief, the Company warns the Commission that a “significant disparity between inter- and intra-state rates affecting compliance with federal oil pipeline safety regulations would not pass scrutiny under either the ICA or the Constitution’s Commerce Clause.” Olympic at ¶ 22. To avoid these issues, the Company argues that the Commission should set rates consistent with the federal ratemaking methodology. *Id.* However, Olympic has presented no evidence, in accord with its burden, that setting just and reasonable intrastate rates using the DOC methodology will have any impact on its ability to comply with federal oil pipeline safety regulations or will be discriminatory toward intrastate shippers. *See* Tosco at ¶¶ 27-28. Tosco notes that this is not the same argument made by Olympic when it requested reconsideration based on the WUTC’s Interim Order. Olympic argued in that proceeding that the 24.3 percent rate increase allowed to go into effect by this Commission raised constitutional issues because the FERC allowed the 62 percent interim request to go into effect, causing a disparity between interstate and intrastate rates. *See, e.g., Olympic Pipe Line Co.*, WUTC Docket No. TO-011472, Olympic’s Motion for Reconsideration (February 11, 2002). Now that the FERC ALJ dismissed Olympic’s case, Olympic has abandoned this argument. Instead, Olympic now urges the Commission to adopt the federal methodology to “avoid” the same constitutional issues. Olympic at ¶¶ 22-23.

17 There are significant problems with Olympic’s position. First, Olympic’s FERC index-based rate filings have caused a disparity between FERC and Washington intrastate rates for years. Tr. at pg. 5064 lines 1-12. Second, there currently are no permanent interstate rates in

effect by which this Commission might gauge any so-called discriminatory impacts of intrastate rates in this proceeding. The FERC ALJ summarily dismissed Olympic's general rate case. Olympic Pipe Line Co., 100 FERC ¶ 63,005, Docket No. IS01-441-003 (July 19, 2002). That being the case, Olympic's arguments amount to telling this Commission it should set Olympic's intrastate rates preemptively high, by using the federal methodology, so that the Commission's ruling will pass constitutional scrutiny. This cannot be the standard by which the WUTC sets Olympic's intrastate rates. This Commission has to set fair, just, reasonable and sufficient rates consistent with its statutory duties and should not base its decisions on what the FERC may or may not actually do.

18 Third, Olympic argues that a conflict "should be avoided if possible" especially since this pipeline's facilities "cannot be segregated into intrastate and interstate portions." *See* Olympic at ¶ 23. In fact, Olympic's facilities can be segregated into inter- and intrastate portions of the pipeline, as demonstrated by WUTC Staff's analysis in Exhibit 1903. *See also* Ex. 1901T at pg. 37 line 4 through pg. 38 line 5. Staff has provided results of operations for inter- and intrastate portions of the pipeline. *Id.* The Company has also conducted its own separation study, which it admits is a "reasonable way" to fairly separate the Company's revenues, expenses, and rate base between federal and state jurisdictions. Ex. 709 at pg. 8 lines 7-21. Thus, Olympic's assertions regarding its inability to segregate the facilities is contradicted by its own analysis. Finally, as described in Tosco's Opening Post-Hearing Brief, the law is clear that the Commission is under no obligation to set intrastate rates equal to interstate rates or use the same methodology in doing so. *See* Tosco at ¶¶ 27-28. Thus, Olympic's self-serving and inconsistent arguments on this issue should be rejected.

#### **D. Retroactive Ratemaking**

19 Staff and Tesoro argue that granting Olympic's request to recover prior period equity returns that were not actually deferred, and for which Olympic had no order authorizing deferral, would constitute retroactive ratemaking. It is a fundamental rule that utility rates are exclusively prospective in nature. *See generally* Puget Sound Energy, WUTC Docket No. UE-010410 at pg. 2 (Nov. 9, 2001). The rule against retroactive ratemaking can serve both the interest of ratepayers, by denying utilities the ability to recover past deficits, and utilities, by preventing regulators from setting rates based on hindsight. *See generally* Id. at 2-3. Tosco agrees that Olympic's proposal of recovering prior period equity returns that were not actually deferred, and for which Olympic had no order authorizing deferral, violates the rule against retroactive ratemaking. The recovery of these equity returns should be denied.

