I. Introduction

1. The decisive issue in this case is not which party's particular interpretation of ratemaking methodology is more accurate or what Olympic Pipe Line Company's (OPL) capital structure "should" contain, and surely it is not what was the cause of the Whatcom Creek rupture. The real issue is whether this Commission will exercise its discretion to allow OPL rates that are sufficient to cover its operating expenses, earn a reasonable return on capital and continue the process of rebuilding public confidence in the Company and the pipeline that the operator has begun. OPL's Board Chairman, Larry Peck, testified at hearing that a rate increase of 47% was the realistic minimum rate increase necessary for OPL to even attempt to meet these goals.[1] The undisputed evidence at the hearing was that a rate increase of this magnitude will have almost no adverse impact on the public and only a minimal impact on ratepayers--who include OPL's owners. It plainly is within the Commission's discretion to allow such a rate increase, and the record is clear that such a rate increase is fair, just, reasonable and sufficient based on the facts of this case.

2. OPL requests that the Commission exercise its discretion to provide OPL with funding sufficient for it both to (i) continue to operate its pipeline consistent with BP Pipelines' standards and the expectations of the communities through which it runs and (ii) obtain the necessary investment capital to safely and reliably restore the pipeline to 100% operating pressure for the long term.[2] While OPL's requested rate increase is based on an appropriately defined COS and *not* on a need for future investment,[3] the Commission nevertheless should consider the impact of its COS decisions on OPL's ability to obtain the $66 million it needs over

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[1] See footnote 9, infra.
[2] OPL Brief at ¶18 .
[3] Id. at ¶156 and ¶¶165-168.

the next three years for future investment.

3. Specifically, OPL requests that the Commission (i) not make an uncompensated switch from the FERC's TOC-based methodology to a DOC-based methodology;[4] (ii) recognize OPL's relative high risk warranting use of either a) the weighted average of OPL's parents' capital structures or b) an above average equity share of capital, combined with an above average cost of equity capital and a debt cost higher than that of OPL's parents; (iii) reject Staff's recommendation that Bayview be excluded from the rate base; (iv) reject Staff's and Intervenor's recommended cuts to OPL's operating expenses; and (v) use OPL's 103 million barrels per year throughput volume.

II. Legal Standards and Governing Principles

B. Fair, Just, Reasonable, and Sufficient Rates

4. This Commission's responsibility obviously goes far beyond simply applying a mathematical process. The Commission must use its expertise, judgment, and discretion to adopt and apply a methodology here that achieves a rate that is "fair" *and* "sufficient" and thus is both in the public interest and meets the legislative requirements.[5]

5. To fulfill the legislature's mandate that rates are both "fair" and "sufficient,"

> [t]he Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by [the legislature]. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they "maintain . . . credit and . . . attract capital."[6]

In a similar context, the U.S. Supreme Court has held that rates

> *should be reasonably sufficient* to assure confidence in the financial soundness of

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[4] Id. at ¶19, ¶40, and ¶¶48-51.
[5] RCW 81.28.010.
[6] Permian Basin Area Rate Cases, 390 U.S. 747, 791 (1968) (citations omitted).

the utility and should be adequate…to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[7]

6. Mr. Peck clearly testified what the minimum sufficient rate increase would be. Mr. Peck stated that with both the 62% interim FERC rate increase and the 24.3% interim WUTC rate increase in place, OPL was "pretty much able to cover the operating needs, but it doesn't cover the capital investment needs."[8] The FERC and WUTC interim rate increases are approximately equivalent to a 47% overall average increase in OPL's tariff rates. OPL's revenues in March and April 2002 from the interim tariff rates were approximately 47% higher than the revenues that would have been generated at the prior tariff rates.[9] In summary, a 47% tariff rate increase for OPL would be the bare minimum.

7. Moreover, Mr. Peck testified that BP views investing in OPL as very risky.[10] Before BP will invest equity in OPL it will need to see a strong positive cash flow, which Mr. Peck defines as the difference between revenue (tariff income) and operating expenses. Mr. Peck testified that BP requires an expected 15% return on equity before it will invest equity in a project.[11] Mr. Peck emphasized that BP and Shell have no more obligations to OPL than a shareholder would have to a publicly traded company and thus have no obligation to invest more unless further investment is financially attractive.[12]

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[7] Bluefield Waterworks & Improvement Co. v Pub. Serv. Comm'n. of W.Va., 262 U.S. 679, 692-93 (1923) (emphasis added).

[8] Tr. at 2821:1-3; Olympic Pipe Line Co., 96 F.E.R.C. ¶61,250 (2001); and Third Supplemental Order in this matter.

[9] Ex. 703C, Schedule 22 at 62 and Schedule 22.2 at 64; 96 F.E.R.C. ¶61,250; and Third Supplemental Order in this matter. The same result is obtained by weighting the interim FERC and WUTC increases by the share of interstate and intrastate revenues in OPL's total revenues--i.e., 47% equals 62% times 0.6 + 24.3% times 0.4).

[10] Tr. at 2032:10 through 2834:11; Ex. 501T at 1, ll. 8-12.

[11] Tr. at 2846:1 through 2847:2.

[12] Tr. at 2853:5-21 and 2846:1 through 2847:9. Tesoro and Tosco claim they do not oppose BP's spending what is needed to restore 100% operating pressure.[12] In fact, Mr. Peck testified that BP will evaluate whether or not to invest equity capital on what return on equity OPL is allowed in its tariff proceedings and not on vague assurances that OPL will be allowed an appropriate return on its incremental investment. Tr. at 2799:6 through 2800:2.

8. Staff[13], Tesoro[14], and Tosco[15] falsely claim that OPL is seeking rates based on future investment, and that BP expects to fund its incremental investment solely from OPL revenues. [16] Mr. Peck testified directly to the contrary, i.e, that BP does not expect a return on investment until a particular project is complete. Mr. Peck testified that BP anticipates the need for additional investment to fund the $66 million necessary to restore 100% operating pressure, *even assuming* a strong positive OPL cash flow that would be entirely reinvested in OPL.[17]

9. Mr. Peck also disagreed with the assertion of Staff,[18] Tesoro,[19] and Tosco[20] that OPL's past losses and large loan balances will discourage BP's investment in OPL. BP evaluates investing in OPL on a forward-looking basis. [21] OPL's past losses are sunk costs that are irrelevant to its decisions on potential future investments in OPL. [22] OPL needs a rate increase to attract *new* investment, not to repay existing loans.[23] Obviously, BP does look at the return on existing equity as a factor in deciding whether to make future investments.[24]

