[Service Date September 27, 2002]

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION	)	DOCKET NO. TO-011472
Complainant,	)	TWENTIETH SUPPLEMENTAL ORDER
v.	)	ORDER REJECTING PROPOSED TARIFFS; AUTHORIZING AND REQUIRING REFILING; ORDERING REFUNDS OF EXCESS INTERIM RATE COLLECTIONS
OLYMPIC PIPE LINE COMPANY	)	
Respondent.	)	
. . . . .	)	

Synopsis: *The Commission grants in part a request by Olympic Pipe Line Company for a general increase in its rates and charges. The Commission authorizes an increase of $367,643.00, or 2.52% in Olympic's intrastate rates, and directs the Company to refund to its customers the portion of interim rates they paid that exceed that level.*

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

1 Olympic is a regulated common carrier that transports refined petroleum products from four refineries in northwest Washington to points in western Washington and Portland, Oregon. Olympic filed applications with this Commission to increase its intrastate rates, and with the Federal Energy Regulatory Commission (FERC), to increase its interstate rates. Both agencies authorized temporary or "interim" rates, subject to refund, pending further review.

2 Olympic has challenges that stem from several events. Those include a catastrophic explosion and its operating, environmental, and legal consequences; potentially flawed pipe that has caused a pressure-reduction mandate; investment in an application for a prospective pipeline route that has been "shelved"; investment in a storage and batching facility that is not fully utilized at present; decisions by Company owners (two giant oil companies) about the pipeline company's financing that leave it owing nearly $150 million in debt and accrued interest, without equity in its capital structure, and assets with a book valve of no more than $118 million; and changes in its accounting systems that render production of detailed accurate information difficult.

3 While it is clear that Olympic has challenges, it is also clear from the record in this matter that Olympic has made significant strides in stabilizing its operations and returning to normal. It has repaired the immediate effects of the explosion, and it is embarked on a program to assess the integrity of its system, to return to 100% pressure, and to re-integrate its Bayview facility into pipeline operations. Olympic is now operationally stable and continuing to improve its situation.

4 Olympic asks the Commission to abandon the regulatory principles that the Commission applies in other settings and to grant Olympic a rate increase in an amount that will persuade its owners to contribute additional funds. Olympic asks that the Commission adopt a ratesetting methodology that it says is used by the FERC, and asks that the Commission not use the depreciated original cost methodology that the Commission generally applies in evaluating utility company rate requests.

5 The Commission in this order rejects Olympic's proposal, but recognizes the exceptional exigencies that Olympic faces in a number of ways. The Commission acknowledges Olympic's situation, and its concerns, in establishing fair, just, reasonable, and sufficient rates. The Commission accepts, out of necessity, evidence of financial operations that would be inadequate if presented by a company not facing Olympic's problems. In addition, the Commission recognizes Olympic's need for cash flow and makes several significant decisions to meet the necessity of its situation.

6 This decision does not produce a large rate increase for Olympic, but it produces a rate that takes Olympic's needs and its exceptional circumstances into account—a rate that is fair to Olympic and its customers, and that is sufficient for a prudent and efficiently managed Olympic to continue its progress toward full recovery and full normal operations, to meet its expenses, and to attract the capital it needs.

7 This decision also provides regulatory certainty and long-term fairness by adopting a fair and Constitutionally well-tested methodology for the calculation of Olympic's rates, by specifying clearly the nature and timing of evidence that Olympic must file in future rate proceedings and by directing the Company to return for further rate review within two years.

8 The Commission's approach also provides incentives for the Company and its owners to correct its engineering and its financial problems swiftly and to return for further rate adjustment when it has the records and the accomplishments to support its request.

9 The Commission authorizes and requires Olympic to refile rates providing it a 2.52% increase.

10 During the interim phase of this docket, the Commission found on a brief and expedited record a need for immediate funding of safety-related improvements. The Commission also identified in its order a considerable number of unanswered questions in Olympic's presentation, but deferred to later phases of the proceeding the quest for answers to those questions and the development of a more complete picture of matters bearing on the calculation of fair, just, reasonable, and sufficient rates.

11 Now, upon a full record that answers many of those questions, the Commission finds that the interim rate authorization exceeds rates that are fair, just, reasonable, and sufficient for the Company and its ratepayers. Olympic asked that interim rates be collected subject to refund, and the Commission ordered them on that basis. The Commission now determines that refunds are owed, and requires Olympic to file a tariff rider that will return to ratepayers the excess collections of interim rates, plus interest, over the rates established in this order. In order to minimize negative effect on Olympic, the refunds must be paid over a period of two years.

II. PROCEDURAL HISTORY

A. Proceeding

12 Docket No. TO-011472 is a filing by Olympic Pipe Line Company on October 31, 2001, for a general increase in its rates and charges for providing pipe line transportation service within the state of Washington.

13 In its filing, the Company asked for a substantial—62%— increase in its rates; it sought immediate (December 1, 2001) implementation of the rates it requested, subject to refund; and it requested a policy statement or declaratory order determining whether the rate-base/rate-of-return methodology or the methodology used in calculating rates for oil pipeline companies by the Federal Energy Regulatory Commission (FERC) would be used to calculate the Company's need for a rate increase.

14 The Commission suspended the general rate increase tariff at its November 16, 2001, open meeting. It also determined to adjudicate, on a fast track, the request for immediate implementation of rates (referred to as "interim" rates in this order), and to address the question of methodology in the general rate proceeding and not independently. The Commission entered an order on November 20, 2001, effecting the suspension and denying the requested policy statement or declaratory order. The Company submitted an amended petition for immediate rate relief on November 21, 2001.

B. Interim Request

15 The Commission convened hearings on the interim proposal on January 14, 15, and 16, 2002. The Commission entered an order on January 31, 2002, in which it granted, in part, Olympic's request for interim relief, subject to refund. The Commission authorized an interim rate increase of 24.3% and, at the Company's request, required that the interim increase be subject to refund if the Commission found that the Company's evidence in the general phase of the proceeding failed to demonstrate a need for an increase of the magnitude of the interim rate.

C. Discovery-Related Matters

16 The Commission conducted numerous prehearing conferences and discovery hearings related to difficulties experienced by parties in securing information from Olympic.[1] Delays resulting from Olympic's failure to comply with commitments and Commission rules relating to discovery resulted in delays in the hearing. Olympic twice waived the suspension date for its filing for one-month periods, most recently until October 1, 2002.

17 Commission Staff moved to dismiss the docket for Olympic's failure to provide discovery responses when due. Hearing was held on the request on April 4, 2002. Commission Staff withdrew support from its motion, and instead requested a revised discovery deadline. Following discussions, the Commission orally granted the request for a revised discovery production date, and entered its Eleventh Supplemental Order on April 8, 2002, setting deadlines for discovery responses and compelling the production of the required information. Olympic failed to provide some of the information that Tesoro requested, and Tesoro moved on April 29, 2002, for sanctions based on Olympic's failure to respond. The Commission denied Tesoro's proposed remedy—to preclude certain issues from being litigated—but heard argument before the administrative law judge on the issues of whether violations occurred and the propriety of alternative sanctions. The administrative law judge entered the Thirteenth Supplemental Order finding that violations did occur and recommending imposition of sanctions. Parties offered comments on the proposal,

[1] The 13th Supplemental Order, provides some detail of and citations to the effort required to secure discovery responses and compliance with discovery rules in this docket.

and on July 23, 2002, the Commission entered its Sixteenth Supplemental Order affirming the proposed sanction.

D. Hearings

18 The Commission held evidentiary hearings on the general rate increase on 15 days during June and July, 2002. The record in this docket includes over 300 exhibits and 5,359 pages of transcript.[2] The proceedings were heard before Chairwoman Marilyn Showalter, Commissioners Richard Hemstad and Patrick Oshie, and Administrative Law Judge C. Robert Wallis.

E. Appearances

19 Respondent Olympic Pipe Line Company ("Olympic") appeared by Steven Marshall, William Ryan, William Maurer, and Jason Kuzma of Perkins Coie, attorneys, Seattle; William Beaver of Karr Tuttle Campbell, attorneys, Seattle; and Arthur Harrigan and Timothy Leyh of Danielson, Harrigan & Tollefson, attorneys, Seattle. Intervenor Tesoro Refining and Marketing Company ("Tesoro") appeared by Robin Brena and David Wensel of Brena Bell & Clarkson, attorneys, Anchorage, Alaska. Intervener Tosco Corporation ("Tosco") appeared by Edward Finklea and Charles Stokes of Energy Advocates, attorneys, Portland, Oregon. Commission Staff appeared by Donald T. Trotter and Lisa Watson, Assistant Attorneys General, Olympia.

III. INTRODUCTION

A. The Company

20 Olympic Pipe Line Company operates a common carrier pipeline from four refineries located in Whatcom and Skagit Counties near the Canadian border in western Washington. The pipeline extends to the state's southern border and crosses it to serve Portland, Oregon. Along the way, it delivers refined petroleum products to various facilities for retail distribution.

[2] As the Thirteenth order notes, however, over 1,000 of those pages were consumed in the resolution of discovery disputes.

B. The Owners

21 BP Pipelines (North America), Inc. ("BP"), owns 62.55% of Olympic's shares, and Equilon Pipeline Company, LLC ("Equilon") owns 37.45%. Equilon has been purchased by Shell but remains the nominal pipeline owner. The two shareholders, among the largest commercial enterprises in the world, each operate a refinery at a northern terminal of the pipeline.

C. The Shippers

22 Olympic serves its shareholders' refineries. In addition, it serves two other refineries in northern Washington State, operated by intervenors Tesoro and Tosco. All of the product transported by the pipeline originates at one of the four refineries. In addition to the four refineries' shipments on their own behalf, which comprise the bulk of the pipeline's traffic, more than 65 individual shippers purchase product from the refineries and purchase transportation directly from the pipeline.

D. The Intervenors

23 Tesoro and Tosco are intervenors, and oppose an increase in rates. Between them, their traffic totals about 23 per cent of the pipeline's transported volume, called "throughput."

E. The Operator

24 Olympic is now managed by a BP subsidiary, BP Pipe Lines, which is the second largest liquid pipeline company in the United States, operating in 33 states. In July 2000, BP Pipe Lines became the operator of Olympic Pipeline Company, replacing Equilon, Olympic's prior management company. All officers and personnel of Olympic are employees of BP. Olympic pays BP a fee for management services.

F. The Witnesses

25 Witnesses who testified for Olympic in this docket[3] included Larry Peck, BP's general manager of the products business line for BP pipelines and chairman of the board of directors of Olympic Pipe Line; Robert Batch, Olympic's President; George R. Schink, Brett A. Collins, Cynthia Hammer, James Mach, George R. Ganz, Leon P. Smith, Dan Cummings, Tom A. Wicklund, Bobby J. Talley, and Howard B. Fox. Tesoro's witnesses were John Brown, Frank Hanley, and Gary Grasso. Robert C. Means testified for Tosco. Commission Staff witnesses were Danny Kermode, Maurice Twitchell, Robert Colbo, Kenneth Elgin, and John W. Wilson.

IV. BACKGROUND

A. Olympic and Its Circumstances

26 Olympic is a company facing challenges, resulting from at least four principal causes. First, it is debt-ridden and has a negative equity. It has no owners' equity in its capital structure, and is obligated to pay off loans (mostly from its owners) with principal and accrued interest totaling nearly $150 million, but its assets in net carrier property have a book value of only approximately $118 million.

27 Olympic suffers from inadequate financing. The Company suffers from financial decisions that Olympic's witnesses candidly admit are aimed at furthering the business needs of the owners. Olympic can neither make nor commit to independent financial decisions. According to the record, the owners cannot agree among themselves to take actions aimed at correcting Olympic's financial situation.

28 Second, Olympic faces regulatory scrutiny based on a devastating accident, the failure of a pipe seam during hydrostatic testing, and the need to make changes and improvements both from its own view of safe operations and to comply with regulatory requirements.

29 Third, Olympic faces litigation from accident victims, from shippers, from owners, from regulatory agencies, and from branches of government, most of which relates to

[3] Olympic withdrew the testimony of William Beaver, one of its attorneys. The Commission granted a motion to strike the testimony of Christy A. Omohundro, because the answers she gave on deposition failed to demonstrate a sufficient foundation for the topic of her testimony. *TR 3924-5*

the Whatcom Creek explosion and to actions that led to and followed it. Some matters have been settled, but others remain pending.

30 Fourth, a FERC administrative law judge has proposed the total rejection of Olympic's interstate rate and the refund of all interim interstate rate collections, for the Company's failure to comply with FERC procedures.

31 This Commission has responded quickly, patiently, and appropriately to Olympic in this docket. On Olympic's expedited and extremely limited interim presentation, it granted rate relief that at the Company's request was made refundable. The Commission patiently encouraged compliance with discovery rules despite repeated failures of compliance, and directed the Company to take steps to reduce its burdens and speed responses. The Commission allowed the Company to make repeated changes to the evidentiary support for its proposal, overruling objections and motions to dismiss, toward the goal of getting sufficient, reliable information from which the Commission could make a studied decision. The Commission rejected pleas to dismiss the proceeding based on allegations that discovery failures prevented other parties' adequate preparation. The Commission rejected pleas to restrict Olympic's evidence, but also rejected Olympic's pleas to extend the time for decision, so the matter can come to closure and the Company can make rational and informed choices aimed at further resolving its financial and engineering problems. Finally, the Commission has given, and continues to give, appropriate consideration to the Company's problems and to accept information that in other contexts might be rejected.[4]

B. Quality of the Record

32 The Company had to deal with its external distractions, but it also had to deal with unavailability of some records because of a dispute with its owner and former manager Equilon and with changes in its accounting system, both of which hindered its efforts to produce data in response to discovery requests.

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[4] *See*, for example, *WUTC v. Rosario Utilities, LLC, Docket No. UW-951483*, Fourth Supplemental Order (Nov. 27, 1996). There, a water company's new owner found records of the prior owner too sparse to support regulatory review. Rather than merely deny the company's opportunity to prove its need for increased rates, the Commission accepted results of existing company information, a valuation study that the Company commissioned, and a Commission Staff investigation that together provided a reasonably reliable means of supporting the calculation of fair, just, reasonable, and sufficient rates.