#### **III. STATUS OF COMPANY BOOKS AND RECORDS**

20 The complexity of this proceeding has been exacerbated by the status of Olympic's books and records. Olympic makes excuses for its questionable financial records, citing the Whatcom Creek accident, pending lawsuits, changes in ownership, limited staff and the collapse of its outside auditor. Olympic at ¶¶ 25-26. While Olympic has faced difficulties in the past few years, there is simply no excuse for the current state of Olympic's books and records. Furthermore, arguing about Olympic's small staff is simply disingenuous when the Company is owned by two international integrated oil pipeline companies with vast resources at their disposal.

21 Olympic does not have an unqualified audited financial report in the record. *See* Olympic Pipe Line Co., WUTC Docket No. TO-011472, Nineteenth Supplemental Order (August 26, 2002). Therefore, the concerns raised by parties throughout this proceeding

regarding the reliability of Olympic's records continues to be an issue. It is questionable whether the financial information underlying Olympic's case is sufficiently reliable to enable the Commission to make an intelligent and informed judgment. *See* Olympic at ¶ 25. *See also* WUTC v. Washington Water & Power Co., WUTC Cause Nos. U-81-15 and U-81-16 (Nov. 25, 1981). Cost-based regulation requires an accurate assessment and verification of actual costs. Tr. at pg. 3662 lines 13-15. As it currently stands, the financial information supporting Olympic's filing is suspect, and parties have been unable to make an accurate assessment or verify Olympic's actual costs. Without an unqualified auditors opinion verifying Olympic's financial data, the Commission should approach the Company's case and representations with skepticism.

#### **IV. RATEMAKING METHODOLOGY**

**A. Investor Expectations; Right to Methodology [n/a]**

**B. FERC Methodology [n/a]**

**i. Nature of Oil Pipelines and History of Regulation [n/a]**

**ii. Rationale for FERC Methodology [n/a]**

**1. Potential for Underinvestment [n/a]**

**iii. Elements of The FERC Methodology [n/a]**

**iv. Commission Discretion in Choosing Methodology [n/a]**

**1. Consistency with Interstate Rates [n/a]**

**2. Past Practices [n/a]**

**C. DOC Methodology [n/a]**

**V. TEST YEAR AND JURISDICTIONAL SEPARATIONS [n/a]**

**VI. OPERATING EXPENSES**

**A. Results Per Books [n/a]**

**B. Whatcom Creek Expenses [n/a]**

**C. Restating and Pro Forma Adjustments [n/a]**

**D. One-time Maintenance Costs [n/a]**

**E. Major Maintenance Costs [n/a]**

**F. Regulatory Costs**

22 Tosco urges the Commission to deny the Company's use of \$2.6 million in rate litigation expenses for the rate year. Olympic proposes to normalize this expense over five years. Ex. 701T at pg. 8 lines 9-13. However, Olympic has failed to justify this significant expense as being a prudent estimate of rate litigation costs, and will result in a windfall for the Company if allowed to go into rates to be collected from shippers year after year. The Company utilized extensive legal resources during this proceeding, and the \$2.6 million dollar estimate reflects this heightened level of activity. It is therefore significantly overstated.

23 Tesoro has made a reasonable recommendation for treatment of regulatory costs based on Olympic's Direct Case 2. Tesoro recommends amortizing \$1 million in regulatory costs, which includes various expenses within this category, over a five year period to normalize the expense. *See* Tosco at ¶¶ 78-79. *See also* Ex. 2301T at pg. 43 lines 15-18. Tesoro's recommendation is a reasonable and prudent level of regulatory costs to be collected from Olympic's customers.

**G. Transitional Costs [n/a]**

**H. Fuel and Power Costs**

24 Olympic mischaracterizes Tosco's analysis regarding fuel and power costs. Tosco used Olympic's actual electricity costs for the last half of 2001, which was the most recent data available. Tosco's total fuel and power cost analysis was fully adjusted for Dr. Means' higher recommended throughput level. Olympic's assertion that Tosco used electric rates substantially lower than rates paid by Olympic is not accurate. *See* Tosco at ¶¶ 81-82.

**I. Federal Income Taxes [n/a]**

**VII. RATE BASE**

**A. Rate Base Methodology [n/a]**

**B. Starting Rate Base (calculation)**

25 Olympic continues to infer that this Commission has adopted the TOC methodology. Olympic's argument is without merit. *See* Tosco at ¶¶ 35-40. Olympic argues that if this Commission "switches" to a DOC methodology, Olympic should be permitted to recover the remaining earnings from the starting rate base write up. Olympic at ¶ 56. However, the Washington Commission has never adopted the TOC methodology. *See* Tosco at ¶¶ 35-40. Therefore, the suggestion by Olympic that a "switch" would require a surcharge to compensate Olympic for use of the DOC methodology is both inappropriate and unfounded.