10. Likewise, Mr. Peck rebutted Staff[25] and Tesoro's[26] claim BP and Shell will invest the money necessary to restore 100% operating pressure, even without a rate increase, because of the benefit to their affiliated refineries. Mr. Peck explained that service between BP's refinery and the OPL main pipeline already has been restored, eliminating this motive.[27] Mr. Peck also

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[13] Staff Br. at ¶13 and ¶91.
[14] Tesoro Br. at ¶3, ¶5, ¶6, and ¶16.
[15] Tosco Br. at ¶2-4, ¶7, and ¶26.
[16] Tr. at 2824:4-17.
[17] Tr. at 2861:15 through 2862:7, 2825:13-24, 2828:2-24, and 2822:23 through 2824:3.
[18] Staff Br. at ¶7.
[19] Tesoro Br. at ¶142 and ¶144.
[20] Tosco Br. at ¶¶122-123; Tr. at 3664:21-3665:7.
[21] Tr. at 2852:11 through 2853:4.
[22] Tr. 2835:3-12, and Tr. at 2865:7 through 2866:6.
[23] Tr. at 2907:21 through 2908:3.
[24] Tr. at 2865:7 through 2866:6.
[25] Tr. 2565:9-17; Staff Br. at ¶61, n. 16 and ¶62.
[26] Tesoro Br. at ¶10; Tr. 5123:18-22.
[27] Tr. at 2901:21 through 2902:3.

testified that BP, Shell, Tesoro, and Tosco all have equal incentives to restore 100% operating pressure.[28]

III. Status and Company Books and Records

11. OPL has provided the Commission with the most reliable information available about past and probable future operating data, including investment, costs, and throughput. When OPL filed for this current rate increase, its entire system had been operational for only four months, and even then only at 80% pressure.[29] Furthermore, the regulatory requirements governing OPL's operation, and necessarily OPL's costs of compliance, have been rapidly changing over the past few years. Thus, unlike most utilities regulated by this Commission, past experience is not a good barometer for OPL's future cost of service or throughput.

12. As OPL acquired more actual data with the passage of time, it updated the projected numbers upon which it based its case with actual data. Although Intervenors have criticized its effort, OPL's only motive was simply to provide the Commission with the most accurate and reliable data available.[30] As pointed out in OPL's opening brief, its use of actual data as it became available actually favored a lower rate.[31]

IV. Ratemaking Methodology

13. The Commission has the discretion to maintain the trended original cost ("TOC") methodology that has been used to regulate oil pipeline rates at the federal level since 1985 when

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[28] Tr. at 2902:4-20.

[29] The change in this figure by about two percent from the original submission was based upon several additional months of actual experience. Tr. at 4062:20 through 4063:22.

[30] Tesoro Br. at ¶45; Tosco Br. at ¶30.

[31] Staff apparently agrees that moving to more accurate data as it becomes available is appropriate. Based on the changes produced by a Puget Sound Energy, Inc. power rate settlement effective July 1, Staff changed its power cost numbers *during the hearings* (Tr. at 4709:10 through 4711:11; id. at 4718:17 through 4719:3,) which doubled Staff's recommended rate increase (Id. at 4720:13-18). Staff agreed that if other numbers changed for the rate year, it would "want to make those changes too (Id. at 4720:1-18).

the FERC issued Opinion No. 154-B.[32] No one contends otherwise. The question is whether, at this fragile moment in OPL's history, the Commission should abruptly adopt a different methodology from that historically relied upon by OPL and its investors. The Commission already has recognized OPL's dire financial straits. Whatever the merits of the FERC methodology (and Staff witnesses who criticize it are demonstrably ill-informed of its elements),[33] now is hardly the ideal moment to visit the costs of such a switch upon this pipeline. Further, none of the advocates of switching methodologies[34] have even addressed the need, discussed at pages 13-14 of OPL's opening brief, as part of any such process, to evaluate and provide compensation for the resulting stranded capital and other costs.

14. All of OPL's prior intrastate rate increases have been based on the federal methodology. In each case, following input from Staff, the Commission allowed those increases to become effective.[35] OPL and its investors reasonably assumed that, in allowing OPL's proposed rate increases to become effective, the Commission approved of the FERC methodology OPL used to determine them.

15. The record contains ample evidence upon which this Commission can exercise its discretion to formally adopt the FERC methodology that, in the past, it has tacitly approved.[36] As discussed in detail in OPL's opening brief, the level of risk associated with OPL's business is high, unique, and includes significant operating, financial, and competitive elements.[37] Further, the rationale behind the FERC methodology is in large part to encourage both investment and

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[32] Staff Br. at ¶114; Tesoro Br. at ¶92; Tosco Br. at ¶54.

[33] See, e.g., Tr. at 4653:5 through 4655:3.

[34] Staff Br. at ¶122; Tesoro Br. at ¶¶98-102; Tosco Br. at ¶62.

[35] OPL Br. at ¶38.

[36] See OPL Br. at pages 12-19. Also, Mr. Collins in his direct testimony explained and adopted a rationale for the adoption of a trended original cost approach – including the need for transition from a valuation methodology, the need for a time pattern of rates that replicate those in an unregulated, competitive market and the promotion of intergenerational equity. Ex. 713 at 6, l. 15 through 12, l. 1.

competition--goals that would be defeated through an abrupt course change now.

A. Investor Expectations

16. Staff and Intervenors ignore the Commission's own records in arguing that there exists no direct evidence that OPL investors relied on continued application of the federal methodology.[38] Staff's 1983 workpapers demonstrate the reasonableness of their reliance.[39]

17. Included in the 1983 Colbo workpapers is information supplied by OPL describing the "severe impact on Olympic in transition from valuation rate base to original cost depreciated." OPL made a timely objection when the methodology issue was first raised in 1983 that *if* there were a switch to DOC, such a switch should only be done with a fair transition from the valuation methodology--which is what the FERC did in Opinion 154-B with the transitional starting rate base and TOC.[40]

18. After receiving OPL's comments, Mr. Colbo prepared a memorandum[41] which set forth a clear choice: It recommended that OPL's WUTC Tariff No. 16 should be allowed to become effective July 1, 1983, as filed *if* the Commission accepted the FERC methodology used for interstate oil pipeline rates.[42] But *if* the Commission used

> the more traditional pro forma, depreciated rate base format, it is recommended that the filing be suspended and set down for hearing unless voluntarily withdrawn.[43]

The Commission allowed WUTC Tariff No. 16 to become effective on July 1, 1983, with the revenue requirement supported by the then-current FERC methodology.

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[37] OPL Br. at ¶129-31.

[38] Staff Br. at ¶¶45-46; Tesoro Br. at ¶¶49-51; Tosco Br. at ¶¶38-40.

[39] Ex. 1917 at 36-40; Ex. 1918.