33 Another apparent challenge was that the Company is inexperienced at intrastate regulatory issues. It has not previously experienced an intrastate rate case, nor has it proposed rates consistently with reference to the Commission's intrastate methodology. It failed to present knowledgeable witnesses to support its theory of the case, failed to present persons responsible for the Company's regulatory activities, and failed to present witnesses able to make commitments related to the Company's financial decisions. In addition, it failed to prepare an initial Washington State presentation. (After committing to file a request for rates consistent with State principles, it offered instead a copy of its filing with FERC to support its intrastate rate increase request.) While acknowledging that it has the burden to prove its need for a rate increase, it failed to present a consistent or coherent picture of its operations in the evidence it offered. It lacked adequate financial evidence and detail to support its presentation. It ended with a proposed test year of information that included nearly half a year of averages and budgeted figures rather than verifiable actual information. And it changed and updated its presentation so frequently and substantially that other parties contended that they could not check and verify the information to the extent they needed to develop confidence in the accuracy of the presentation.

34 Olympic repeatedly failed to meet minimal requirements of the rule relating to discovery, and it failed repeatedly to meet its own commitments relating to discovery. It failed to locate, collect, and prepare information in a timely way following its receipt of requests for information.

35 The Company did not devote adequate resources to discovery. It provided insufficient staffing and inadequate planning for discovery. According to representations on the record, Olympic was providing responses to often-identical discovery requests in both the federal and state rate proceedings and identical or substantially similar requests from different parties in the same proceeding, without making efforts to coordinate the responses, either internally or between attorneys representing it in the federal and state rate matters. This created a state of disarray that resulted in a direction by the Commission that Olympic's legal counsel begin such coordination, that opposing counsel coordinate with each other and with their counterparts in the FERC proceeding, and that counsel set priorities for their requests, in order to increase the likelihood that they would receive the most critical information first.

36 Staffing and the effort expended on discovery responses appear to constitute a definite choice. The Company asserted rate case costs of $2.4 million and chose to have multiple lawyers (seven) in the hearing room, yet failed to provide sufficient staffing to plan, track, and produce discovery responses.

37 Olympic's attorneys, based on their statements during discovery-related proceedings of lack of knowledge about Company progress in producing discovery responses, apparently failed to monitor Company discovery production. Olympic failed repeatedly to comply with provisions of the Commission's discovery rule, WAC 480-09-480.[5] It initially ignored some parties totally when preparing responses, neither providing any requested information nor bothering to explain what they were doing or when they would provide the information. Olympic appeared to ignore repeated requests, imprecations, and directions from the Commission to manage discovery and comply with discovery rules.[6] Olympic repeatedly failed to fully comply with WAC 480-09-480, which requires it to cooperate with other parties, share information about the status of requests, tell parties promptly about delays and when responses will be available, and communicate informally with regard to problems, understandings, or concerns. These failures cannot be explained by inadequate staffing, as compliance with these requirements is the responsibility of counsel and the Company had at least seven attorneys, with the resources of large and experienced firms, representing it in this proceeding. Finally, Olympic failed to comply with a Commission order compelling it to provide information.[7]

38 The result of all of these events is a Company presentation that is inadequate. Were it not for the efforts and the presentation of Commission Staff, and the Commission's obligation to act in the public interest and to determine rates that are fair, just, reasonable, and sufficient, the Company's presentation would require dismissal.

C. Request for Dismissal

39 Tesoro asks that the Commission dismiss this proceeding. Dismissal is not the answer here. We find that the entire record is sufficient for necessary decisions. All

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[5] *See*, the Thirteenth and Sixteenth supplemental orders in this docket and citations therein.
[6] *See*, Thirteenth Supplemental Order, paragraphs 5 through 8 and paragraph 13, and references cited therein.
[7] Sixteenth Supplemental Order.

of the parties deserve answers to some of the basic questions that Olympic raises: What regulatory methodology should govern the setting of Olympic's rates? What effect should be given to some of the decisions Olympic has made? What capital structure is appropriate for ratemaking purposes? What level of rates is appropriate, given the Commission's access to a sufficient record to make that decision? Resolving the issues brings closure to this record and this matter, offers a vehicle to define clearly the kinds and the depth of information that the Company should provide in future proceedings, and makes considerably easier the Company's next approach for rate relief.

40 To resolve this matter the Commission will focus on the Company's objective indicators of need, make the best of the information that is available in the entire record, resolve the legal, policy, and evidentiary issues posed by the record, provide Olympic and its customers with rates that are fair, just, reasonable, and sufficient, given the record available to work with, and instruct the Company clearly on what it must do to comply in the future with economic regulatory requirements in this jurisdiction. In this order the Commission encourages and provides incentives to the Company to address its current challenges and to return with a well-prepared, coherent, verifiable, and adequately supported rate proceeding in the near future.

41 The Commission in this order reviews the evidence and the arguments of parties regarding Olympic's request in this docket for a general rate increase request. In doing so we will in general follow the outline of the parties' briefs.

V. LEGAL STANDARDS AND GOVERNING PRINCIPLES

42 The parties appear to agree about the basic framework that governs ratemaking in Washington State. They appear to disagree about the meaning of some terms and about what actions constitute proper or sufficient behavior under the law.

A. Burden of Proof

1. Burden of proof generally

43 All parties agree that Olympic bears the burden of proof to demonstrate that it is entitled to the rate relief that it requests. Olympic's view of its burden differs from the view of the other parties. Olympic notes that this means it must prove its

entitlement by a preponderance—51%—of likelihood. However, Olympic often relies on accounting principles that are not designed for ratemaking calculation, on unverified reports, on estimates based on averaging of months that are not shown to be representative of the period they are asked to represent, on budgeted rather than actual numbers, and even on the generalized testimony of witnesses, without an additional basis, to support its presentation. Evidence with such deficiencies is not sufficient in ratesetting matters except upon a strong showing of necessity and urgency and the unavailability of other information. We find no such showing, except as noted in this order. Another perspective is that accurate and supportable direct information is the best evidence, and that without reliable and detailed support for the statements of witnesses, such evidence lacks credibility for the purpose of setting rates.

44 Olympic's use of estimated, budgeted, and unverifiable figures—and in many instances no figures at all—fails any test of reliability that the Commission has used when actual, verifiable, historical results of operations have been available. The matters at issue—rates that could mean millions of dollars of additional revenue to Olympic and millions of dollars in additional expense to Olympic's shippers, and Olympic's status as the only party who can reasonably be expected to have the relevant information—demand that Olympic provide detail to support its contentions.

45 The Staff and opposing parties have no independent source of internal Company information and must, therefore, rely on the Company to supply the formation necessary to test the reasonableness of the Company's request for rate relief. In a discouraging number of instances, it failed to produce timely, accurate, or verifiable information to support what its witnesses said. It asks the parties and the Commission to take on faith that the witnesses' testimony accurately[8] represents the Company's true results of operations for ratesetting purposes,[9] when those witnesses could not provide details demonstrating that the numbers actually supported the proposition for which they were offered.

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[8] There is no perception that Olympic's witnesses were less than forthright in their testimony. The honesty of their testimony adds support to the information they were able to provide, but lack of supporting detail is a barrier to its acceptance.

[9] We address below the distinctions between acceptable principles for reporting actual financial results and conditions, and acceptable principles for the calculations for rates to apply in the foreseeable future.

46 Only the information and the analytical expertise contributed by Commission Staff permit the Commission to make a reasonable and legally sufficient assessment of the Company's condition and its need for rate relief. The Company failed to meet its burden to prove by a preponderance of the credible evidence that it is entitled to the rate increase it requests and it is only through the contributions of other parties' evidence and analysis that this record is sufficient.

2. Use of the Interim order as proof of matters contested in the General phase

47 On brief, Olympic argues that its preferred result is supported or mandated because the Commission has already decided a number of controlling issues in the Third Supplemental Order on interim relief (Interim Order).[10] Olympic's reliance on the Interim Order is misplaced. The results of that order and the analysis, findings, and conclusions that support that order's result have no necessary bearing on the result of the general rate increase phase of this docket.

48 The Commission's Interim Order noted at paragraph 11 that:

> A request for interim relief, as we discuss at greater length below, presents only the opportunity to review a short-term snapshot of the extent of need and to examine whether circumstances allow for a longer-term review or require that we take action immediately.

49 The Commission emphasized in the Interim Order at paragraph 10 that the record produced in the interim proceeding raised numerous questions. The Commission stated that a complete record and answers to many of those questions would be required before the Commission could analyze the Company's needs.

50 Now Olympic has had the opportunity to present its full case, and the parties have contributed to make a sufficient record. It is a different record from the record on the interim, supported with considerably more information. Findings on the interim were based on a tiny fraction of the information now available. The Commission must now make findings based on all of the evidence that is now available. This evidence demonstrates a Company that is operationally stable (if its owners so permit), meeting

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[10] *See* Olympic's opening brief at paragraphs 1, 2, 7, 17, 159, and 178.

its challenges, and working consistently toward solving its problems. The former findings and conclusions are not precedential, and do not now bind the Commission as it views the complete record.

B. Determining Fair, Just, Reasonable and Sufficient Rates.

1. General Considerations

51 All parties agree that the Commission is obligated to establish rates for carriers that are fair, just, reasonable, and sufficient. Under RCW 81.04.250, the Commission in setting rates

> . . . may use any standard, formula, method or theory of valuation reasonably calculated to arrive at the objective of prescribing and authorizing just and reasonable rates.

52 The statute specifically authorizes, but does not require, the Commission to give consideration to the following factors, in addition to others: the effect of rates on the movement of traffic; the public's need for transportation facilities and services at the lowest level of charges consistent with providing, maintaining and renewing the facilities and service; and the carrier's need for revenue at a level that "under honest, efficient, and economical management" is sufficient to cover costs of service and a reasonable profit.[11]

53 The parties present two regulatory methodologies for the Commission to consider in discharging its duties under the statute: a methodology Olympic proposes, which it states is used by FERC, and a depreciated original cost methodology, which Staff and intervenors propose and which this Commission has used extensively in regulating public utilities under Title 80 RCW.

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[11] *RCW 81.04.250*. The statute also allows the Commission to consider the relation of carrier expenses to carrier revenues. The Commission has undertaken a comprehensive study of costs and expenses for carriers of persons and property by motor vehicle and uses operating ratios in setting rates in those industries, where a large number of carriers are regulated. The Commission has not undertaken such a study for pipeline carriers, and the record in this docket does not explore any element of such a ratio for Olympic or other pipeline carriers. The Commission therefore rejects Olympic's suggestion on brief relating to an operating ratio.

2. End Result Test; Public Interest Test.

54 All parties agree that the Commission must set rates that are fair, just, reasonable, and sufficient. Olympic now says its presentation supports a 59% increase in rates. It urges in its answering brief, however, that if the level of rates calculated according to formulae of general application is not sufficient to induce its owners to make further investment, the Commission must nevertheless approve a 47% rate increase[12] to achieve that purpose, in order to satisfy both an "end result" test and a "public interest" test.

55 Olympic calls attention to what it calls the "end result" test. It argues that the Commission has the obligation to make such adjustments to ratesetting as may be called for by circumstances. It urges an "end result" test that it says requires the Commission to increase the authorized rates to secure additional investment. Olympic also urges application of what it calls a "public interest" standard. In support of this standard it says that the Company's rates will not be felt by members of the public; that the intervenor ratepayers are large companies for whom the rate increase would be a tiny portion of their revenues; and that the interim order proves that the Company needs additional revenues.

56 Tesoro responds that the end-result test is a mechanism for judicial review in which a zone of reasonableness is confirmed, not an excuse for acting in derogation of the statutory standards. Tesoro argues that the public interest standard is an umbrella under which all Commission activity must take place, not a vehicle that Olympic can ride to whatever result its owners wish to achieve, and that it will not allow the Commission to authorize Olympic to recover expenses that are not reasonably proved or investments that it hasn't made. Commission Staff argues that there is no "amorphous" public interest standard that entitles a company to whatever it seeks, but that the Commission must comply with the general mandate in RCW 81.01.040 to regulate in the public interest "as provided in the public service laws."

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[12] The Company did not announce a number prior to its answering brief. It calculates this number as definitive based on Mr. Peck's testimony that at then-current rate levels the firm was able to cover operating needs. Neither the calculation nor the testimony are supported by objective evidence or expert testimony explaining the basis for underlying decisions leading to the 47% conclusion. The calculation assumes a relationship with interstate rates, which in light of recent information of record that Olympic's interstate rate application is subject to dismissal appears to be uncertain at best. Olympic has provided no objective basis for concluding that the proposed level of intrastate rates is necessary to produce rates that are fair, just, reasonable, and sufficient.

57 The Commission concludes for the reasons cited by Staff, Tesoro, and Tosco that neither an end-result test nor a public interest test is shown on this record to override the statutory requirements for calculating rates that are fair, just, reasonable, and sufficient. The mechanisms that the Commission uses in this docket have passed judicial scrutiny as meeting the requirements of statute and constitution and being consistent with the public interest. As Tosco points out in its answering brief, the Commission's methodology is well established and has been proven sufficient to set rates that attract capital and are fair, just, reasonable, and sufficient.

3. Commission's dual role.

58 Olympic contends that the Commission's dual role as economic regulator and safety regulator requires it to set rates sufficiently high to fund safety requirements. Tesoro points out that the safety role does not mandate that the Commission abandon its statutory ratesetting responsibilities. Staff argues that all parties agree that Olympic must operate safely and that it must have rates sufficient to meet its reasonable capital needs. Tosco states that all regulated companies must prove in the ratesetting process that their needs for safety investments are real.

59 The Commission must include in rates the opportunity to recover all reasonably proved expenses of an efficient and well-operated pipeline company. In general terms, these include all reasonable expenses, reasonably proved, and include the return of capital through depreciation and the cost of obtaining capital needed for the operations. Intervenors and Commission Staff do not challenge the proven expenditures that Olympic claims as safety related.

60 The Commission reaffirms its obligation as an economic regulator to provide Olympic, as any other utility that it regulates, the opportunity as a prudently run and efficient business to earn a reasonable return, after payment of its reasonable expenses. There is no inconsistency posed by existence of the Commission's dual role, which exists in other industries as well as in pipelines. There is no obligation to treat safety items separately from other expenses or capital investments. The Commission includes in the calculation of rates the opportunity to recover all reasonably proved safety items.

61 It would violate the statutory mandate that we set fair, just, reasonable, and sufficient rates to increase Olympic's rates above the level that is found proper, merely because its owners demand a higher return than proper as a prerequisite to further investment.