**C. Deferred Return (calculation) [n/a]**

**D. Bayview**

26 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 accounting for the resulting throughput, is untenable.

27 Olympic offers justification for its \$21 million investment in Bayview on the grounds that, despite its limited operation, it is nonetheless used and useful. Olympic at ¶ 111. Among these justifications is that Bayview serves as the headquarters for the northern area maintenance team, provides warehousing for cathodic protection devices and other equipment, and diesel storage for smart pig runs and water for hydrostatic testing. Id. Tosco does not agree that this limited use justifies the investment in these facilities.

28 The Company invested in Bayview to increase capacity, and by logical extension the throughput on its system and represented as much to this Commission. Ex. 2201T at pg. 29 lines 3-7. Bayview has not fulfilled its intended purpose as demonstrated by Olympic's 1998 letter filing for a rate increase relating to investment in the Bayview Terminal. Ex. 2003C at pg. 24. However, Dr. Means has included Bayview in rate base but also included the estimated additional throughput made possible from Bayview's existence. Olympic's proposal of including Bayview in rate base, but excluding the additional throughput, is not appropriate. The substantial cost of the investment, without the additional throughput, is not justified or prudently incurred.

29 To put this in perspective, if an electric utility built a 10 MW generating facility, but the plant was either never generating electricity or was no longer in operation, the fact that the utility could park maintenance trucks or store equipment at the facility would not make it "used and useful" in providing electric service. It is without question that the above described-facility



would not be included in the rate base of this hypothetical electric utility. Similarly, Olympic's proposed treatment of Bayview is inappropriate.

30 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 [n/a]**

**F. CWIP [n/a]**

**G. AFUDC [n/a]**

## **VIII. CAPITAL STRUCTURE**

**A. Actual Capital Structure [n/a]**

**B. Hypothetical Capital Structure [n/a]**

**i. Historical Capital Structure [n/a]**

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

31 The determination of a proper capital structure for Olympic is extremely important. Given the link between Olympic's financial difficulties and its parents' failure to provide a larger share of their investment in the form of equity, it would be reasonable to base Olympic's rates on the same all-debt capital structure that underlay its request for interim relief. Ex. 2201T at pg. 21 lines 7-10. However, Dr. Means has followed a more conventional approach of recommending a

hypothetical capital structure based on the capital structures of the oil pipeline proxy group. Id. lines 10-13. Dr. Means recommends that the capital structure be set at the proxy group's median capital structure of 47.4 percent equity and 52.6 percent debt. Id. lines 13-15.

32 Olympic weakly asserts that if the Commission focuses on the oil pipeline proxy group, as recommended by Dr. Means, there is reason to choose an equity ratio for Olympic above the highest levels of those companies because of Olympic's risk profile. *See generally* Olympic at ¶ 128. However, Olympic has not provided any justification or evidence that use of the median capital structure of the oil pipeline proxy group would be inappropriate or that the Commission should deviate from the group to set the capital structure for Olympic. Use of the oil pipeline proxy group is appropriate and Olympic's unsupported assertions on the need to deviate from the group should be dismissed.

33 Olympic also argues that since some of its loans are from the parent companies, the parents' capital structure should be used for setting rates. Olympic's argument is devoid of financial logic. Olympic has made much of its precarious financial state, pointing to its debt laden financial structure. To set rates, however, Olympic asks this Commission to ignore its actual capital structure and pretend the debt is equity. If Olympic's capital structure was indeed 86 percent equity, the Company would be facing a far less onerous financial crisis. Furthermore, to pretend that the debt is equity is completely unfair to shippers, as it artificially inflates the Company's revenue requirement. Dr. Means has put forth a very reasonable compromise, by assuming 47.4 percent of the Company's capital is equity, even though Olympic is actually funded 100 percent with debt. Olympic's recommendations should be rejected outright. The parent companies' capital structure has no bearing on what a fair capital structure should be for ratemaking purposes, because it is the risk to which funds are put, not the source of the funds,

that controls. In other words, investments made by the parent companies are treated as debt rather than equity, and use of a capital structure that ignores this treatment is not appropriate. Adoption of Olympic's recommended capital structure would provide a windfall for Olympic to the detriment of its shippers.