[40] Further, OPL told Staff in 1983 that "pipelines are extremely volume sensitive; small changes or error in forecast could completely wipe out earnings-high risk day to day." Ex. 1917 at 40. OPL identified other risks in the 1983 workpapers including "refinery shutdowns," "competition from other transportation modes," "earthquakes," "vandalism," and "regulatory actions." Id. at 38.

[41] Ex. 1918 at 7.

[42] Id.

19. The Commission has a non-delegable duty to ensure that all tariff rates entrusted to its jurisdiction by the Legislature are fair, just, reasonable and sufficient. The Commission fulfilled its duty when, after Staff's analysis, it allowed OPL's general rates to go into effect without suspending them or otherwise evaluating the issue further, as it had the power to do. On the two major occasions when potential departure from the federal methodology arose (1983 and 1996), the FERC-based rates went into effect.[44] OPL and its investors had every reason to believe that the Commission accepted the FERC methodology upon which OPL's rates were based and no reason to believe that, in this proceeding and at such a critical time in OPL's financial history, there would be an uncompensated about-face.

20. In Green Mountain Power Corp.,[45] a recent case with facts similar to those here, the Vermont Public Utilities Commission (Vermont PUC) exercised its discretion to apply a non-traditional ratemaking methodology due to the financial emergency facing its second largest electric utility. The Vermont PUC decided that the public interest was served by granting rates that would keep the utility financially viable and rejected a suggestion that bankruptcy would be preferable to ignoring its traditional cost-based ratemaking methodology:

> The Board's obligation . . . is to establish just and reasonable rates. As this Board has previously ruled, traditional ratemaking methodologies may sometimes need to yield to other considerations (such as the need to attract capital) so long as the final result remains fair to ratepayers.
> . . .
> Applying these principles, we find it necessary to depart from the traditional ratemaking methodologies and to establish rates that, for the good of . . . ratepayers, will enable GMP to improve its financial viability and to have access to capital markets.[46]

21. If the Commission here retains, even on a provisional basis for a set number of years, the

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[43] Id.
[44] OPL Br. at ¶38 n.64.
[45] 2001 Vt. PUC LEXIS 15 (2001).
[46] Id. at *3-5.

federal pipeline methodology, and implements that methodology properly, OPL's rates will be sufficient to attract the capital that it needs. As the Vermont PUC decided, it is preferable better to use a methodology that produces a rate that not only is "fair" but also is "sufficient" to attract needed capital than to adhere to a traditional methodology--the application of which runs the risk of pushing a regulated entity into financial collapse.

B. FERC Methodology

22. Staff erroneously argues that TOC and DOC are not *expected* to generate the same present value of earnings received over the life of a given asset.[47] Mr. Elgin's arguments cited in Staff's Brief at ¶96 are related to why the *actual* results generated for an asset may differ somewhat due to fluctuations in economic and financial conditions over the life of the asset.[48] As a result, the *actual* earnings under TOC may be somewhat less or more than those generated under DOC.[49] Staff's claim that TOC is flawed in theory and practice is unsupported. TOC and DOC, if used from the outset of an asset's life, produce the same expected return[50] and could be used without prejudice to OPL or its rate payers on a going-forward basis for newly acquired assets. However, an uncompensated mid-life switch from TOC to DOC would be unfair to OPL in that it would deny OPL the opportunity to earn a fair return on its existing assets.[51]

23. As explained in OPL's opening brief, deferred returns are an integral part of the TOC

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[47] Staff Br. at ¶96. Williams Pipe Line Co., 31 F.E.R.C. ¶61,377, at 61,834 (1985) (citations omitted) states: "It is important to emphasize that TOC and net depreciated original cost are, as recognized by Justice, essentially the same except for their treatment of inflation. TOC reflects inflation through an automatic adjustment to rate base. Net depreciated original cost reflects estimated inflation in the nominal rate of return. This difference between them results in a different timing of the recovery of the cost of equity capital, when inflation exists, over the life of the property. But, and this is crucial, as Justice admits, '[t]heoretically, TOC results in the same discounted value of the earning stream for the investor as does 'untrended' original cost.' The Commission concludes that TOC is an acceptable cost-based rate base alternative to net depreciated original cost." See also Ex. 201T at 13, l. 17 through 26, l. 16; OPL Br. at ¶¶48-50.

[48] Id.

[49] Id. If inflation is declining over time, TOC will be lower.

[50] Id.

[51] Id.

methodology and their recovery is necessary to allow OPL to earn a fair return on its existing investment.[52] Staff[53] and Tesoro[54] essentially advocate retroactive ratemaking by claiming that OPL over-earned in periods well before the two-year backward look allowed under Washington statute.[55] No party has alleged that OPL over-earned during the past two years. The lack of prior protests of OPL's tariff rates by any shipper and the Commission's allowance of those rates to go into effect also serve to discredit allegations that OPL historically over-earned.

24. Therefore, there is no basis for not allowing OPL to recover its deferred returns. Further, not allowing OPL to recover these deferred returns would deny OPL the opportunity to earn a fair return on its existing investments. Again, this is an area where the Commission has the discretion to allow OPL to recover its existing deferred returns even if the Commission decides to use a DOC-based methodology on a going-forward basis.[56] Failure to allow OPL to recover these deferred returns would be unfair to OPL and would send a signal to OPL's owners that they may not be able to earn a fair return on any future OPL investments.

25. Similar arguments exist for the Commission to allow OPL to recover the remaining earnings on its starting rate base write-up (SRB) even if the Commission decided to use a DOC-based approach on a going-forward basis.[57] However, there is no reason for the Commission to abandon the FERC's TOC-based methodology because OPL and its shippers, over the life of OPL's investments, are neither benefited nor harmed by the continued use of FERC's TOC-based methodology.[58] OPL urges the Commission to continue to allow it to justify its rates using the FERC's TOC-based methodology.

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[52] OPL Br. at ¶48-50.
[53] Staff Br. at ¶98.
[54] Tesoro Br. at ¶70, and ¶¶75-78.
[55] See RCW 81.04.235 "Limitations of Action."
[56] OPL Br. at ¶¶48-50 and also see discussion below of "A DOC-Based Methodology."
[57] Id. at ¶51 and also see discussion below of "A DOC-Based Methodology."