4. Federal / State Jurisdictional Legal Issues.

62 Olympic states that the same pipes and personnel and energy and all of the other resources needed to provide service are required to provide both interstate and intrastate service, and that it is improper for states to discriminate against Olympic's interstate customers by charging different rates. Therefore, the Company argues, the Commission should use FERC methodology to ensure that there is no illegal discrimination.

63 Intervenors and Commission Staff challenge this argument. Commission Staff points out that the federal law preserves independent state jurisdiction.[13] It is not illegal for federal and state rates to be set on different bases. Staff points out also that Olympic, in its filings with the Commission in prior years, has neither consistently used the same methodology in calculating rates nor maintained identical rates in the two jurisdictions.

64 Tosco and Tesoro both point out that the Commission has addressed and resolved this issue in the Eighth Supplemental Order in this docket. There, we ruled that the Commission is bound to follow state law in setting rates. We have no legal obligation to abrogate our ratesetting responsibilities under state law in order to mirror interstate rates for which different costs and different regulatory frameworks may apply. The Commission will set rates consistent with the requirements of state law, as set forth in the Eighth Supplemental Order,[14] as we are permitted to do under the Constitution and laws of the United States. Those rates will meet the statutory and Constitutional tests applicable to ratesetting. We will consider Olympic's proposal to use methodology of the Federal Energy Regulatory Commission (FERC). But we are not legally bound to adopt FERC procedures, and we will use principles of state law to determine whether their application is appropriate.

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[13] *Simpson v. Shepard*, 230 U.S. 352, 418, 33 S. Ct. 729, 57 L. Ed. 1511 (1913).
[14] *Eighth Supplemental Order*, March 8, 2002. The Eighth order denied reconsideration of the Commission's final order granting interim relief. Inasmuch as no review was taken of the order, the matter appears to be resolved for purposes of the proceeding.

5. Investor Expectations; Right to a Methodology.

65 A related legal issue with regard to methodology is whether the Commission has previously approved use of the Company's proposed FERC methodology and, if so, whether Olympic or its investors have a right to the continuation of the prior methodology. Our answer to those questions is "No."

66 This is not the first time that Olympic has filed rates for intrastate traffic within Washington State. Since completion of the pipeline in 1969, it has filed for rates on a number of occasions. Without exception, until the most recent two filings, the Commission has allowed those rates to go into effect by operation of law.

67 The process of allowing rates to become effective is set out in Washington statutes. Pipeline companies must file rates at least 30 days before their stated effective date. *RCW 81.04.130*. This is to allow the Commission the opportunity to review proposed rates to determine whether they should be suspended for further study. If not suspended, the tariffs become effective. *RCW 81.28.050.*

68 Olympic argues that its prior filings were all made under FERC methodology and that by allowing them to go into effect, the Commission was making an affirmative decision to adopt FERC methodology. It cites Staff memoranda prepared for open meeting decisions on whether to suspend proposed rates for review to support its argument that the Commission made a choice to adopt the FERC methodology. It then argues that this adoption gave rise to investor expectations that preclude the Commission from departing from FERC methodology and, indeed, give investors the right to penalties in the form of asserted deferred profits that Olympic allegedly forewent by using FERC methodology. It asks for the return of this deferral over a five-year period to avoid a challenge under the Constitution for a taking without compensation.

69 Tosco responds, consistent with Tesoro and Commission Staff, that Olympic has not before proposed to the Commission the methodology that it now offers, that it has not been consistent in the methodology of its filings before this Commission, and that its Washington State rate filings have not been consistent with its filings before FERC. Commission Staff argues that Olympic produced no proof of investor expectation, and Tesoro, citing Olympic board minutes, says the evidence proves just the opposite. Staff cites *Farmers Union Exchange v. FERC, 734 F.2d 1486 (1984) and P.O.W.E.R.*

v. Utilities and Transportation Commission, 104 Wn.2d 798 (1985) for the proposition that investors have a right to regulated rates that are fair, just, reasonable, and sufficient—but they have no right to any particular methodology.

70 Olympic is correct that the Commission has not suspended any but the most recent of its prior rate filings. The significance of that pattern is far less, however, than the Company seeks to make of it. First, the Commission has never taken any action in any setting to approve the Company's rates or any methodology on which they were based.

71 The question upon review of a filing is whether to allow it to go into effect or to suspend it for closer review. By declining to suspend, the Commission makes no ruling on the propriety of a filing. The statutory framework itself makes clear that the Commission adopts no part of a filing that it does not approve. It provides that a filing will become effective unless the Commission suspends it,[15] not that a filing becomes or is deemed to be approved without suspension. Failing to suspend merely means that the filed rates become effective and that the filing company has the right and obligation to collect them until it files replacement rates that become effective or until the Commission or third parties prevail in a complaint against the rates. The Commission cannot establish rates without a hearing. *RCW 81.28.230*.

72 Moreover, Olympic has not consistently used any methodology to support its filings with the Commission, and its filings have not consistently paralleled its FERC filings. The Company is not now proposing the same methodology that it used to calculate rates in prior filings. It used a valuation methodology prior to 1996 and has used different methods of calculation since then. Its claim that investors have a right to the continuation of the methodology that the Company has used in the past rings hollow under the facts and under the law. Even if the Commission had adopted FERC methodology, the *Farmers Exchange Bank* and *P.O.W.E.R.* decisions cited above make clear that there is no right to a particular methodology in the determination of rates.

73 Finally, there is no evidence of any expectation on the part of the investors in Olympic in any methodology. On the contrary, indications from Board minutes following the Whatcom Creek incident give no indication of reliance on any

[15] *RCW 81.04.130; RCW 81.28.050*.

methodology and state an expectation of a far lower rate request than Olympic later sought.

74 Without so labeling its claim, Olympic is presenting an argument of estoppel. Here, however, it is not presenting its own claim, but that of its owners. Our first observation is that Olympic's interests are different from those of its owners, and its owners could have intervened to present their own claims. Their participation could have assisted the development of the record. They did not choose to intervene, and therefore the record is almost totally devoid of direct evidence as to their claim of reliance as well as to other of their actions and decisions.

75 Surmounting for purposes of discussion the hurdle presented by absence of the asserted injured parties from the proceeding, estoppel requires a clear showing of (1) an admission, statement, or act, inconsistent with a claim afterward asserted; (2) action by the other party on the faith of such admission, statement, or act; and (3) injury to such other party arising from permitting the first party to contradict or repudiate such admission, statement, or act. *Shafer v. State, 83 Wn.2d 618, 521 P.2d 736 (1974); Metropolitan Park District v. State, 85 Wn.2d 821, 539 P.2d 854 (1975).* Estoppel is founded in fraud, to prevent one who lures another into changing position from taking advantage from the misdeed. *Black's Law Dictionary, Equitable estoppel, 571 (7th Ed., 1999).*

76 All elements of estoppel must be proved. *Dept. of Ecology v. Adsit, 103 Wn.2d 698, 694 P.2d 1065 (1985).* Surmounting for purposes of discussion the absence of evidence that the Commission actually adopted a methodology, or that it announced doing so, or that it could legally do so without a hearing; surmounting the absence of evidence and cross examination as to exactly what actions were taken by the Olympic's owners on the faith of any asserted admission, statement, or act; and surmounting the absence of evidence and cross examination as to injury to the owners arising from the asserted contradiction or repudiation of such admission, statement, or act, we note that estoppel will not be found against government acting in a governmental (as opposed to proprietary) function unless necessary to prevent manifest injustice and unless the exercise of governmental function is not impaired. *Finch v. Matthews, 74 Wn.2d 161, 443 P.2d 833 (1968).* Here, ratesetting is one of the Commission's core governmental functions. *Title 81 RCW.* Adopting Olympic's position would impair the Commission's ability to set fair, just, reasonable and

sufficient rates in this proceeding and perhaps in other, future proceedings.[16] Olympic has not shown manifest injustice to itself or others: it chose to propose the rates that it did; it chose not to ask the Commission to determine the issue of methodology until it sought this rate increase; it chose not to seek rates at an earlier time; and it earned net income and paid to its owners a substantial amount of dividends based on the rates that it filed.

77 Finally, when a representation is a statement of law, reliance may not be claimed because those asserting reliance have every opportunity to determine the truth of the representations.[17] Here, Olympic asserts the representation of a matter of law, but those whose injury is argued had every opportunity to examine the law to learn that the Commission had not made a determination as to the appropriate methodology to apply to Olympic, that the Commission has the discretion under law to adopt a methodology, and that there is no right to a particular methodology.

78 For all of these reasons, we determine that there is no indication in fact that Olympic's investors ever had an expectation of rates set according to Olympic's proposed "FERC" methodology and we determine that Olympic's investors have no right or entitlement to the continuation of any asserted methodology.

6. Retroactive Ratemaking.

79 The parties agree that it is improper for the Commission to engage in retroactive ratemaking.[18] Olympic contends that it is not seeking retroactive rates; the other parties disagree.

80 Retroactive ratemaking could arise from two situations in this docket. The first is Olympic's request to recover alleged deferred equity returns from prior periods that were not actually deferred on Olympic's books and for which the Commission did not authorize deferral. The second relates to the Company's deferred payment of interest

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[16] It could also act to the detriment of ratepayers, resulting in an improper advantage to one group of private individuals to the detriment of others. *U.S. v, Chappelle, 81 F. 152 (1897).*

[17] *Chemical Bank v. Washington Public Power Supply System, 102 Wn2d 874, 691 P.2d 524 (1984, cert. Den. Haberman v. Chemical Bank, 471 U.S. 1065, 85 L.Ed.2d 497, 105 S.Ct. 2140 and Chemical Bank and Washington Public Power Supply System v. Public Utility District No. 1 of Benton County, Washington, 471 U.S. 1075, 85 L.Ed.2d 510, 105 S.Ct. 2154).*

[18] *See*, Olympic's opening brief, par. 24; Tesoro's opening brief, paragraphs 37-38; Staff's brief, pp. 9-10.

relating to past periods, which it now seeks to collect through future rates as unpaid interest or interest on that unpaid interest. We will address those issues later in this order.

7. Status of Company Books and Records.

81 The status of Olympic's books and records was a topic of considerable interest and some heat during the discovery and hearing phases of this docket.

82 Much was made of Olympic's inability to produce an unqualified certified audit report[19] for prior periods. Olympic explained that one of its owners, Equilon, had been the prior manager. On the substitution of BP as manager, Equilon took the Company's records and refused to provide information to the auditor.

83 That issue appears headed toward resolution. Olympic offered to the record on August 12, 2002, after the record was closed, a copy of an unqualified certified audit report produced by the firm of Ernst and Young. The Commission rejected the proposed exhibit, finding that the timing prevented discovery and cross-examination about the document at this stage of the proceeding, and finding that the document could engender further delay if we interrupted the briefing schedule to allow testing of the document. [20]

84 We do not believe that it is necessary to do more than acknowledge the offer of the audit report, because the Commission does not consider lack of an audit report in setting rates in this docket. We accept Olympic's books for purposes of this proceeding, as recommended by Commission Staff, with necessary adjustments for ratemaking purposes. Olympic in general keeps its books according to generally accepted accounting principles, or GAAP, and its reports to the FERC and to this Commission under the FERC Uniform System of Accounts, or USoA.[21]

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[19] In this context, an "unqualified" report is one that may state conditions for understanding of the presentation but is not qualified in its assessment that the reports adequately reflect the Company's condition.

[20] The Commission rejects Olympic's petition for administrative review of the order rejecting the exhibit. Administrative review does not lie against the order because it is not an initial order resolving the issues in an adjudication. RCW 34.05.461. Olympic did not petition for review of the interlocutory order under WAC 480-09-760 within the time allowed by rule.

[21] When the terms Uniform System of Accounts and USoA are used in this order, they refer to the Uniform System of Accounts prescribed by the FERC. The USoA is in the record as Exhibit 1105 and is set out in the Code of Federal Regulations at 18 CFR 352.

85 It is an elementary ratemaking principle that a company's results per books, whether GAAP, USoA, or other standards, are not displayed for the purpose of determining proper rates for future periods. Instead, they are designed to give investors and regulators an accurate picture of what actually happened during the period of the report. An annual report that all agree is accurate does not answer the ratemaking question of whether the income during the period is properly matched with the expenditures, so that in setting rates the Commission is reasonably sure that ratepayers in the near future will be paying the costs of the service that they receive. To make those determinations, it is necessary to remove elements that are related to prior periods, that are not representative of a typical year, or that are not related to the regulated business (restating actual adjustments), and to include elements that are known and measurable for the future (*pro forma* adjustments). It is also necessary to understand exactly what each financial entry contains, so the classification of income and expenses may be properly made.

86 Challenges for this record arose when the Company witnesses tried to explain what the entries meant and what was included, and when the Commission Staff auditors attempted to trace transactions through the system to determine proper ratemaking treatment for the events underlying the recorded numbers.

87 The testimony of Ms. Hammer and Mr. Collins about the Company's books, and the testimony of Mr. Twitchell and Mr. Colbo about their examination of the books, made clear that it was not possible to trace many individual cost items through the Company's bookkeeping system in order to verify the accuracy of the Company's presentation. The Staff witnesses testified in detail about their challenges in attempting to verify individual elements, including their discovery of the posting of a considerable volume of information on a cash basis instead of the required accrual methodology that would better tie expenditures to the proper periods. Ms. Hammer confirmed that the underlying documents—receipts or invoices—might not be traceable or available at all, that the classification of expense elements was done by different people and not checked during the process of entry into the Company's electronic bookkeeping system, that the means of calculating some numbers is through a formula embedded in the software, and that she had no independent knowledge (other than observing the relationship of the resulting numbers) about how or why the formula was used or the nature of its details.

88 Ultimately, the Commission Staff members used a variety of means by which they gained sufficient confidence in the books and records to certify to us that, subject to recommended adjustments, the Commission can have confidence that the results for calendar year 2001 are adequate for ratemaking purposes. The usefulness for ratemaking purposes is independent of the question of whether any underlying numbers were certified in an audit or whether they complied with GAAP or USoA standards. It is of course true that well—and consistently—kept books, following required accounting methods, are helpful and would greatly assist the ratemaking audit process.

89 For the future, it is clear that Olympic must develop some way of tracking items in its system and verifying their classification; improve the accuracy of a ratemaking audit; and lend additional confidence to the results of a ratemaking examination. Some of the issues in this docket could have been resolved more easily if the Company had better access to adequate records and had shared that access early on.