## **IX. RATE OF RETURN**

### **A. Cost of Debt**

34 Olympic asserts that Dr. Means' analysis regarding Olympic's Cost of Equity and Cost of Debt is inconsistent. Olympic at ¶ 138. However, the Cost of Debt simply was not an issue Tosco chose to address because the Cost of Debt does not reflect current risks and market conditions, but rather reflects risks and market conditions when the debt was issued. Ex. 2201T at pg. 24 lines 14-23. Therefore, Dr. Means accepted the Company's position on the Cost of Debt and properly focused on the Cost of Equity in both the Company's direct and rebuttal case. However, if the Commission does adopt Dr. Means' proposed capital structure, then use of Tesoro witness Mr. Hanley's calculation for the Cost of Debt would be appropriate. Ex. 401T at pg. 2 line 21.

### **B. Return on Equity**

- i. General Principles [n/a]**
- ii. Analysis, Including Review of Testimony if Desired [n/a]**
  - 1. The Median Cost of Equity is More Representative Than the Mean In This Case [n/a]**
  - 2. Olympic's Use of the Risk Premium Adder Is Unjustified [n/a]**
    - a. Competition [n/a]**

**b. Risk of Financial Failure [n/a]**

**C. Overall Cost of Capital [n/a]**

**X. REVENUES**

**A. Test Year Revenues [n/a]**

**B. Throughput [n/a]**

**i. Role of Throughput in Determining Revenues [n/a]**

**ii. Calculation of Appropriate Throughput for Ratemaking Purposes [n/a]**

**iii. Adjustment Mechanism Based on Throughput [n/a]**

**XI. CALCULATION OF REVENUE DEFICIENCY OR SURPLUS**

35 Olympic's calculation for revenue deficiency and corresponding rate increase is not representative of Tosco's position in this proceeding. Based on Olympic's Direct Case 2, Dr. Means' recommendations applied to the traditional Washington methodology for public service companies results in a rate increase for Olympic of approximately 2 percent. Tr. at pg. 3681 lines 18-19. *See also* Tosco at ¶ 5. As explained in Tosco's opening Brief, additional adjustments proposed by WUTC Staff and Tesoro should be made to Dr. Means' recommendations.

36 The following chart illustrates Dr. Means' recommendations based on Olympic's rebuttal case, but is for illustrative purposes only. As explained by Dr. Means when he testified, he did not present a total cost of service analysis, therefore his adjustments based on Olympic's Direct and Rebuttal cases should be combined with adjustments recommended by WUTC Staff and Tesoro. This chart demonstrates that even when only the major adjustments addressed by Dr. Means are made to Olympic's filing, only a very minimal rate increase can be justified. When

proper adjustments by WUTC Staff and Tesoro are also made, even less of an increase is shown to be warranted.

<b>Recommended Rate Increase with Dr. Means' Recommendations Based on Olympic's Rebuttal Case</b>		
Line	Depreciated Original Cost	
	130 Million Barrel Throughput Level	130 Million Barrel Level + Vol. Deficiency Surcharge Calculated Based On Only 103 Million Barrels Realized In The First Year.
1 Dr. Means' Cost of Service per Barrel <sup>1</sup>	\$0.3554	\$0.3554
2 Implied Rate Increase Relative to OPL's Current Average Rate of \$0.344	3.3%	3.3%
3 Approximate Surcharge Rate Increase <sup>2</sup>	N/A	6.7%
4 Total Rate Increase <sup>3</sup>	3.3%	10.2%
5 Revenue (000's)	\$46,185	\$39,121
<b>**Dr. Means recommendations should be combined with recommendations from WUTC Staff and Tesoro.</b>		

**XII. REFUNDS [n/a]**

Dated: August 28, 2002

<sup>1</sup> Ex. 2212

<sup>2</sup> Surcharge of 6.7 percent cited in Ex. 2201T at page 4, line 19 is based on an average cost per barrel of \$0.3923. The surcharge would be lower for the average cost of service in this table of \$0.3554.

<sup>3</sup> Calculated by multiplying the rate increase percent by the surcharge percent.

Respectfully submitted by:

---

Edward A. Finklea    OSB # 84216  
Chad M. Stokes      OSB # 00400  
Energy Advocates LLP  
526 N.W. 18th Avenue  
Portland, OR 97209-2220  
Telephone: (503) 721-9118  
Facsimile: (503) 721-9121  
E-Mail: mail@energyadvocates.com

Of Attorneys for Tosco Corporation