C. DOC Methodology

26. If the Commission determines that it wants OPL to justify its rates on a going-forward basis using DOC, it is essential that a mechanism be set up to allow OPL to recover its deferred returns and the remaining earnings on its staring rate base (SRB). Dr. Schink proposed a five-year surcharge mechanism.[59] The five-year surcharge for deferred returns would be approximately 11 cents per barrel, and, for the SRB, the five-year surcharge would be approximately 1 cent per barrel.[60]

VIII. Capital Structure

B. Hypothetical Capital Structure

2. Use of Parents' Capital Structure (Excluding FERC Rationale)

27. Because OPL is not a stand-alone company capable of raising needed capital on its own, it is appropriate to use the capital structure of the parents absent a compelling basis for deviating from this result.[61] In such a case, the proxy group of companies afford a beginning point for setting the structure, which is then determined based on relative risk factors.[62] As explained in detail in OPL's opening brief,[63] OPL's risk level merits a capital structure well above that of the highest-risk proxy company and approaching that of OPL's parents.[64]

28. Tosco witness Dr. Means confirmed that Kinder Morgan was the highest-risk company in

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[58] OPL Br. at ¶¶48-50.

[59] Ex. 201T at 24, ll. 1-11 and 26, ll. 9-16; see also OPL Br. at ¶50 n.84.

[60] OPL Br. at ¶50 n.84. An upper limit would be imposed on the revenues generated by these surcharges to ensure that there would be no overcollection.

[61] Ky. W. Va. Gas Co., 2 F.E.R.C. ¶61,139 (1978); Kuparuk Transp. Co., 55 F.E.R.C. ¶61,122, at 61,377 (1991) (sufficient market risks were identified to apply the "strong preference in Opinion No. 154-B for the use of a parent company's capital structure if the parent guarantees the oil pipeline's external debt"); ARCO Pipe Line Co., 52 F.E.R.C. ¶61,055, at 61,242 (1990) ("a pipeline which has issued no long-term debt . . . or which issues long-term debt guaranteed by its parent to outside investors should use its parent's actual capital structure").

[62] See Transcon. Gas Pipe Line Corp., 71 F.E.R.C. ¶61,305, at 62,193 (1995) ("The Commission's general policy is to accomplish this task [of reconciling conflicting interests] by finding a capital structure which is consistent with the sound financing of the pipeline in light of how the pipeline's risk profile would be perceived by investors.").

[63] See OPL Br. at ¶¶124-136.

the oil pipeline proxy group and that its equity ratio was 58.6% with a cost of equity of 17.94%.[65] OPL's risks are higher than any company in the proxy group.[66] No party offered credible evidence disputing OPL's position that its risks are higher than any company in the proxy group. With the exception of OPL, no party offered any witness with pipeline operational experience.[67] At minimum, OPL's imputed equity share for ratemaking purposes should exceed the upper end of the range of equity shares (61.35%) for these companies.[68]

29. OPL's risks are inherent in the operation of a pipeline in Western Washington, where virtually the entire line is in an HCA and subject to seismic activity. If the Whatcom Creek accident has significance to this proceeding, it is because the damage causing the accident arose from installation of an adjacent new water line to serve increased urban demand. Investors in a safely operated pipeline face the certainty of such damage and the uncertainty of the capacity of technology to detect it. They face the certainty of increased regulation and the uncertainty of the magnitude of the cost of compliance. In the case of OPL, they face the uncertainty whether the company can survive such costs. Staff and Tesoro both assert that OPL and its parents have been financially irresponsible,[69] but ignore that OPL's parents have made a *net* investment in OPL of $56.45 million since 1990.[70] A regulatory approach that punishes this level of financial commitment to safe operation by ignoring the inherent risks of operating this pipeline and setting a punitive capital structure would be inconsistent with this Commission's commitment to pipeline safety and its obligation to set rates that are not only fair but also sufficient.

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[64] Id. at ¶¶126-133.
[65] Tr. at 3702:5 through 3704:24.
[66] OPL Br. at ¶¶128-31.
[67] See material cited at footnote 291 of OPL's opening brief and associated text.
[68] OPL Br. at ¶¶128-135.
[69] Staff Br. at ¶¶13-14 and ¶200; Tesoro Br. at ¶7.
[70] OPL Br. at ¶120.

VII. Rate Base

D. Bayview Terminal

30. Staff seeks to remove Bayview from the rate base.[71] Although Staff, Tesoro, and Tosco did not offer any witness familiar with oil pipeline operations,[72] each have offered opinions on the operation of the Bayview terminal, what it should be used for, and when it could and should be returned to its initially intended function.[73] In contrast, OPL presented expert witnesses with actual pipeline experience. Their opinions regarding Bayview should be accepted as the most informed.[74]

31. The unrefuted facts regarding OPL's Bayview investment are:

1. The investment of $24 million[75] was merited based upon the anticipated improvement in throughput of 5 million barrels per year,[76] using even a rudimentary estimate of increased gross revenues. Tesoro, for example, does not contest that batching will deliver the anticipated throughput increase but argues that Bayview should be excluded unless Bayview is returned to its initially intended function.[77]

2. Bayview is currently serving important and useful functions but not the primary

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[71] Staff Br. at ¶175-182. Tesoro offers two recommendations: (1) exclude Bayview or (2) include Bayview but assume an unsupported throughput level. Tesoro Br. at ¶¶125-28; Ex. 3401-T at 31, l. 11 through 35, l. 9 and 57, l. 4 through 60, l. 9.

[72] Tr. at 4725:20 through 4727:1 for Staff Witness Mr. Colbo; Tr. at 4652:14-20 for Staff Witness Mr. Twitchell; Tr. at 4814:25 through 4815:12 for Staff Witness Mr. Elgin; and Tr. at 5028:16 through 5029:22 for Tesoro Witness Mr. Brown.

[73] Tesoro also misstates positions of OPL witnesses. In its Brief at 126, n. 120, Tesoro implies that OPL Witness Talley said the increased capacity associated with Bayview is 35-40,000 barrels. In fact, Mr. Talley had said he understood Tesoro's position to be that the increase in capacity was 35-40,000 barrels.

[74] OPL Br. at ¶108-111.

[75] Tr. at 4145:11-18.

[76] Ex. 1601T at 17.

[77] Tesoro Br. at ¶128.

function of improved batching.[78]

3. Bayview is not now performing its initially intended function due to two regulatory actions: a) the requirement to conduct inspections and effect repairs by reason of the Lone Star ERW pipe in OPL's system and b) HCA regulatory obligations that, even had the ERW pipe seam issue not arisen, still would have prevented OPL from achieving 100% MAOP throughout its system.[79]

4. Neither of these regulatory requirements is a result of the Whatcom Creek accident. One was triggered by the ERW seam failure during the September 1999 hydrotest; the other was imposed uniformly on the industry.[80]

5. OPL management has determined to focus on achieving 100% MAOP rather than divert resources to return Bayview to performing its initially intended function before achieving 100% MAOP. Bayview should be ready to perform its initially intended function at about the same time 100% MAOP is achieved. OPL reasonably believes that first achieving 100% MAOP produces a larger throughput gain than delaying it in favor of returning Bayview to full operation sooner.[81]

32. Based on these facts, Staff argues that Bayview is not fully "used and useful," and thus should be excluded from the rate base. This contention is essentially that, where new regulations affect a pipeline's ability to maintain maximum throughput because of compliance requirements,

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[78] Id. at 10.