VI. CHOICE OF RATEMAKING METHODOLOGY

A. Ratemaking Methodology.

90 Olympic urges that the Commission adopt a ratesetting methodology that it says is used by FERC in setting rates for interstate traffic on regulated pipelines. Other parties oppose the proposal. We will first seek to define the proposal that Olympic is making, and then address the parties' arguments as we look at the basic contentions about the use of Olympic's methodology and the alternative approach that this Commission has used in other proceedings.

B. Consideration For and Against the Proposed FERC Methodology.

91 Olympic asks the Commission to apply "FERC methodology." As parties have noted, there is more than one methodology for presentations to FERC. Olympic states that it proposes a regulatory methodology propounded in FERC Order 154-B, and we will evaluate its application on that basis.

92 In this docket, Olympic asks the Commission to apply the "154-B methodology,"[22] first because it is obligated to do so (which theory we have rejected above). Olympic also contends that the proposed methodology represents the best methodology for the review of oil pipeline rates. We have the authority to consider Olympic's proposal under RCW 81.04.250.[23]

1. Nature of Oil Pipelines.

93 Olympic contends that the inability to regulate entry and exit is a critical difference between pipelines and other regulated industries that demands a regulator look critically at the standards to apply in setting rates for pipelines. Olympic urges that the Commission find oil pipeline regulation so fundamentally different from the regulation of other common carriers that it justifies application of a FERC methodology containing standards entirely different from the Commission's preferred rate methodology.

94 Tesoro responds that there is nothing about the pipeline industry or the history of its regulation that should persuade the Commission to alter Washington State methodology for setting the rates of public utility companies. It points out that the State Legislature has dictated the standards to apply within the state.

95 Commission Staff responds that there is no fundamental difference at all between oil pipelines and other public utilities that are regulated in Washington State. Among the common attributes with other utilities are high fixed costs and low operating costs, economies of scale, the absence of legal barriers to entry, and little or no competition.

96 The Commission finds that there is no fundamental difference between oil pipelines and other industries regulated by the Commission. Electric companies and wireline telephone companies have the same economic attributes - businesses with high fixed costs and relatively low operating costs—but merely deliver different products. The Commission does not regulate entry or exit in either of those industries.

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[22] Tesoro argues that Olympic's presentation does not comply with the FERC methodology, citing Tesoro witnesses Grasso and Brown. In particular, they point out that the FERC methodology does not allow recovery of deferred returns from periods in which the valuation methodology was not in effect, does not allow a starting rate base write-up, and does not allow use of the parents' capital structure.

[23] See the discussion earlier in this Order of our authority and obligations under this statute.

97 Olympic urges that the existence of competition is also an argument for the FERC methodology. Commission Staff points out that Olympic has failed to demonstrate that competition exists for Olympic's business. Other modes of petroleum product transportation do exist. In particular, the four refineries served by Olympic also transport refined products via motor carrier and via barge. While Olympic argues that these transportation modes offer real competition to Olympic, it failed to provide information to the record about the rates charged for those services. Tesoro did offer evidence of rates, which so substantially exceed the pipeline rates for transportation that even were the requested increase granted in full, other modalities would still cost much more than pipelines for transportation services. Olympic confirmed that it has more demand for pipeline transportation than it can fill, demonstrating that despite the availability of other modalities, Olympic loses no traffic to its competition. Olympic is commercially able to operate at full throughput—there are no occasions reported on the record when demand for Olympic's pipeline was undersubscribed. Olympic contends that even were its originally-proposed 62% rate increase approved, its shippers would not need to pass any increased costs along to retail customers. Finally, the record demonstrates that Olympic offers advantages in efficiency as well as economy to shippers that other modes do not, including greater convenience in many settings.

98 The elements that Olympic offered for consideration as to the nature of the oil pipeline industry provide no meaningful distinction from other regulated companies to support application of the proposed FERC ratesetting methodology.

2. History of Regulation.

99 Olympic asks the Commission to review the history of oil pipeline regulation at the federal level, arguing that the history of federal regulation demonstrates that the proposed application of FERC 154-B principles is proper for use in Washington State.

100 Commission Staff responds that the history of oil pipeline regulation in Washington State dates back to the early days of the prior century, within a decade of the inception of oil federal pipeline regulation. Regulators of oil pipelines and other utilities used a valuation methodology in setting rates.[24] That ratesetting

[24] Under a valuation methodology (sometimes called replacement cost ratemaking), rates were set on the value of a company's assets rather than on the original cost of those assets. In times of rising

methodology was found improper by a United States Supreme Court decision.[25] There is no evidence of the need for or use of any so-called transition methodology in any other industry.

101 Commission Staff notes that Olympic finds distinctions from other regulated industries in provisions of the Interstate Commerce Act that do not apply to pipelines. Commission Staff also suggests that we look at the history of Olympic's filings with the Commission. As noted above, we find that Olympic has not used a consistent methodology in its filings.

102 Olympic's evidence and its arguments regarding the history of oil pipeline regulation fail to demonstrate any distinction between pipelines and other industries regulated by the Commission that would warrant consideration of special regulatory provisions such as Olympic proposes. On each of the proposed distinctions, we find that there is no difference that would argue for a different ratesetting methodology.

3. Consistency with Interstate Rates.

103 Olympic argues that consistency between interstate and intrastate rates best serves the public interest. Other parties contest that argument.

104 Commission Staff states that consistency is neither required nor achievable, and points out that even under Olympic's filings there has been no consistency between interstate and intrastate rates for several years. Tesoro states that the Commission is not obligated to match interstate rates. It also notes that Olympic itself has failed to file consistent versions of interstate calculations.

105 The Commission rejects Olympic's argument. The state and the federal government each set rates on jurisdictional traffic. As noted above, a state commission is not obligated to produce rates consistent with interstate rates—only to determine rates that are fair, just, reasonable, and sufficient. We find no policy reasons to support the concept of identical rates to the exclusion of factors that meet Washington's statutory standards.

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values, a company would earn on the value of assets rather than a return on the capital contributions of the investors.

[25] "The heart of the matter is that rates cannot be made to depend upon 'fair value' when the value of the going enterprise depends on earnings under whatever rates may be anticipated." *FPC v. Hope Natural Gas Co.*,320 U.S. 591, 601, 64 S. Ct. 281, 88 L. Ed. 333, (1944).

4. Review of the FERC Methodology.

106 Olympic argues for the application of FERC's "trended original cost," or TOC, methodology. Under that approach, the cost of equity is calculated by combining narrowly defined discounted cash flow with the depreciated original cost (DOC) methodology, similar to but not identical with the methodology by which the Commission has decided many rate proceedings. Under TOC, the effect of inflation is then identified and taken from the return. The earnings that would have been realized from inflation are calculated and deferred, and the company is allowed a return on and amortization of the deferred earnings. In this proceeding, Olympic argues that the Commission must apply the TOC methodology by relating back to 1983 and to calculate a starting rate base of $9.1 million. The imputation of a starting rate base enabled it to calculate a deferred return of $23.8 million on which it must earn a return and which, it argues, constitutes an asset that the Commission cannot take away without compensation.

a. Trended Original Cost (TOC) Methodology.

107 Olympic contends that, over time, the returns under the TOC methodology and the depreciated original cost (DOC) methodology are identical and the only difference is the timing of recovery. Olympic argues that TOC recognizes competition faced by many new pipelines and tends to foster future competition. Olympic also argues that the DOC methodology creates a potential for underinvestment not present in TOC.

108 Tesoro and Commission Staff both challenge Olympic's contentions. Tesoro contends that Olympic cites no authority for its arguments, and disputes the contentions in witness Smith's testimony. Commission Staff argues that there is no supporting evidence for the contentions and that courts have determined that any lawful methodology gives investors a fair return. Commission Staff points out that Olympic conceded that competition provides no grounds for a TOC methodology when a pipeline faces no competition.

109 Tosco acknowledges that the FERC rationale in adopting TOC methodology related to fostering competition from new pipelines. It points out that the factors assertedly significant to the FERC rationales do not exist here. Tesoro points out that Olympic

does not explain why the FERC's underlying rationale is relevant to the Commission's regulatory responsibilities.

110 Olympic responds that a midstream change in ratemaking methodology is unfair.

111 The Commission finds no rational analysis in this record that supports use of the TOC methodology. Olympic is not faced with effective competition—from existing or prospective oil pipelines or from any other modes of transportation—and Olympic does not explain why the FERC rationale should apply here. We disagree with Olympic's conclusion that over time, the result is identical in TOC or DOC. The Commission agrees with Tesoro's observation that TOC methodology is more complex and, to the extent that it errs in its calculation of inflation, or to the extent that a company operates more or less efficiently than anticipated, or to the extent that a company fails to seek regular updates of the methodology, TOC could easily produce a legacy ratepayer obligation larger or smaller than intended. It is much better to avoid bifurcation of a derived rate of return.

112 By means of its deferral of earnings, TOC produces, by definition, a situation in which future ratepayers pay for past costs. In some industries, for limited purposes and for good reason shown, the Commission has authorized deferrals. It has not done so in a manner analogous to Olympic's proposal, nor for the time frame suggested. Olympic has neither asked for the authority to book deferrals nor has it actually recorded them. We treat the issue of deferrals in more detail, below.

113 We reject the contention that there is a potential for underinvestment unless TOC is applied; the record fails to demonstrate any objective evidence to that effect and fails to provide a persuasive rationale. Finally, we reject Olympic's contention that to change methodologies in midstream would be unfair, because there simply is no stream flowing here. The Commission allowed rates to become effective. It did not approve Olympic's use of the TOC methodology, did not approve a starting rate base, did not authorize the Company to record any deferrals, and did not authorize deferred returns.

b. Starting Rate Base and Deferred Return.

114 Olympic proposes calculation of a "starting rate base," a device developed by FERC as a transition mechanism when it accepted regulation of oil pipelines from the

Interstate Commerce Commission (ICC). Olympic argues that if it is not allowed the TOC methodology, it must be allowed to recover $2.1 million in remaining earnings from starting rate base, amortized over a five-year period.

115 Tesoro argues that Olympic has not provided any reason why a rate base write-up is necessary, and that it proposes a rate base write-up based on nonexistent deferrals of return. Tesoro argues that Olympic has not demonstrated that it did defer the returns (but it has substantially overcollected its authorized rate of return) and Olympic should not be allowed a return on investment that it did not supply. Tesoro contends that every jurisdiction to consider the starting rate base, including the District of Columbia Circuit, has rejected it.

116 Commission Staff argues that there is no reason to adopt a starting rate base. Because the Commission has not adopted a ratemaking methodology for Olympic, it has no need to transition from a prior methodology to another one. Staff points out that Olympic asks regulators to accept starting rate base, while acknowledging that it is a fiction.

117 The Commission rejects the concepts of a starting rate base and a deferred return. The Commission has not adopted any prior methodology for Olympic that requires it to implement a transition measure. There have been no deferrals of earnings—the Company neither asked for authority to book deferrals nor did so itself. Because it has not, we would risk retroactive ratemaking were we to approve the proposal.

118 The Commission recently addressed a similar question in the 7th Supplemental Order in Docket No. UE-010410, In re Puget Sound Energy. There, we said:

> The Commission determines that it is legally barred from . . . amend[ing] the accounting order in Docket No. UE-010410 under the doctrine of retroactive ratemaking.

119 Here, Olympic asks us not to *amend* a prior accounting order, but to *create* one retrospectively. Olympic is prohibited by RCW 81.28.080 from charging a different rate from that shown in its tariff. Yet it demands that we reach back in time to alter the tariffed rate under which it operated by recognizing a deferral that was neither

authorized nor recorded, and impose that deferral now to make up for Olympic's not collecting it in the past.[26]

120 We find no obligation to provide a starting rate base and Olympic provides no sound policy reason for the Commission to engage in this exercise. Granting Olympic's request would be both improper and illegal.

121 We hear no persuasive policy arguments that say doing so makes any sense at all for the Company, for the shippers, or for the public in Washington State.

122 The Commission rejects the Company's proposed TOC methodology.

C. Consideration of Depreciated Original Cost Methodology.

123 Commission Staff proposes a depreciated original cost, or "DOC" methodology. As the Company acknowledges, it is essentially similar in principle to the Company's TOC proposal, except for the starting rate base and deferred return elements. We have rejected those Company-proposed elements and now turn to the DOC methodology.

D. Commission Decision on Methodology

124 As Commission Staff points out, the Commission has used the DOC methodology in setting rates of public utilities for many years and the principles have been tested in numerous judicial and operating contexts. The DOC methodology has been sustained on judicial review in this and other jurisdictions and has proved itself over time as fair, just, reasonable, and sufficient to allow regulated utilities the opportunity to earn an adequate return to accomplish their business purposes and secure funds at reasonable costs. As noted above, Olympic has the essential characteristics of a public utility. We adopt the DOC methodology for application to Olympic.

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[26] The Company also contends that it would be retroactive ratemaking to consider its actual earnings in determining whether to accept or reject its proposal to allow it a return on income that it did not defer in the past. Its argument proves the point that by going back now, without having approved the deferral in the past, to create a deferral, the Commission would engage in retroactive ratemaking.

VII. OTHER CONTESTED MATTERS

A. Test Year.

125 Olympic on rebuttal identifies calendar year 2000 as a "base period," and updates it to a "test period" consisting of the 12 months of October 2000 through September 2001. The test period includes seven months of unadjusted actual operations, two months of budgeted figures, and three months consisting of three times the average of the first five months' actual results.

126 Olympic justifies this by saying that it wanted to make its FERC and its Washington State filings parallel, to avoid confusion. It argues that its estimates and its averages represent items that are known and measurable, and that therefore qualify for use in ratemaking. It argues that Tesoro and Tosco both accept use of the Company-proposed period.

127 Tesoro does support the Company's "case 2" proposal, with adjustments, noting that the information in Case 2 was the most well-studied information in the proceeding. It rejects the use of updated information filed on rebuttal, however, contending that the rebuttal information was not subject to discovery and cross-examination and that it is therefore insufficiently reliable for use in ratesetting.

128 Tosco also acknowledges that it used the base period that Olympic proposed when suggesting adjustments to the Company case. It tempers the acknowledgment, however, with the observation that the Staff proposal is a reliable and informed alternative.