[79] Tr. at 4152:3-22; id. at 4169:5 through 4170:14; Ex. 1601T at 9, ll. 8-11 ("Recently enacted Federal pipeline regulations require all major U.S. pipeline companies to perform integrity management programs which involve the same approach to testing evaluation and repair that Olympic is performing.") (citing 49 C.F.R. §195.452) (emphasis added). OPL's "headstart" on the HCA regulations will enable OPL to return to MAOP sooner than it could otherwise. Tr. at 4024:12 through 4028:15; Tr. at 4171:22 through 4172:8.

[80] Ex. 1501T at 5-6; Tr. at 4024:22 through 4028:15; Ex. 1601T at 6; Tr. at 4171:8-15.

[81] Tr. at 4168:5 through 4169:14; Ex. 1609 at 23.

the rate base should be reduced while those efforts take place. In contrast, no party contends that the investment in the pipeline itself should be reduced because of the requirement to operate at 80% pressure while restoration work goes forward.

33. Similar reasoning applies to Bayview, which is partially idled due to the efforts to fulfill regulatory requirements applicable to the entire pipeline. Like the pipeline itself, Bayview is still "used and useful," although it is not being used as initially intended because of these efforts.[82] Had OPL not built Bayview, it would have had to provide other facilities to perform the current functions Bayview is now performing.[83] Like the reduced pressure operation, the impact of Bayview's relative idleness is on throughput, and it arises from the very same regulatory compliance efforts as the reduced pressure operation. The temporary partial idleness of one part of the pipeline facility by reason of inspections and repairs to achieve regulatory compliance does not require that the facility be removed from the rate base temporarily and then put back in when compliance is achieved and the facility is fully operational.

34. The current status of Bayview is analogous to that faced by utilities that constructed generation plants that come on-line in a time of surplus. When the Colstrip 3 plant came on-line, the capacity was surplus to the electric power needs of the customers. Pacific Power & Light Co. sought an increase in rates because Colstrip 3 was used and useful. Staff argued the plant was not used and useful because the power was not needed at the time. The Commission rejected Staff's argument:

> The Commission is aware that the plant is currently producing power, and,

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[82] "'Used' is defined as 'employed in accomplishing something'; 'useful' is defined as 'capable of being put to use; having utility; advantageous; producing or having the power to produce good: serviceable for a beneficial end or object'. *Webster's Third New International Dictionary* 2524 (1976). Thus, RCW 80.04.250 empowers the Commission to determine, for ratemaking purposes, the fair value of the property which is employed for service in Washington *and* capable of being put to use for service in Washington." People's Org. for Wash. Energy Res. v. WUTC, 101 Wash. 2d 425, 430 (1984).

[83] Ex. 1601T at 11, l. 15 through 13, l. 14;.Tr. at 4074, l. 24 through 4075, l. 18.

> in fact, power from the plant was used to meet the company's power needs in December 1983. The Commission is aware that the current surplus may end in the not too distant future. The Commission has considered the power reserves of the company and is convinced that the Colstrip 3 plant is used and useful to the ratepayers of the state of Washington . . . .[84]

35. Bayview, like Colstrip 3, is a completed facility that is not contributing all it was intended to because of external factors. However, OPL, like PP&L, incurs costs in operating the plant.[85] Like PP&L's use of Colstrip 3 for reserves and peaking needs, OPL used the Bayview facility during the test period for pipeline services.[86] Moreover, the current restrictions on Bayview's use may "end in the not too distant future."[87] Like Colstrip 3, Bayview is used and useful in providing service and should be included in OPL's rate base, despite the fact that it is not currently being utilized to perform its initially intended function.

36. The treatment of the Bayview issue epitomizes one of the choices presented to this Commission. Staff's position is that a facility whose functions are temporarily limited through the need to comply with new regulatory requirements should be removed from the rate base until it is restored to its initially intended function. But taking Bayview out of rate base will reduce rate base by over $20 million and will thus reduce revenues by $2-$3 million, depending on the rate of return. Taking Bayview out of rate base will thus reduce OPL's ability to restore the pipeline to 100% MAOP and Bayview to its initially intended function

H. Other

37. Both Tesoro and Staff claim they do not challenge capital improvements or recurring expenses necessitated by regulatory compliance and safety.[88] In fact, each propose substantial reductions in operating expenses. Tesoro's Mr. Brown has recommended disallowing $11.9

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[84] WUTC v. Pac. Power & Light Co., 1984 Wash. UTC LEXIS 29, at *16-17 (June 12, 1984).
[85] Ex. 1601T at 15, ll. 12-15.
[86] Id. at 14, ll. 10-17.
[87] See Tr. at 4168:19-25.

million for outside services.[89] Staff makes similar, less severe reductions, which effectively reduce rate year operating expenses by $6.4 million.[90]

38. Two main issues separate the parties: (1) the appropriate test year to be adjusted for "known and measurable" changes and (2) the meaning of the term "known and measurable."

39. Except for Staff, the parties adopt the same test year beginning October 2000. Staff proposes calendar year 2001 as the test year[91] (data for October-December 2001 were not available when OPL made its rate filing). Staff supports its use of a calendar 2001 test year to use three more months of current data and to avoid alleged problems with OPL accounting data. Accepting Staff's philosophy, OPL's rebuttal case includes four additional months of actual data and two months of budgeted data.[92]

40. Staff criticizes OPL's budget data, despite OPL's budget being based on a tested, rigorous capital spending budgetary process implemented successfully by Europe's largest corporation, and it is grounded in BP's expertise in operating pipelines in the United States and in cost control measures that it has implemented company-wide, of which OPL benefits.[93] Staff's experts admit that they lack information regarding the most basic facts that determine whether costs are reasonable, and whether they will recur.[94] No one can foretell the future with certainty, but OPL's process, grounded as it is in BP's rigorous, cost/benefit analysis, provides the most reliable basis for making an estimate. OPL's updated operating expenses are drawn

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[88] Tesoro Br. at ¶5

[89] OPL Br. at ¶83.

[90] Based on the difference of Staff proposed operating expense of $29.8 million (Ex. 1904 at 1, ll. 24) and Olympic proposed operating expense of $36.2 million (Ex. 703C, Schedule 21). Tosco's Dr. Means advocated no such reductions, but, in its brief, Tosco has endorsed others' proposed adjustments. Tosco Br. at ¶15.

[91] Ex. 2001T at 10, l. 4.

[92] Ex. 801T at 5, ll. 6-7.

[93] Ex. 1609 at 40 through 54 contains an extensive explanation of the rigorous process to which BP subjects proposed capital projects.

[94] Tr. 2661:15-18; id. at 2513:5 through 2515:10; id at 4592:25 through 4595:13

from a combination of actual data and revised budget estimates and provide a more timely and better informed basis for determining known and measurable changes.

41. An example of the extreme approach taken by Staff in this case is Mr. Colbo's proposed reclassification of 98 percent of OPL's maintenance expense to other categories.[95] Mr. Colbo's restating adjustments to maintenance expenses reduce the amounts included in the rate year dramatically, ostensibly because the expenses are not recurring and thus should be amortized, and because he contends that some maintenance expenses are capital investments. Mr. Colbo cited no factual basis for either conclusion and ignored OPL's factual presentation of what is "known and measurable" about the nature, and probable recurrence, of these maintenance costs. Nor does Mr. Colbo provide any accounting authority for his proposed reclassification of maintenance expenses to capital. Mr. Kermode, who opined that certain line-lowering should be capitalized, did not know the facts about the nature of the activity necessary to such a determination.[96] Although Staff acknowledges that the Uniform System of Accounts (USoA) is the accounting standard that oil pipelines must follow,[97] Staff ignores unambiguous instructions in the USoA regarding the accounting treatment of maintenance expenses.[98]

42. Tesoro concludes that maintenance costs should be disallowed entirely. Mr. Brown, with no oil pipeline operational experience, offers only speculation to argue that these costs are one-time expenses or should be classified as capital costs. Staff has acknowledged that "it is not reasonable to disallow the costs if they are prudent and properly relate to providing to regulated service."[99] Mr. Brown does not provide any facts to support disallowance under this standard. As was the case with Mr. Colbo, Mr. Brown totally ignores the experience-based testimony of Mr.

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[95] Ex. 2001T at 21, ll. 4-10.
[96] Tr. 4586:3-19; 4592:25 through 4595:13.
[97] Tr. 4544 ll. 5-11.
[98] OPL Br. at ¶91.

Talley that these maintenance costs will recur with increasing frequency in the future.[100]

43. Staff dismisses entirely the effects of new regulations on OPL's costs without any basis for disagreeing with OPL's experienced witnesses. The very nature of the regulations themselves, the high percentage of OPL's line that passes through HCA, the increasing urbanization of western Washington, the constant improvements in technology for detecting potential failures, and the public demand for safety all make a decline in safety-related maintenance costs highly improbable. Staff and Intervenors have offered no credible evidence to the contrary.[101]

44. Without any recognition of the extensive testimony relating to the considerations that have contributed to OPL's operating expenses, Messrs. Colbo and Brown propose adjustments that would deny recovery in the rate year of operating costs that are directly related to increased regulation. For example, there is simply no basis in the record for disallowing the maintenance expenses that OPL, in compliance with the USoA, has included in rate year operating expenses in the rebuttal case. These expenses have been developed using a combination of the actual expenditures for the period October 2001 through April 2002 and updates to the budget. By rejecting the use of these data, and relying instead on arbitrary adjustments that dismiss actual experience and management's carefully prepared projections for the future, Staff and Tesoro seek to deny OPL the opportunity to recover these costs in rates.

45. There are other examples of arbitrary reductions in rate year operating expenses proposed by Staff and Tesoro. For example, Mr. Brown recommends that remediation expenses be disallowed based, in part, on his belief that the amounts included in the rate year are accruals.[102]

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[99] Staff Br. at ¶145.
[100] Ex. 1601T at 23, ll. 9-10.
[101] OPL Br. at ¶18, ¶74, ¶93, and ¶129.
[102] Ex. 2301T at 42, ll. 16-19.

In fact, OPL has removed all accruals for remediation expenses and replaced them with the actual expenditures.[103] Likewise, no party has denied that OPL is incurring substantial expenses as a result of this proceeding. Consistent with general regulatory practice, OPL and Tesoro recommend that the rate year cost of service should include the costs of rate litigation, amortized over five years.[104] However, Staff proposes to deny OPL any recovery of this amount.[105]

46. The numerous, downward adjustments to OPL's rate year operating expenses have several characteristics in common. First, they ignore the testimony from Mr. Talley and Mr. Wicklund concerning the factors that have increased OPL's operating costs now and in the future. Second, they do not reflect reasoned application of the "known and measurable" concept. Costs are disallowed, or reclassified, without regard to any requirements for a probative showing that such adjustments are either warranted by the facts or appropriate according to this Commission's standards. Third, the actual expenses incurred by OPL and the reasoned estimates contained in OPL's budget are accorded no weight. Instead, every speculation, from whatever source, positing that maintenance expenses are non-recurring,[106] or should be reclassified as capital cost[107] or otherwise disallowed, is treated as fact and relied on to urge denying OPL the opportunity to recover its costs. In contrast, OPL has provided detailed testimony supporting the amount and treatment of its costs and the Commission should adopt for the rate year those operating expenses relied on by Mr. Collins for OPL's rebuttal case.

IX. Rate of Return

A. Cost of Debt

47. Staff's and Intervenors' positions are discussed in OPL's opening brief at ¶¶137-140.

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[103] Ex. 801T at 6, ll. 14-17.
[104] Ex. 701T at 8, ll. 9-12; Ex. 2301T at 43, ll. 20 through at 44, ll. 2.
[105] Ex. 2001T at 23, ll. 14-21
[106] Id. at 20, ll. 2-4; Ex 2301T at 41, ll. 17 through 42, ll. 5

The key points are that OPL's recommended 5.26% debt cost is the debt cost of its parents and is so low because of their 86.85% equity share. If the Commission chooses for OPL a hypothetical equity share in the 40% to 60% range, then the debt cost of the oil pipeline proxy group of 7.54% would be appropriate. But, if the Commission were to impose the punitive 20% or 0% equity shares proposed respectively by Staff and Tesoro, then the appropriate interest rates would be in the "junk bond" range of 10.19% to 22.66% with a mid-point of 16.425%.[108]

B. Return on Equity

48. To determine OPL's cost of equity capital, Dr. Schink used a single-stage forward-looking DCF model of the type that the Commission has determined is appropriate.[109] Tosco witness Dr. Means based his cost of common equity capital recommendation on Dr. Schink's analysis.[110] Staff and Tesoro have not calculated their recommended cost of common equity capital based on a single-stage forward-looking DCF model.[111]

49. Staff incorrectly asserts that the DCF methodology presented by OPL: (1) is multi-stage, (2) uses improper data, and (3) uses a too small proxy group.[112] First, the FERC DCF methodology is single-stage; it averages two growth rates to produce a rate for use in the single-stage model.[113] Second, the so-called improper data Staff complains about are the analyst earnings expectations and GDP growth used to estimate the expected dividend growth rate for the DCF model. The FERC, in a number of decisions, has explored the proper definition of the DCF growth rate and uses analyst earnings expectations and GDP growth to estimate that growth