129 Commission Staff advocates use of the calendar year ending December 31, 2001 as a test year. It challenges the Company's presentation as containing untested new information, new budgets, and estimates that are not known or measurable. In particular, Staff notes that Olympic's proposal does not capture its accrual methodology, which in practice makes accrual adjustments annually and not monthly. Staff also notes that its proposal more accurately reflects actual operating conditions under the imposed 80% pressure restriction.

130 The Commission adopts the Commission Staff test year proposal, consisting of calendar year 2001, as the appropriate period to examine the Company's performance for ratemaking purposes. Commission Staff testimony made it clear that in instance

after instance, the Company recorded transactions on a cash basis – that is, when receipts were received or invoices paid. The Company represented that it used the accrual basis for its books – that is, that expenses were booked when the obligation arose and revenues when the right to payment arose. Only the accrual basis clearly allows an examination of events in a given period and only the accrual basis provides the proper matching of expenses to revenues that is the foundation of ratemaking.[27] Tesoro contends that the same problem is present no matter what period is chosen, but we believe, based on the record and the evidence provided by Commission Staff, that its proposed test year does contain year-end accrual adjustments and that it is more reliable and less problematic than any other available period. Olympic's proposal would capture year 2000 accruals but not those for the year ending September 30, 2001, creating two reliability problems. Reliability issues exist with regard to any of the proposed test periods; we are satisfied that review of the underlying Staff-proposed test period was adequate and that it is sufficiently reliable for use in this docket, and that it is the best available on this record.

B. Jurisdictional Separations.

131 Olympic argues, based on the testimony of its witnesses Schink and Collins, that it is impossible to undertake a meaningful separation of economic elements that serve both interstate and intrastate traffic on an integrated and unseparated basis. Commission Staff, on the other hand, notes that jurisdictional separations are common. They are routinely accomplished for any multijurisdictional utility, and they have repeatedly been accepted as proper by the courts. Staff accepts as the best available factors for the purpose the separation factors derived by the methodology proposed by the Company itself, based on the volume of traffic and the distance traveled.[28]

132 The Commission accepts the jurisdictional separation proposal of the Commission Staff. It is a rational and verifiable way of identifying the proportion of costs and revenues attributable to intrastate operations, it is the best available on this record, and it is appropriate for use in this proceeding.

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[27] The Commission acknowledges that it has accepted cash basis accounting as a starting point for the smallest regulated businesses, for whom it is the only realistic option.

[28] The separations factors differed because of differences in throughput assumptions. Use of total Company information in this docket would result in a rate decrease.

C. Regulatory Costs.

133 The parties addressed two different kinds of "regulatory costs." One kind was the cost resulting from requirements of regulatory agencies that the Company undertake additional physical, engineering, record-keeping, or other activity in order to comply with new or increased regulatory requirements.

134 Olympic argues that there is no classification in the Uniform System of Accounts for "regulatory" expenses incurred in compliance with safety regulations, so there is no means of identifying them. It argues that increased oversight and recent legislation will add expense, and that increased liaison with regulatory agencies will be needed, as well.

135 Commission Staff noted the contentions of additional need for recovery of regulatory expenses in the Company's rebuttal case, and responds that the Company did not present any comprehensive or reliable means of quantifying additional expected expenditures. Staff notes that the record demonstrates Olympic's pride in being "ahead of the curve" in meeting regulatory requirements, and observes that all of Olympic's expenditures during the test period as a result of regulatory action are embedded in the record and are being recovered. We address any specific remaining matters under individual topics relating to the subject of the asserted requirements, and not at this point. If Olympic wishes separate consideration of what it terms regulatory costs, it must set up and use a system that will identify, track, and verify those costs to permit their audit and verification for rate case purposes.

136 The second kind of "regulatory expense" relates to what can loosely be called rate case expenses. Commission Staff notes that the test year contains approximately $680,000 of expenditures that are asserted to be regulatory in nature. Detail of the expenditures is not available, and the question was raised whether other legal or regulatory expenses were included in that total.

137 Olympic supplemented its filing with the contention that its regulatory expenses for the period had reached one million dollars. On rebuttal, it again supplemented the figure with the contention that its rate case expenses had reached $2.6 million. The Company does not propose detailed, supported adjustments to reflect the proposed increases, however.

138 Tosco and Tesoro object strenuously to consideration of regulatory expenditures of $2.6 million for rate case expenses, arguing that the sum is not separated by jurisdiction and that it includes substantial unnecessary litigation expenses related to this rate proceeding. Commission Staff suggests that the Commission accept the Company's first information, inasmuch as the Company faces enhanced regulatory responsibilities in the near term. Staff suggests that if we choose the one million dollar figure that we amortize it over a period of five years.

139 The Commission makes no adjustment to reflect a proper level of regulatory expenses, thus accepting the sum that the Company booked during the test period.

140 We note that while higher-than-normal level of regulatory costs are embedded in the Company's actual operations for the year 2001, a higher-than-normal level of activity is likely to continue at least until the Company's next rate case is concluded. The test year includes some of its expenses for the FERC and WUTC rate proceedings, as well as a high level of regulatory activity – higher than may be expected to continue indefinitely, despite increased scrutiny.

141 We do not reach questions relating to prudence of the Company's expenses for this rate case, both because we reject contentions of higher expense levels and because sufficient information is not available. We believe that it is essential for the Company to correct the flaws in its presentation and believe that by accepting the Commission Staff recommendation to make no adjustment, we provide abundant funding for a prudent and economical Company to make necessary accommodations to its internal business systems and to secure capable expertise in preparation and presentation of information in a Washington State rate proceeding. We anticipate that by the time Olympic files its next rate proceeding, it will have corrected the flaws in its record-keeping and accounting processes and will have all of the necessary detail to support its proposal, which will be timely prepared, supported, presented, and made available to others. We direct the Company to maintain records of its "regulatory" expenses that are sufficient to identify what was done, what activity (rate case, for example) it related to, what jurisdiction it related to, and who did it.

D. Transition Costs.

142 Olympic changed managers in July 2000. It terminated its prior management relationship with Equilon, one of its owners, and hired BP, its other owner, to provide

its management services.[29] This change resulted in costs to Olympic of $2.3 million. It asks inclusion of $455,000 in allowable expenses, as part of a five-year amortization of the total.

143 Tesoro argues that this is a nonrecurring, unsupported, affiliated expense that occurred prior to the base period and is unrelated to providing service. Tosco argues that this is not related to service provided to shippers and that it is merely the result of a change in majority ownership.

144 Commission Staff argues that the expense is analogous to acquisition costs, which cannot be charged to ratepayers, and asks to exclude the entire sum. Staff points out that the costs have no recurring effect on pipeline operations.

145 The Commission rejects this expense and, in addition, adopts the Staff-proposed Adjustment RA-6 to remove employee relocation expenses. Like acquisition costs, the transition costs are not shown to benefit ratepayers. We find no sufficient basis for imposing this one-time charge from a prior period upon ratepayers as an element in company rates. The Commission therefore accepts the Commission Staff adjustment RA-06, "Remove Employee Relocation Expense."

E. Rate Base Presentations.

146 Rate base is a measurement of a company's net investment in plant in service, that is, its capital assets that are used and useful in performance of a company's public service functions. All parties start from Olympic's actual books and records.

147 Olympic proposes a total-Company rate base of $ 92,715,000. This sum includes its calculation of deferred return of $23.8 million and its proposed $9.1 million addition to compute a "starting rate base."

148 Commission Staff proposes a total company rate base of $61,510,551. Among other things, it excludes the Company's deferred return and starting rate base calculations. Most notably, it excludes the Company's $23.2 million investment in the Bayview storage and batching facility, and it includes as capital investment a portion of test year "maintenance" projects that Commission Staff proposes to capitalize rather than

[29] We also note that the Company did not comply with the filing requirements of Chapter 81.16 RCW, pertaining to affiliated interests, with regard to the Management Agreement.

expense. Commission Staff also proposes the use of an end-of-period rate base, and proposes the inclusion of Construction Work in Progress (CWIP) for projects scheduled to be completed in the year 2002.

149 Tosco does not present a rate base proposal. Tesoro's analysis parallels that of the Commission Staff in many regards, but it would make inclusion of Bayview in rate base contingent on calculating rates on a throughput that assumes both the ability to operate at 100% pressure and the full operation and inclusion of the efficiencies that Olympic contended Bayview will provide.

F. Additional Improvements.

150 The Company argued that it must add $66 million in improvements over the next three years, in order to comply with regulatory and BP's own operating safety requirements. We address this contention below, beginning at paragraph 303.

G. Bayview.

151 Bayview is a storage and batching facility for refined petroleum products that is designed to accumulate products for larger shipments, which can be transported more efficiently than smaller shipments, to increase system throughput, to allow shipments during times when a refinery is not manufacturing product, and to remove bottlenecks. It was completed at a cost of $23.2 million and put into service about two months prior to the Whatcom Creek incident—too short a time for its benefits to be assessed. As a result of the pipeline closures and pressure reductions in effect since the Whatcom creek incident, Bayview has not been used for its intended purpose since the incident in 1999.

152 The facility is now being used for emergency pressure relief, as headquarters for construction and maintenance and the staging of construction and maintenance equipment, and for storage of fuel and water for pig runs[30] and hydrostatic testing. The Company admitted that these uses do not require use of the Bayview facility and that facilities obtained only to accomplish those uses would cost far less. The Company nevertheless includes Bayview in rate base because it is being used for some business-related functions and its use for its intended purpose is rendered

[30] A "pig" is a device that is run through the line, equipped to recognize anomalies in reflections of electronic signals that it emits in order to identify possible areas of pipeline weakness.

impossible by regulatory constraints. The Company argues in its answering brief that the investment was prudently made; that Bayview is currently performing important and useful functions; that the only reason Bayview is not used for its initially intended functions is regulatory delay; that Olympic is focusing on achieving 100% pressure as its first business goal; and that it expects to have Bayview on line for its intended purpose soon after it achieves 100% pressure. Olympic argues that it is unfair and inappropriate to penalize it for the temporary loss of this facility for a temporary period due to unforeseen circumstances, and that comparable situations have not resulted in this treatment for other utilities. Furthermore, it contends that removing Bayview would reduce the Company's revenue substantially and make it more difficult for the Company to achieve full pressure and other aspects of regulatory compliance.

153 Commission Staff proposes that Bayview be rejected for purposes of rate base calculation. Staff argues that the facility is not in service, that it is unlikely to be in service for at least 18 months and possibly longer, that its current uses are minimal and do not justify the capital investment or the ongoing costs (the electric power demand charge associated with the facility, for example). Staff proposes to remove Bayview from rate base but consider it to be construction work in progress (CWIP) and allow it to accrue an allowance for funds used during construction (AFUDC). Commission Staff, however, also recommends allowing a return on the CWIP representing Olympic's Bayview investment (the equivalent of allowing it in rate base) at its year-end (highest) level.

154 Tesoro proposes to include Bayview in rate base. It proposes as a condition to doing so, however, that the calculation of rates also be based on the revenues associated with operations at full pressure and Tesoro's calculation of the benefit of use of the facility for its intended purpose. If the Commission does not include the facility's contribution to operations at full pressure, Tesoro asks that it be entirely excluded from rate base. Tesoro strongly opposes use of CWIP in rate base. Tosco's position is similar to Tesoro's.

155 The Commission accepts Olympic's proposal to consider Bayview a proper element of its rate base. In making this decision, we note that it was completed and put into operation, and that in those circumstances considering it to be construction work in progress (CWIP) may be inappropriate. Moreover, while Staff proposes to calculate AFUDC on the asset, it also proposes to include CWIP from this and other projects

scheduled for completion within a year in rate base at year-end levels. While that might be permitted under RCW 81.04.250, to the extent Staff proposes use of a "traditional" depreciated original cost rate base, analogous to ratemaking under Title 80 RCW, we are concerned that treatment of CWIP as an asset may be flawed under the *P.O.W.E.R.* decision.[31]

156 We are persuaded that inclusion of Bayview in rate base is permissible under the facts of this proceeding because its non-use is due only to relatively short-term regulatory requirements. Olympic estimates that the issues relating to Bayview may be addressed shortly after return to full pressure, and we acknowledge Olympic's desire to achieve full pressure as its first priority. The facility is temporarily out of service, analogous to situations in other industries when major assets have been taken out of service for temporary periods.[32] The facility is expected to return to service shortly, and supporting its availability in this manner will serve both the Company and ratepayers. It is inappropriate to pull an item from rate base when it is down for repairs or as a result of other relatively short-term activity, unless there is substantial demonstrated doubt regarding its return, a topic that was not explored on this record. We also provide below that the Company must return for a general rate case and we will consider the effect of the facility on throughput at that time, when it will presumably have some time in service from which its effect on throughput will be known.[33]

157 The Commission therefore rejects the Commission Staff's proposed *pro forma* adjustment PA-02, removing Bayview investment and expenses. The Commission notes that the Staff's proposal for CWIP in the rate base exceeds the Bayview Project adjustment by $1.5 million. We exclude the entire proposed sum because CWIP is not a part of the investment that is contributing to the operation and helping Olympic to conduct its business, and because once the assets are put into service, the Company can recover its financing costs. The remaining $1.5 million investment will accrue AFUDC until that time.

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[31] P.O.W.E.R. v. Utilities and Transportation Commission, 104 Wn.2d 798, 711 P.2d 319 (1985)
[32] *Washington Utilities and Transportation Commission v. Pacific Power & Light Co.*, Cause No. U-83-57, Second Supplemental Order (1984).
[33] No issues relating to Olympic's prudence in constructing or operating Bayview were sufficiently explored on this record for the Commission to make an informed decision on the topic. Allowing it as an element in rate base does not foreclose a future review.

H. Average v. End-of-Period Rate Base.

158 Commission Staff proposes use of end-of-period rate base calculation, recognizing that it is not the best match between revenues and costs, as a means to mitigate the effect of regulatory lag (the time between a request for a rate increase and the time when the Commission reaches a decision) on the Company's capital needs. Commission Staff's proposed adjustment PA-09 would increase the Company's intrastate revenue requirement by $145,740, all other things equal. Olympic accepts the Staff proposal, as does Tosco on the condition that the test period ends on or before December 31, 2001.

159 Tesoro opposes the use of end-of-period rate base, arguing that only the average of monthly averages method of calculating rate base fairly balances the interests of the Company and its ratepayers.