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[107] Ex. 2001T at 21, ll. 9-21; Ex 2301T at 42, ll. 6-13.
[108] Id. at ¶140.
[109] Id. at ¶¶145-147; Ex. 201T at 43, l. 2 through 49, l. 16; id. at 57, l. 2 through 65, l. 10.
[110] Ex. 2201T at 6, l. 20 through 8, l. 14; Tr. at 3698:10-11; id. at 3698:21 through 3701:11; OPL Br. at ¶154; Ex. 201T at 75, l. 18 through 78, l. 23.
[111] OPL Br. at ¶¶151-153; Ex. 201T at 65, l. 13 through 75, l. 17; id. at 78, l. 24 through 88, l. 23.
[112] Staff Br. at ¶¶108-113.
[113] Tr. at 2244:7-15.

rate.[114] The Commission's "Standard DCF Studies" also rely on analyst forecasts.[115] Third, the five-member oil pipeline companies proxy group has been found by the FERC to be large enough to use to estimate the cost of equity.[116] Tesoro witness Mr. Hanley and Tosco witness Dr. Means also rely on this same oil pipeline proxy group.[117]

50. Tesoro incorrectly asserts that OPL presented a DCF-based cost of equity solely because it is the method preferred by FERC.[118] In fact, OPL looked to previous Commission decisions and its expressed reasoning for guidance in calculating the cost of equity.[119] In prior decisions, this Commission has stated a preference for a single-stage forward-looking DCF approach, exactly what OPL has presented.[120] Tesoro, however, ignores previous Commission decisions regarding the preferred method of calculating the cost of equity and recommends a cost of equity estimate of 13.0% for OPL based on averaging results produced by several methods in a manner inconsistent with past Commission decisions.[121] Nevertheless, Tesoro witness Mr. Hanley calculated a single stage DCF ROE result for the oil pipeline proxy group of 15.8%.[122]

51. Staff acknowledges that past Commission decisions have relied on the single-stage forward-looking DCF method in determining the cost of equity.[123] Staff , however, did not address the Commission's reasons for favoring DCF, nor did it present a calculated cost of using the Commission's approved single-stage forward-looking DCF method. Nevertheless, its expert,

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[114] See Northwest Pipeline Corp., 71 F.E.R.C. ¶61,253 (1995); Enron Gulf Coast Gathering Limited Partnership, N. Natural Gas Co., 79 F.E.R.C. ¶61,039 (1997); Transcon. Gas Pipe Line Corp., 84 F.E.R.C. ¶61,084 (1998)

[115] Ex. 201T at 47, l. 7 through 48, l. 9. Tesoro witness Mr. Hanley utilizes the FERC approach of averaging analysts earning expectations and GDP growth in his DCF calculations.

[116] SFPP, L.P., 86 F.E.R.C. ¶61,022, at 61,099 (1999).

[117] Ex. 401T at 5, ll. 5-8; Ex. 404 at 3; Tr. at 3701:12-15.

[118] Tesoro Br. at ¶86.

[119] OPL Br. at ¶¶145-147.

[120] Id.

[121] Tesoro Br. at ¶150.

[122] OPL Br. at ¶153.

[123] Staff Br. at ¶206.

Dr. Wilson, performed a DCF calculation for the oil pipeline proxy group companies that generates an ROE range of 13.3% to 17.2%, with a midpoint ROE of 15.25%.[124] In contrast, Staff's recommended combination of DCF and non-DCF methods with multiple proxy groups produces a 9% ROE.[125] Tosco's real ROE estimate is 13.0%, which, using OPL's inflation estimate of 1.515%, produces a nominal ROE of 14.515%.[126] Dr. Schink's calculated ROE for OPL is 15.65%, including a risk adder of 0.95% to reflect OPL's above-average risk.[127]

52. Staff, Tesoro, and Tosco all claim, without supporting evidence, that OPL is no riskier than a typical pipeline[128] and that a risk-adder is not necessary.[129] They each fail to consider the asymmetric risks faced by OPL.[130] Staff merely asserts, without factual support, that this is not an issue.[131] Tesoro appears not even to understand the concept of asymmetric risk; it mislabels it as "isometric" risk,[132] and it relies on Tosco's witness for an opinion on the issue. Tosco admits that financial risk can raise the cost of capital and that without its parents OPL "would likely be in bankruptcy."[133] However, Tosco does not include these factors in its cost of equity calculation.

53. OPL presented many factors that made it riskier than the typical company in the oil pipeline proxy group.[134] To summarize, these factors include its small size, lack of diversity, operations almost exclusively in High Consequence Areas and in seismically active and geographically difficult areas prone to land slides, large number of water crossings, and ERW

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[124] OPL Br. at ¶153.

[125] Staff Br. at ¶213.

[126] Tosco states that its recommended ROE for OPL is 13.0% with no indication that this is a real ROE value. Tosco Br. at ¶9 and ¶114. However, Dr. Means labels it as real ROE. Ex. 2212.

[127] Ex. 201T at 3, l. 12 through 4, l. 7.

[128] See discussion in Section IX of this brief.

[129] Staff Br. at ¶215; Tesoro Br. at ¶¶88-91; and Tosco Br. at ¶¶118-123.

[130] OPL Br. at ¶129-132.

[131] Staff Br. at ¶215.

[132] Tesoro Br. at ¶4 n.9.

[133] Tosco Br. at ¶124.

pipe seam failure issues.[135] While Staff and Intervenors agree that OPL faces these special risks,[136] without support and contrary to basic finance principles, they urge this Commission to reject incorporation of OPL's increased riskiness in its cost of equity.[137]

54. Tesoro argues that Mr. Peck said OPL was "safer and not more risky" than oil pipelines in the proxy group.[138] A full reading of Mr. Peck's testimony, however, leads to the opposite conclusion. While Mr. Peck said OPL was currently an operationally safe pipeline, due to the substantial investments it has made--and is making--for safety purposes; he also testified that it faced profound financial risks: "[t]he bigger risk to Olympic, to me, is really around its future uncertainties financially."[139] OPL has said it would, as it already has, shut down segments of its system rather than allow them to be operated in a fashion it believes unsafe. The prospect of a complete or partial shutdown presents huge financial and operational risks.

C. Overall Cost of Capital

55. Staff and Tesoro did not use the Commission's preferred single-stage forward-looking DCF method in preparing their cost of equity and overall cost of capital estimates. Staff's single-stage DCF cost of equity of 15.25%[140] produces an overall cost of capital of 11.13% when combined with the upper end of Staff's reasonable range of capital structures of 50%[141] and a 7% cost of debt. Tesoro's single-stage DCF cost of equity estimate is 15.80%[142] which produces an overall cost of capital of 11.37% when combined with its recommended 46.40% equity capital structure and 7.54% cost of debt. Tosco's calculated single-stage DCF cost of equity is

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[134] OPL Br. at ¶4 and ¶¶126-136.

[135] Mr. Peck characterized OPL as a "one-trick pony" because of its dependence on the revenues generated by a single pipeline. Tr. at 2905:11 through 2906:11.

[136] OPL Br. at ¶129.

[137] Staff Br. at ¶215; Tesoro Br. at ¶88 and ¶90; Tosco Br. at ¶106 and ¶¶111-114.

[138] Tesoro Br. at ¶90.

[139] Tr. at 2860:20-21.

[140] OPL Br. at ¶153.

[141] Staff Br. at ¶200.

14.515%.[143] Since Tosco adopts the proxy group's capital structure, it is appropriate to use the proxy group's cost of debt of 7.54%[144] in calculating OPL's overall cost of capital which, based on Dr. Mean's recommended capital structure of 47.4% equity and 52.6% debt,[145] is 10.85%.

56. OPL's overall cost of capital is 14.28% based on a 15.65% cost of equity, 5.26% cost of debt, and 86.85% equity capital structure.[146] However, if the Commission decides that OPL's risk is less than that of its parents and, consequently, that a capital structure with less equity is appropriate, then the cost of debt should be increased accordingly.[147] If the upper end of the range of equity shares for the proxy group of 61.35%[148] is used as OPL's equity share, the debt rate associated with that capital structure would be higher than that of OPL's parents.[149] The overall cost of capital would be 12.52% with this alternative capital structure based on the average debt rate for the proxy group of 7.54%[150] and OPL's cost of equity of 15.65%.[151]

X. Revenues

B. Throughput

57. OPL agrees with Staff that "throughput is critical to Olympic's ability to recover its fixed costs" and that "most of Olympic's costs are fixed (i.e., do not vary with throughput)."[152] Neither Tosco nor Tesoro use throughput numbers based on known and measurable data. Instead, they base their throughput numbers on speculation on what throughput might be if OPL were able to restore its system to 100% pressure. But, it is undisputed that OPL's system will not be at 100%

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[142] OPL Br. at ¶153.
[143] OPL Br. at ¶154.
[144] Tesoro Br. at ¶147.
[145] Tosco Br. at ¶10.
[146] OPL Br. at ¶155.
[147] Id. at ¶138.
[148] Id. at ¶123.
[149] Id. at ¶139.
[150] Id. at ¶138.
[151] OPL Br. at ¶148, ¶149, and ¶153.
[152] Staff Br. at ¶223.

pressure at any time during the rate year and for some period beyond.

58. OPL agrees with Staff's analysis and rejection of Intervenors' unsupported assumption that OPL's system will be at 100% during the rate year.[153] In particular, Staff states that "it is difficult to fault Olympic on the ERW issue, because the Alert Notice (Batch, Ex.667) is not particularly prescriptive, and Olympic has hydrotested the line when it went into service (Batch Tr.3018:7-8). Accordingly at this point, Staff is comfortable with recommending throughput based on 80% pressure."[154]

59. OPL also agrees with Staff in rejecting Tosco's efforts to "impose adverse economic consequences if the line is not up to 100% pressure by a date certain," stating that because Olympic does not control the permitting process and pressure authorization process, such is penalty is not warranted."[155]

60. But Staff's throughput position is based on an assumption that there will be no work on OPL's system in order to restore pressure to 100%, and thus no downtime on OPL's system. This assumption is equally without a factual basis. There will be the same level of spending and future work on and associated downtime with the system during the rate year.[156]

61. Staff sets up an incorrect premise when it makes the following argument: "For example,

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[153] Staff Br. at ¶229.

[154] Id. at ¶229.

[155] Id. at ¶231.

[156] OPL will continue to perform substantial repair work, with associated downtime, for at least the next three years--well beyond the rate year. "Olympic needs $66 million in additional capital over the next three years (i) to complete the testing, evaluation and repair of ERW pipe in its pipeline system in order to restore that system to 100% maximum operating pressure, (ii) for safety upgrades mandated by federal regulations and BP Pipelines' internal standards, and (iii) for other capital improvements and maintenance projects." Ex. 1601T at 5, ll. 4-10. This work requires OPL to formulate a repair program based on evaluation of testing data, obtain permits and then perform the excavation and repairs. Ex. 1601T at 8, ll. 1 through 9, ll. 23. The earliest this work can be completed and the MAOP can be achieved is in the second quarter of 2004. Ex. 1605C. Mr. Talley said: "The timetable that I have proposed to get us to 100 percent requires $66.3 million over the next two-and-a-half years." Tr. at 4124:23-4125:1-3. The amounts to be spent on testing and repairs over the next three years is at the same level as spent in 2001 and is being spent in 2002. There is ample evidence that the level of spending, the level of work, and the associated downtime will continue to be similar in the next three years as it most recently was.

if a pipeline is shut down for three months during a base period, *and if that downtime was atypical*, the actual throughput for that base period would not be used to set rates."[157] Staff then incorrectly assumes that the past year of work and downtime will *not* be typical for the rate year.

62. OPL's throughput recommendation is based on the most recent actual throughput data (*after* all segments were restored and operating at 80% pressure). By definition, use of actual past data includes all factors affecting throughput such as downtime associated with work projects. Past work resulting in downtime is thus completely accounted for. The only question is whether the level of past work and associated downtime are representative of future work in the rate year. The testimony is undisputed and the answer is yes. Assuming that it obtains rates sufficient to attract the needed risk capital, OPL will continue to work on restoring its system at the same level as in the recent past and will thus continue to experience the same level of associated downtime.[158]

63. The only way for Staff's assumption of no future work and no future downtime to be potentially true would be if there were not a rate increase sufficient to attract the needed capital to continue work on restoring the system. If Staff's arguments are based on an assumption of no future work, then they are inconsistent with the public interest. Staff's unsupported assumption would have the effect of reducing the very rates that are needed to continue the restoration work.

XIV. Conclusion

64. For the reasons stated above, the Commission should exercise its discretion to set rates for the pipeline that are sufficient for OPL to cover its operating expenses, earn a reasonable return on capital, and to continue its work of rebuilding public confidence in the pipeline. Both the hearing record and sound public policy support the tariffs proposed by OPL, and OPL

[157] Staff Br. at ¶225.

respectfully requests that the Commission implement them.

DATED this ____ day of August, 2002.

Respectfully submitted,

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[158] OPL Br. at ¶161; Tr. at 4748:8-1; see also footnote 158, supra.