160 The Commission accepts the Commission Staff proposal and therefore adopts Commission Staff's proposed *pro forma* adjustment PA-09, Plant in Service 2001 NRP.[34] This treatment of rate base is appropriate in exceptional circumstances such as those Olympic has experienced since 1999 when regulatory lag may affect a Company's opportunities to seek timely rate relief. Here, the Company must work on its records and must focus its efforts on engineering matters for the short term. This adjustment to the traditional rate base calculation is warranted and appropriate. It contributes to the Company's ability to serve its customers and contributes to rates that are fair, just, reasonable, and sufficient.

I. AFUDC.

161 AFUDC, or Allowance for Funds Used During Construction, is the means by which the capital costs of construction projects are recognized in regulatory accounting. AFUDC compensates the investor for the cost of funds contributed to construction of a project before it enters service and begins producing revenue and earning a return. Construction work in progress is not yet used in the utility's operations, so a separate record is maintained of the investment in projects. When a project is put into service, the entire cost of the project, including the capitalized cost of the funds devoted to the project, are considered part of the project's costs.

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[34] Non Revenue Producing.

162 Commission Staff notes that the Company does not accrue AFUDC on construction projects, and points out that it should do so to comply with Statement 71 of the Financial Accounting Standards Board (called "FASB 71"). Staff recommends that the Commission order Olympic to comply. Tosco supports the Commission Staff.

163 Tesoro opposes use of CWIP or AFUDC for two reasons: first, that without detail that is now missing from the record, the parties and the Commission cannot be certain what Olympic's CWIP calculation includes, and second, because FERC would reject all AFUDC on unsupported CWIP. At a minimum, Tesoro states, AFUDC should be calculated by a 50% in-service ratio. The Company assumes a 100% in-service ratio, which includes all accumulated AFUDC in rate base.

164 The Commission accepts Staff's recommendation to direct Olympic to begin recording and capitalizing actual interest during construction, or IDC, whichever is appropriate, in its books and records. The Commission has adopted the FERC Uniform System of Accounts for reporting purposes. The FERC USoA addresses interest during construction. Instruction 187, "Construction work in progress," states:

> This account shall include the cost of carrier property under construction and the cost of land acquired for such construction as of the date of the balance sheet. It includes interest and taxes during construction, material and supplies delivered to the construction site, and other expenditures that will eventually be part of the cost of the completed property . . .

165 The definition of interest during construction, or IDC, appears in 18 CFR 352 in instruction 3-3(11) and (12). The Company must comply with the FERC USoA in preparing its FERC and WUTC reports. To the extent that the Company is not keeping the information in the required form, it must maintain records to enable it to prepare and verify the accuracy of the FERC report to this Commission.

166 In addition, to serve the needs of this Commission, we direct the Company to maintain an off-book or side record of AFUDC calculating the rate of interest included in IDC by using the Commission-authorized rate of return, that is, the cost of debt and equity using the capital structure authorized by the Commission.

167 The Commission adopts the Commission Staff adjustment RA-08, "AFUDC." The future recordings in the side record must begin with the most recent period for which

the Company has accurate records, and must include information as to the source of each entry, the source of the information it enters, and an assessment of the information's credibility.

VIII. CAPITAL STRUCTURE

168 A corporation needs capital to carry out its business.

169 Pipelines require the use of physical assets. A utility company must acquire the assets—the pipes, the real property, other physical items—that are necessary to run the business. The physical assets that are owned and used in the business comprise the company's rate base. The funds that investors supply, either through cash or its equivalent or by foregoing a distribution of earnings, make up the equity in a firm. Equity, coupled with funds from the company's borrowing, provide the capital that is necessary to conduct business. The proportion of the source of various capital in a business—usually common or preferred shares, or bonds representing debt—comprises the company's capital structure.

170 In general terms, in an independent corporation the purchase of common stock gives the buyer a share in the ownership of the company. It provides no guarantee of earnings, and its earnings are distributed after other obligations are paid, but its return to the investor is not limited if the company succeeds. Loaning a company money, however, provides both a limitation on earnings (to the level agreed in the loan instrument or bond) and a preference: ordinarily, lenders receive payment before shareholders' earnings are distributed. Some instruments can be secured, either with an interest in assets or with the agreement of a guarantor who agrees to pay if the borrower cannot.

171 A company's capital structure shows the proportion of debt and equity (sometimes including variants such as preferred stock and short-term debt). Also, in general terms, as the proportion of equity rises, the company's own financial risk falls, and the reverse is true as well: as the proportion of debt rises, the company's financial risk rises because it is obligated to payments on the debt and constrained by the accrual of interest which, if unpaid, will compound and become larger. In tight times or emergencies, a company with a high proportion of debt has less flexibility because of its obligations.

A. Olympic's actual capital structure.

172 Olympic's actual capital structure consists of 100% debt. Olympic has negative equity in its capital structure and, according to the figures of record, its debt exceeds the book value of its net carrier property by about $32 million, which includes CWIP. Olympic must therefore pay off or secure the forgiveness of millions of dollars in debt before it can begin showing a positive equity. In recent, pre-Whatcom Creek times, the Company maintained an equity ratio in the range of 11 to 16 per cent.

173 As recent needs for capital arose, the owners chose to lend or guarantee loans to Olympic rather than provide a cash investment in equity or issue stock to the public. Commission Staff points out that at least four events caused Olympic's financial problems: 1) the Whatcom Creek explosion and its consequences, including temporary closure, 2) the Electrostatic Resistance Welding (ERW) seam failure and its consequences, including pressure reductions, 3) Olympic's unproductive investments in the Cross Cascades pipeline project and Bayview, and 4) failure of Olympic's management to address rate increase issues in a timely manner. The Company's response to these events was to finance with debt.[35] Combined with its earlier policy of paying out all earnings, the equity balance quickly turned negative.

174 Olympic's present actual capital structure would not be prudent for an independent public utility. An independent public utility could not be in the capital structure situation that Olympic faces, because it would have faced earlier pressure to maintain a stronger equity position and it would have lost access to the financing market long before reaching a negative equity of Olympic's present magnitude.

175 Olympic denies that its capital structure plays any part in its current financial difficulties, although it stresses its need to secure financing from the owners whose decisions led it to its present situation, and states the uncertainty of their continuing willingness to provide additional loans.[36]

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[35] By lending to Olympic rather than contributing equity, Olympic's owners may have reduced their risk of loss of capital and may have secured a return through interest that could not be achieved on equity during periods of loss.

[36] We acknowledge the testimony of Mr. Fox at TR 4438-4441. He stated that BP at one point was willing to consider the conversion of debt to equity, but Equilon was not, killing the concept for the moment.

176 In response to concerns over Olympic's lack of equity, Olympic states that equity is not cash, but rather is a claim on assets in favor of shareholders. Olympic contends that a 40 to 50 percent ratio of equity in its capital structure today would not affect Olympic's access to cash from parents or third parties. Lenders would look only to the owners' willingness to back loans, or to earnings multiples, not to percent equity, which merely indicates the prospect of owning part of this pipeline. Olympic argues that a higher equity percentage would not have enhanced Olympic's ability to "weather the storms" or allow Olympic to borrow without parent approval.

177 Commission Staff contends that Olympic is incorrect when it says "equity is not cash" but rather a "claim on assets in favor of shareholders." Staff argues that this statement is at odds with the fundamental financial principle that equity is the measure of shareholder-provided cash. Equity provides the foundation of the enterprise, and enables it to obtain additional cash by other means, i.e., debt. Equity, says Staff, is infused in the form of cash.

178 The Commission finds without merit Olympic's argument that equity is not the equivalent of cash. As Staff points out, the only way for a company to acquire equity is through the acquisition of cash or its equivalent. Olympic's argument applies equally to debt: once the loan is received and the cash is spent, debt in a corporation's capital structure merely represents a claim on assets in favor of lenders. Equity represents cash or its equivalent that investors have put at risk in a company. For Olympic to improve its actual capital structure, it must receive cash or its equivalent (such as the forgiveness of debt) from investors or lenders. Olympic itself argues in its opening brief that regardless of the form cash infusions take, it cannot at the present time meet its capital spending objectives except through cash or cash equivalents from its parents.

179 The Commission also rejects Olympic's argument that it would be in no different financial situation had it held a strong equity position prior to the Whatcom Creek inducement. It may be true that additional investment would have been needed. But a stronger equity position would have facilitated – more – balanced financing, would likely have avoided some of the current negative equity and provided a shallower hole to dig out of, and would have been prudent for reasons of general business purposes.

180 Olympic's existing capital structure is not an appropriate balance of financial safety and economy. It does not provide sufficient capital to allow access to independent financing or to meet the reasonable exigencies of business operations without calling on the discretionary good will of the owners. The business decisions that have produced the existing capital structure severely restrict Olympic's options when it comes to financing. Olympic cannot seek independent third-party financing without its owners' actions.

181 Parties present different views on whether the Commission should use the Company's actual capital structure for ratesetting purposes, or whether it should use a hypothetical capital structure. The next question, then, is how the Commission should respond.

B. Use of Hypothetical or Actual Capital Structure for Ratemaking Purposes.

182 Selection of an optimal capital structure is generally the business decision of a corporate board, when deciding whether to issue stock or to borrow (or issue bonds). As with other business decisions of a regulated utility, the board's decision is subject to review if there is a sound regulatory reason for doing so. In the past, the Commission has recognized that a regulated company's capital structure must balance strength with cost, acknowledging that increased equity not only bears the cost of a higher return but also that unlike interest on commercial debt it must be paid with after-tax dollars.

183 Olympic asks for a hypothetical capital structure. It recommends using either the weighted average capital structure of its parents, containing 86.85% equity, or the upper end of the equity share range for the oil pipeline proxy group companies, which has averaged 61.35% over the past five years.

C. Use of Parents' Capital Structure.

184 Olympic is wholly owned by two large integrated oil companies. They are Equilon, which has been acquired by Shell, and BP. Between them, Olympic says, the owners have supplied Olympic's financing needs by providing infusions of cash or by guaranteeing loans from third parties, who in turn measure Olympic's creditworthiness based on its cash flow and its parents' equity, not Olympic's equity.

Olympic contends that its equity ratio is irrelevant from the standpoint of Olympic's potential sources of financing.

185 All other parties oppose Olympic's proposal to use its parents' capital structure. Tesoro argues that use of the parents' capital structure under the circumstances of this proceeding would (1) allow an improper "windfall" for Olympic, (2) reward financial imprudence, (3) discourage actual equity investment, and (4) undermine the Commission's regulatory authority to ensure Olympic's continued safe and prudent operation. Absent the establishment of a prudent actual capital structure, Olympic may not be able to respond to its regulatory obligations, its financial needs, and its operational risks.

186 Commission Staff responds that the appropriate consequence of the funding course Olympic's owners have chosen is a parent-financed equity infusion. However, Olympic suggests that such a financial guarantee may not occur in the future. Staff argues that this makes no sense and Olympic's argument must fail.

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

188 We reject Olympic's arguments for the use of its parents' capital structure. Olympic did make clear during the hearing that Olympic's parents will no longer guarantee financing but will make a decision whether to provide additional loans only after learning the Commission's decision on the Company's request for increased rates.[37] Its parents' capital structure may result in part from achieved earnings that exceed an appropriate regulated rate of return.[38]

189 The Company's board has determined that the actual level of equity in its capital structure should be less than zero. In that circumstance, the Commission should not force ratepayers to fund the nonexistent obligation to pay for a return on nonexistent equity, including a liability for nonexistent taxes, without sound reason for doing so.

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[37] The Company identifies this level in its brief as a 47% intrastate rate increase, based on its analysis of the testimony of Mr. Peck, Olympic's CEO.

[38] See, *Bluefield Water Works & Improvement Co. v. Public Service Commission of WV*, 262 US 679, at 692 (1923).

The result of accepting the parents' capital structure would be to put an excessive burden on ratepayers, reward Company behavior that is not in the Company's best interests, and eliminate any regulatory incentive for the Company to achieve a reasonable capital structure.

D. Risk-Based Capital Structure.

190 Olympic points out correctly that the Commission does not set the cost of equity, but determines what the market requires. Olympic then argues that the same concept applies to capital structure. The choice of the appropriate structure, it contends, rests on an assessment of Olympic's risk. Even if the Commission focuses on the oil pipeline proxy group, Olympic argues, there is every reason to choose an equity ratio for Olympic above the highest levels of those companies because of Olympic's competitive, operational, and financial risk profile. It argues that no Staff or Intervenor witness credibly refuted evidence of Olympic's operating risks. Those witnesses, it contends, had no pipeline operational experience and generally were unfamiliar with the new federal regulations on oil pipelines.

191 Commission Staff responds by saying that Olympic faces no effective competition. Other pipelines have the same or more significant operational issues and Olympic operates above industry safety standards. Furthermore, there is no evidence that Olympic's operations bear any resemblance to risks of owners.

192 First, the Commission cannot accept Olympic's premise that the Commission merely finds the capital structure that the market would dictate. We have noted that capital structure is a consequence of decisions of a company and its board of directors. It is the Commission's responsibility to determine the appropriate balance between equity and debt that best balances cost and safety for ratemaking purposes. We are not engaged in finding what the market dictates.

193 Second, as Commission Staff points out, Olympic's witnesses did not substantiate their contentions that the Company has significantly different risks from other pipeline companies. Their claims to that effect are not credible. Neither are Olympic's risks the same as those of its parents. They are engaged in very different enterprises. Olympic does not address why its proposed capital structure options best balance financial safety with economy. The Commission rejects Olympic's risk-based, market-driven argument.

E. Fiscal Responsibility.

194 Olympic argues in its answering brief that while both Staff and Tesoro assert that Olympic and its parents have been financially irresponsible, they ignore the fact that Olympic's parents have made a net "investment" of $56.45 million since 1990. Olympic argues that a regulatory approach that punishes this level of commitment to safe operation by setting a punitive capital structure would be inconsistent with this Commission's commitment to pipeline safety.

195 The Commission can commend Olympic's owners for providing funds since the Whatcom Creek incident that have helped Olympic meet the immediate challenges; helped Olympic identify and make an effective start at accomplishing the tasks that need to be done to resume full service and reduce future risks; and helped Olympic stabilize its operations. It is also true, however, that owners' withdrawal of dividends totaling $51.6 million since 1990 operated to reduce available equity and that the owners have provided recent funding only as debt.

196 However, those are not the controlling factors in determining capital structure. As Commission Staff points out, Olympic uses the term "investment" to include both debt and equity, when in this context it is clear that loaning funds with the expectation of an agreed interest rate and the return of the loan with interest does not serve the same business purposes as equity investment that is without the same expectations and priorities. Olympics' parents' capital structures do not reflect the view that debt and equity are interchangeable equivalents.

197 Olympic's concerns about a "punitive" capital structure are poorly taken, as it is Olympic's board and its owners whose decisions have produced the Company's actual capital structure. The Commission could not be punitive if by merely accepting the judgment of the Board and the owners as to appropriate capital structure. Olympic itself argues that capital structure is irrelevant when it comes to financing, if the owners provide or guarantee the funds.

F. Setting the appropriate capital structure.

198 All of the parties suggest at least one scenario for including some equity in the capital structure for the calculation of rates. Tesoro asks that we use the actual capital

structure unless Olympic brings its actual capital structure up to the industry norm, which Tesoro estimates as 46% equity. Its logic is very strong. Tosco recommends use of Olympic's actual capital structure unless it secures substantial equity investment, whereupon the Commission should use a capital structure with 47.4% equity and 52.6% debt.

199 Commission Staff through its witness Dr. Wilson urges that we adopt a hypothetical capital structure with 20% equity as an incentive to the Company and its owners to return to a rational capital structure.[39] We agree that this level is an appropriate first step, as Olympic's actual capital structure approached that level during some years prior to the 1999 incident.

200 We have in other instances approved use of a higher-than-actual capital structure as an incentive to a company to achieve a better-balanced capital structure with a higher proportion of equity.[40] In the recent Puget decision we accepted the higher-than-actual equity ratio in its structure for ratemaking purposes—along with a mechanism requiring improvement and with sanctions for failure to achieve specified goals. We believe that including equity in a hypothetical ratemaking capital structure is important to provide an important incentive to the Company to increase the proportion of equity in its actual capital structure and to provide the opportunity for retained earnings that will help begin the process. Use of this hypothetical capital structure is thus for an important regulatory purpose and is for a sound reason.

201 We acknowledge that the Company has faced considerable challenges and that it is making solid progress toward overcoming them. We do not think it appropriate at this stage in Olympic's recovery to adopt strict goals for equity achievement, and we do not adopt 20% as an ultimate goal. We will require the Company to file again for rates within two years, and we state that in determining whether to maintain, increase, reduce, or eliminate the equity in the capital structure for ratemaking purposes we expect to consider the extent to which the Company has made substantial progress to correcting its existing unhealthy actual capital structure.

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[39] Dr. Wilson would recommend a 50% equity structure if the owners made substantial equity infusions to achieve a structure approaching that level. The Company and its owners have not taken that step and have not offered to do so, so we give no further consideration to that option.

[40] *See, WUTC v. Puget Sound Energy, Docket No. UE-011570/UG-011571, Eleventh Supplemental Order.*

IX. RATE OF RETURN

A. Return on Equity

202 The Commission's task in determining an appropriate rate of return on equity is to assess the rate that a prudently and economically run company must pay for capital in the marketplace to acquire equity funds. The parties have differing views about the proper cost of equity to use for ratemaking purposes for Olympic.

203 All parties agree that the *Bluefield* and *Hope*[41] cases established several tests that must be satisfied to demonstrate the fairness of the rate of return. These tests include a determination of whether the rate of return is: (1) similar to that of other financially sound businesses having similar or comparable risks; (2) sufficient to ensure confidence in the financial integrity of the regulated company; (3) adequate to maintain and support its credit, so that it may attract the capital, on a reasonable cost basis, to provide adequate and reliable service to its shippers.

1. Proposals for Return on Equity.

204 Olympic, through witness Schink, recommends a risk-adjusted 15.65% return on equity for Olympic using a modified FERC discounted cash flow approach. Tesoro's witness, Mr. Hanley, recommends a 13% return on equity. Tosco, through Mr. Means, recommends a return on equity of 11.28%, and Dr. Wilson, for Commission Staff, recommends a return on equity of 10%.

2. Risk premium.

205 Olympic contends that in setting the rate of return on equity (ROE), the Commission must allow a rate of return to the regulated company commensurate with the risk to which the invested capital is exposed. Olympic says it has demonstrated that it faces much higher risks, competitive, operational, and financial, than a typical oil pipeline.

206 Olympic points to Mr. Peck's testimony in the hearing to conclude that, while Olympic is currently an operationally safe pipeline due to the substantial investments it has made for safety purposes, the Company nevertheless faces profound financial

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[41] *Bluefield v. Public Service Commission*, 262 US 679 and *FPC v. Hope Natural Gas Co*., 320 US 591, cited above.

risks. These risks derive from the prospect of complete or partial shutdown, to avoid unsafe operation.

207 Staff and Intervenors disagree, asserting that Olympic faces neither competitive risk nor unique business risk.

208 Tesoro notes that Dr. Schink proposed a risk adder in his direct testimony based primarily on the business risk of competition. Olympic's owner companies refused to provide Olympic's own witness information about their use of competitive modes, and Mr. Cummings acknowledged that Olympic did not provide the witness with information it had gathered. Olympic's witness, Mr. Peck, freely acknowledged his belief that Olympic was safer and not more risky than other oil pipelines, including those in the proxy group.

209 Tosco adds that perhaps the best evidence that Olympic faces insignificant competitive risk is its ability to demand a 59% rate increase without fear of losing customers. Tosco also argues that consideration of Olympic's financial risk is inappropriate because the risks that Olympic faces are the result of its owners' business strategy.

210 We reject the application of a risk-adder in light of Olympic's failure to prove that its competitive risks merit such treatment. As Tesoro characterized it, Olympic put forth the risk adder and then proceeded to search for the risk. The Company's first effort focused on competition presented by other modes of oil transportation: trucks and barges. Any doubt that we may have had about the non-existence of effective competition, in light of overnomination and significantly lower prices, was put to rest with Mr. Peck's testimony to the effect that if pipeline capacity is available, water-borne transpiration is not a cost-effective alternative. In its rebuttal case, the Company introduced operational and financial risks as justification for its risk-adder. Operationally, Olympic spent much time and effort describing its own safety efforts and risks but presented no systematic study of a comparison of these conditions to those of other pipelines. Olympic has convinced us that it is operating safely and that its risks of disaster are not substantially greater than those of other pipeline companies. Finally, consideration of Olympic's financial risk due to its own financial circumstances is inappropriate because the risks that Olympic faces are the result of its own business strategy in dealing with several significant decisions it has made.

3. Cost of equity methodology

211 Olympic posits that the Commission relies on a forward-looking, single-stage discounted cash flow (DCF) analysis to determine the ROE for a regulated company.[42] Olympic goes on to point out that the Commission has noted the shortcomings of the non-DCF methods used by Tesoro and Staff and declined to use a multi-stage DCF model of the type used by Tesoro witness Hanley.

212 Dr. Schink employed the FERC's DCF methodology, a forward-looking, single-stage DCF model, which Olympic contends should qualify as a "standard DCF study" as defined by the Commission. His resulting recommendation of 15.65% ROE includes a nominal cost of equity capital for a typical oil pipeline of 14.70%, increased by a risk adder of 0.95%. This falls well within FERC's ROE zone of reasonableness of 10.81% to 17.54% for an oil pipeline company.

213 For Commission Staff, Dr. Wilson recommends a return on equity of 9%. In light of the declining cost of money and Staff's generous recommendations for end-of-period rate base and CWIP, Staff considers this recommended equity return to be eminently fair.

214 Responding to Olympic's position that the Commission would not rely on non-DCF methods, Staff notes that the older Commission cases relied on by Olympic stated that the Commission would not rely on non-DCF methods as the sole basis, but would consider them as "interesting" and "useful" checks on DCF results.

215 Staff argues that Dr. Schink employs a mechanical calculation using limited and faulty data to produce an unreliable return on equity. His method is a multi-stage DCF that includes analysts' earnings growth estimates for near-term growth and Gross Domestic Product for long-term dividend growth. It uses a five company proxy group for measuring business risk of owning and operating an oil pipeline. To the extent that predictions are a part of the analysis, Staff argues, they are not investors' demands; they are notoriously unreliable; they are notoriously optimistic; and they form no sufficient basis for investors' expectations. The five company proxy group is a small and limited universe. It includes limited partnerships that pay

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[42] *In the Matter of the Petition of GTE Northwest Incorporated*, Docket No. UT-931591, Third Supplemental Order (1994); see also *Washington Utilities and Transportation Commission v. Avista Corporation*, Docket No. UE-991606; Docket No. UG-991607, Third Supplemental Order (2000).

out the return of capital and are unrepresentative. In sum, Dr. Wilson testifies that the use of the FERC methodology for computing DCF is a mistake.

216 Staff offers Dr. Wilson's presentation of a comprehensive study to account for the unique characteristics of Olympic, rather than merely following FERC's formula. In his study, Dr. Wilson estimates the cost of equity under the Commission's preferred DCF approach and other methodologies. He applies these methodologies to publicly held enterprises in three comparable industries: oil pipelines, natural gas pipelines, and integrated petroleum companies.

217 Dr. Wilson's traditional DCF analysis yielded a cost of equity ranging from 5.4% to 17.2%. Because of the very wide variation in results, Dr. Wilson also performed a "fundamental" DCF calculation, a capital asset pricing model (CAPM) study, and a comparable earnings study.

218 The fundamental DCF study uses retained earnings as the measure of expected growth, yielding a range of 10.8% to 12.9%. The CAPM analysis separates the total risk of an investment into systematic, unavoidable risk and unsystematic risk associated with a particular stock or company. The range of CAPM results are built on an estimated range of systematic risk of 1.75%, the (current Treasury bill rate), to 4%, (the risk premium over the past half-century). The results ranged from 6.09% to 9.60%.

219 The comparable earnings analysis produces the return on equity required for the stock to trade at a price equal to book value. To the extent that investors expect a higher return on equity, stock prices will trade higher than book value, signaling to regulators that investors perceive earnings that exceed the cost of capital. The results of Dr. Wilson's comparable earnings analysis range from 6.04% to 9.53%.

220 Based on his analyses, Dr. Wilson identifies a reasonable range of return on equity of 8% to 10%, and recommends that a fair rate of return on equity for Olympic is the mid-point of this range, or 9%.

221 Commission Staff distinguishes Dr. Hanley's study for Tesoro, arguing that while its recommendation of 13.00% is also based on multiple studies, it applies equal weight to the results of all four studies. Staff also points out that notwithstanding this estimate, Tesoro agreed that Staff's overall structure and cost of capital comprised a

reasonable solution given the facts of the case. Tosco's recommendation of 11.28% accepts Olympic's DCF methodology, but rejects the use of the mean to determine the representative cost of equity, as it is unduly affected by an outlier in the proxy group. Commission Staff argues that this study is subject to the same flaws as Dr. Schink's study and should be rejected for the same reasons.

4. Commission Discussion and Decision

222 The Commission is often faced with setting a cost of equity for ratemaking purposes for publicly held public service companies for which data on a range of peer companies are readily available. Comparing Olympic to its peers in the oil pipeline industry is problematic given Olympic's dissimilarities from these companies and the small size of the peer group. As a result, we are persuaded that Staff and Tesoro are correct in asserting that Olympic has presented a case where sole reliance on the DCF method to calculate the cost of equity will distort the result.

223 Indeed, if we are to apply good judgment rather than a fixed formula, other studies will not only be interesting and useful, but necessary in this record to narrow the result. Dr. Wilson's traditional discounted cash flow analysis yielded a very wide range of options, from 5.4% to 17.2%.

224 The Commission respects Dr. Wilson's recommendation that we accept the midpoint of his range, or 9% for setting rates. However, we observe that his recommendation is influenced by a very low, low-end systematic risk of 1.75%. In the interest of providing a greater incentive to Olympic's owners to increase their equity, we mitigate that influence and choose the cost of equity at the high end of Dr. Wilson's recommended range, a cost of equity of 10%.

B. Cost of Debt.

225 A regulated company is entitled to consideration in the calculation of rates of its cost of the debt needed to support the debt portion of the company's capital structure for ratemaking purposes. In some proceedings, this is a simple mathematical calculation, deriving the overall cost of debt and multiplying that by the proportion of debt in the capital structure. Here, because of Olympic's unique capital structure and the nature of its debt, parties argue for other approaches.

226 Olympic argues that the appropriate cost of debt is dependent on the capital structure the Commission adopts for Olympic. Its own proposal is to use the parents' embedded cost of debt, 5.26%, consistent with Olympic's proposal of the parents' capital structure and to reflect that the parents raise capital for Olympic.

227 For Staff, Dr. Wilson recommends an 80% debt capital structure with 7% cost of debt, which he calculates to be the approximate current cost of high-quality long-term corporate bonds. For Tesoro, Mr. Hanley makes two recommendations. If there is no significant equity infusion, the Commission should use a 100% debt capital structure and 6.74% cost of debt (Olympic parents' 2001 embedded cost). If there is an equity infusion, then Tesoro recommends the use of a hypothetical cost of debt based on the weighted cost of debt for the proxy group of oil pipelines companies of 7.54%. Tosco states that if the Commission adopts Tosco's proposed capital structure, then Tosco would accept the use of Mr. Hanley's recommended cost of debt.

228 Regarding the capital structure proposals of the other parties, Olympic argues that to be consistent, a higher cost of debt is needed to recognize the risks of a stand-alone company with little or no equity. Olympic observes that Dr. Means admitted that if Olympic were a stand-alone company with such high debt, it would be subject to a junk bond rate of interest far in excess of 7 percent. *(Tr. 3713: 20)* Therefore, Olympic concludes that if the Commission chooses an equity share in the 40% to 60% range, a debt cost of 7.54% would be appropriate. If the Commission imposes the punitive 20% or 0% equity shares, the appropriate interest rates would be in the junk bond range of 10.19% to 22.66%.

229 The Commission agrees with Olympic that the appropriate cost of debt should be dependent on the capital structure this Commission adopts for the Company. Having adopted Commission Staff's position on capital structure, we also adopt Staff's recommendation on cost of debt.

230 However, Olympic goes on to argue that to be consistent, the adoption of a 20% equity capital structure should be accompanied by the adoption of a cost of debt reflecting junk bond rates. Their reasoning is that a stand-alone company with no equity could only borrow money at very high rates. We are not convinced by this argument. Our adoption of a 20% equity capital structure is not premised on treating Olympic as a stand-alone company, but instead recognizes that it is a creature of its parents, who have chosen a financial strategy that is beneficial to them, but not to

Olympic, both in good times and in bad. The interest rates that Olympic has actually experienced have not exceeded the 7% recommendation made by Dr. Wilson. *Ex. 604, p. 3*. Olympic has advanced no information in the record leading us to believe that the Company will actually have to pay junk bond debt rates, and we find no justification for burdening the ratepayers with such a high cost of debt when the cost is not incurred.

C. Overall Rate of Return.

231 Based on a capital structure of 80% debt and 20% equity, a cost of equity of 10%, and a cost of debt of 7%, the resulting overall cost of capital to be used for ratesetting is 7.6%. Table 1 shows this calculation.

TABLE 1: OLYMPIC PIPE LINE COMPANY
AUTHORIZED CAPITAL STRUCTURE AND COST OF CAPITAL
FOR THE 12 MONTHS ENDED DECEMBER 31, 2001

COMMISSION'S DECISION

Ln#	Description	Capital Structure	Cost Rates	Weighted Cost Rates
	(A)	(B)	(C)	(D)
1	DEBT	80.0%	7.00%	5.60%
2	EQUITY	20.0%	10.00%	2.00%
3	TOTAL (Line 1 + Line 2)	100.0%		**7.60%**

X. REVENUES

232 In determining whether a rate increase is needed, two steps are necessary. One is the calculation of cost of service under regulatory principles during the period when rates are expected to be effective. The other is the calculation of revenues without a rate increase during that same period, to determine whether a rate increase is needed to bring the level of revenues to the level of costs.

233 Just as the parties have disagreed about many elements of the cost of service, the parties also disagree on elements of revenue. The principal element of disagreement is the level of throughput to assign for purposes of calculating rates.

A. Test Year Revenues.

234 Having accepted Commission Staff's test period, we accept Staff's test year *pro forma* revenue figure of $38,069,493 on a total company basis, before rate changes.

B. Throughput and Role of Throughput in Determining Revenue.

235 Throughput is the volume of product that Olympic ships on its system during a specified period. Capacity is the volume of product that the system will hold at any given moment. Because Olympic receives revenue almost exclusively for transporting a volume of product, identifying the proper throughput (volume transported) is critical to a determination of the revenues it will earn.

C. Calculation of Appropriate Throughput for Ratemaking Purposes.

236 The calculation of Olympic's throughput is complicated for two principal reasons. First, the Company is operating under a pressure restriction of 80% of normal operating pressure, pending the resolution of issues relating to older pipe of a manufacture with known seam integrity problems. One of those seams burst under hydrotesting of Olympic's line prior to returning to service, underlining the need for inspections and repairs. The Federal Office of Pipeline Safety imposed the pressure restriction and is overseeing the process by which Olympic may succeed in having the restriction removed.

1. Pressure Variance.

237 The 80% pressure restriction was in place during the test year. If the adjusted year is a reasonably reliable indicator of actual product transportation, it may be used to predict future traffic under that pressure restriction. If the test period throughput is abnormally low for some reason, or if the pressure is allowed to increase to the level of normal operations, the volume of traffic will increase,[43] although not by 20%; the

[43] Olympic agrees that it is oversubscribed for transportation services, and that as long as the refineries that it serves continue to operate, it will be able to fill whatever throughput it can offer to shippers.

Company explained that the laws of physics conspire to limit the effect of friction-reducing agents and that optimum throughput at full pressure is approximately 7% greater than throughput at 80%, all other things being equal.

2. Down Time.

238 One concern about the representativeness of throughput during the test year is that the year was one in which the Company was making improvements to and performing maintenance on the lines as a result of the transfer of ownership and BP's maintenance standards, and because of the need to comply with regulatory requirements. While some maintenance can be accomplished without stopping traffic in the line, other maintenance cannot. If the level of maintenance requiring down-time increases above normal during a given period, the volume of traffic decreases and is not representative of throughput in normal times.

239 The return to normal operations will have a significant effect on revenues, and its timing will have a significant effect on the revenue that Olympic will achieve.

3. Shipping Patterns.

240 A second concern has to do with customers' shipping patterns. When product is delivered, it is said to be "stripped" from the pipeline. Stripping interrupts the flow of traffic. The number and placement of strips therefore affect throughput. If product were stripped from the line more often than normal, or were stripped in different locations, throughput could vary from normal. Because the test year follows a period of total interruption, and because it is during a period of limited flow when shippers may have chosen a different mix of traffic to meet their needs, we cannot be sure that the test year is fully representative even of normal throughput at reduced flow.[44]

4. Effect of Bayview.

241 The final significant element in calculating throughput is determination of the timing and effect of returning the Bayview facility to its intended use in facilitating the

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[44] Olympic was repeatedly asked about these factors during discovery phases of the proceeding. It contended that it had no information about such matters other than what appeared in rather cryptic notations on green sheets of paper from which the requested information could be compiled. It did not produce a compilation or summary of the information when the Commission ordered it to do so. *See*, the 13th and 16th Supplemental Orders in this docket.

combination of shipments. Olympic has testified that its first goal is to demonstrate to regulators that the 80% pressure limitation may be lifted then it will work to restore Bayview to service. Olympic anticipates that Bayview can be restored to service quickly after elimination of the pressure restriction. The effect of Bayview is uncertain; Olympic represented at the time the project was approved that it could increase "capacity" by 35,000 to 40,000 barrels per day, or 12.8 million bbl/yr. Its estimates of improved throughput in this proceeding were much smaller, though still quite significant, at 4.375 million bbl/yr.[45]

5. Olympic proposal:

242 Olympic urges the Commission to adopt its use of ten months' unadjusted throughput, annualized, of 103 million barrels per year. Olympic asserts that the information is real, that it is the best available information, that it includes actual down-time, and that it is thus the best and most accurate for use.

243 The Company numbers begin with the first month of operations after the line restarted following the shut-down. They are rooted in a period of recovery that included extensive down-time. They do not recognize information that is clear on this record—that the Company is improving its performance. They also offer little incentive for further improvements. For these reasons, the Commission rejects this proposal.

6. Tesoro Proposal

244 Tesoro asks that throughput be set at a "normal" level, that is, the most recent available throughput prior to the Whatcom Creek incident, plus an increase in throughput that reflects Olympic's representations at the time it secured a rate increase to fund construction of the Bayview facility.

245 Tesoro argues, *inter alia*, that Olympic is not entitled to use of a reduced throughput for setting rates because the reduction is a product of its own imprudence in maintaining its facilities – *i.e.*, that if Olympic had been acting prudently, it would have tested and replaced the pipe segments with problematic seams, and it would not have suffered the Whatcom Creek incident. It argues that to use the lower number shifts the obligations of ownership and operation of a common carrier to the shippers.

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[45] Olympic's opening brief, paragraph 110.

It does offer to reduce its calculation of throughput if Bayview is excluded from the calculation of rates. Olympic responds that its figures are based on actual experience, so only its numbers reflect actual recent operating experience and actual experienced down-time. Staff argues that Tesoro's proposal is unjustified in fact.

246 We reject Tesoro's proposal. It does not reflect reality. Tesoro has established that the pipe seam failure and the leak causing the explosion happened, but it has not established that the Company was imprudent in its actions leading up to the events or that a result should be a total rejection of the reality of the 80% restriction. Imputation of Bayview's contribution to throughput is not proper, as the facility is not in operation and the date of its reentry to service is not certain. Tesoro has not demonstrated an adequate reason for making the imputation. Our task is to set rates that are fair, just, reasonable, and sufficient. Tesoro's proposal seems unduly punitive in nature and does not recognize the fact of the limitation nor its effect on overall Company operations. There are too many unanswered questions in Tesoro's allegations of imprudence to support a finding that would exclude consideration of the actual conditions during the time rates are expected to be in effect.

7. Tosco Proposal

247 Tosco recommends throughput for ratemaking purposes of 130 million barrels per year (bbls/yr) by adding pre-1999 actual figures of 116.3 million, plus the 35-40,000 bbls/day that Olympic represented Bayview would add to throughput, or about 13.7 million bbls/yr. Tosco recognizes that this is not sufficient for Olympic during the period of reduced throughput, and proposes to resolve that problem by recommending a surcharge, applicable over five years, by which Olympic would recover the deficiencies caused by the pressure restriction and Bayview's unavailability. Because of the structure of the surcharge, Olympic would benefit by eliminating the pressure restriction and getting Bayview on line earlier, and would not receive the full benefit to the extent that the events happen later than Olympic estimates.

248 The Commission rejects Tosco's proposal. There is dispute about the accuracy and meaning of Olympic's earlier "capacity" representation regarding Bayview, and we think it would be premature to set throughput on that basis. Tosco's proposal for a short-term surcharge is an innovative and attractive way to accommodate the Company's present needs and move on, but it does not acknowledge the number of

still-open questions and the need for an opportunity for further review when the Company's operations have returned to a state closer to normal.

8. Commission Staff Proposal

249 Commission Staff proposes use of 108,323,000 barrels per year throughput as the most accurate estimate at 80% pressure. It is based on actual experience during the test year it proposes and is analyzed with comparison to pre-1999 operations.

250 Commission Staff says at paragraph 227 of its brief, that

> If the 80% pressure condition is used for throughput, Staff's calculation of 108,323,721 bbls/yr. should be used. In its calculation, Staff compared the only available months of demonstrably comparable throughput data. Staff measured the relationship between throughput for July 2001 and August 1998. These months shared the same characteristic of high throughput, but August 1998 was at 100% pressure and July 2001 was at 80% pressure. This permitted a direct, objective comparison between the two operating conditions. The resulting 93.17% ratio was multiplied by 1998 total throughput to arrive at a reasonable estimate of what throughput would be at 80%, pressure.[46] The result was 108,323,721 bbls/yr. (Colbo, Ex. 2001-T at 30-32; Ex. 2003-C at 21).

251 Commission Staff acknowledges some uncertainty in the numbers, including the role of down-time and the effect of new batching procedures, information that Olympic did not provide to the record, but argues that the Staff-proposed numbers are the most reliable indicators available of likely throughput during the coming year.

252 Olympic urges rejection of Commission Staff's proposal. It argues that the Staff's proposal would create a windfall to shippers, that it would abandon the throughput approach of the interim proceeding, and that it would ignore undisputed levels of down time. Staff challenges each of these contentions.

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[46] 1998 was the last year of "normal operations" for Olympic. Therefore, the level of downtime that occurred in 1998 is representative of the normal level.

9. Commission Decision

253 We disagree with Olympic and find that the Staff proposal avoids the uncorrected use of unrepresentative experience that is embedded in Olympic's proposal. Staff's proposal is a studied and thoughtful inquiry that expands and improves on the use of the scant available information at the time of the interim proceeding. Staff's proposal does not ignore undisputed levels of down-time—the levels are uncertain because the Company failed to provide information that could have helped to establish an appropriate level of down time. Rather, the Staff approach recognizes witnesses' statements that the Company is improving its operations and becoming more safe and stable, and the approach therefore recognizes that use of data with excess embedded down-time would be improper. Staff's proposal finds an appropriate balance between the Company's reliance on an unadjusted period including erratic operations, coupled with the Company's failure to provide down-time and other information when ordered, and the intervenors' unrealistic short-term assumptions of full pressure and full Bayview operations.

254 The Commission therefore adopts the Commission Staff's proposed *pro forma* adjustments PA-01, "Revenue", at 108,323,000 bbls/yr throughput, and PA-04 "Power & DRA," which are both calculated on the basis of Staff's proposed throughput.

10. Adjustment Mechanism Based on Throughput.

255 Tosco and Commission Staff both support mechanisms to modify rates when the Company is able to return to full pressure and reactivate Bayview. Tosco proposes a surcharge based on Olympic's estimates of when it will return to normal operations. Commission Staff supports the concept of a tracking mechanism. Olympic supports the Commission Staff proposal and agrees to work cooperatively with parties to develop an agreed approach. Tesoro does not comment on the topic in its brief.

256 The Commission appreciates the creative suggestions. An adjustment mechanism, however, would be one-dimensional in its application, while the Company's areas of concern are multifaceted. Consequently, we think that the better approach is to direct the Company to file a general rate case between July 1 and October 1, 2004.

257 While the information of record is sufficient to set rates (given its limitations and the recent exigent circumstances affecting the Company), the lack of some data and the remaining questions about Olympic's operations call for the opportunity for an additional review with better information.

11. Rate Filing Ordered

258 By directing that Olympic file two years from now, we provide a full opportunity for Olympic to resolve remaining issues with Bayview and with throughput. The two-year period also provides an incentive for early performance: if Olympic exceeds its estimates and resolves those matters earlier, the timing will allow collection of additional revenues from increased throughput that can be used for such things as improvement of Olympic's capital structure.[47]

259 Clarification and resolution of certain issues in this rate case should make a future rate case go more smoothly. If Olympic modifies or supplements its accounting system to provide information unavailable during this proceeding; if Olympic's filing is well-supported; and if the Commission and potential parties are given access to necessary information, it is possible that suspension may not be necessary.

XI. RESULTS OF OPERATIONS

A. Results Per Books.

1. Actual Results of Operations

260 Olympic bases its presentation on its financial statements for 2000 and 2001. During the hearing, it was agreed that the financial statements had not been given unqualified certification by a certified public accountant.

261 As noted above, Olympic submitted for the record on August 12, 2002 (after the record had been closed), a document purporting to be an unqualified audit of its 2000 and 2001 operations. The Commission rejected the document, balancing its value to the record with the uncertainties and additional process that might be demanded in conjunction with its receipt into evidence.

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[47] We acknowledge that the Commission cannot foreclose a complaint based on earnings, and Olympic may apply earlier if it believes doing so will address its needs and provide necessary answers to still-remaining questions.

262 Also as noted above, we accept the financial information of record, and we rule that the information of record has been adequately tested for use in this proceeding. We emphasize that Commission Staff accepts the Company's prior financial statements as an acceptable starting point for ratesetting examinations. We accept Commission Staff's evaluation and find that the evidence of record is sufficient for purposes of this proceeding notwithstanding the parties' criticisms of the reported unaudited data. To the extent these criticisms may be perceived as an objection to the use of the data as a starting point, we overrule the objection. With the additional information and analysis that Staff provided, the record is sufficient for the resolution of the issues we address in this docket.

263 Olympic petitioned for "administrative review" of the evidentiary ruling on September 12, 2002. We reject the petition, as the ruling of which Olympic asks review was not an "initial order" dispositive of the merits and thus not subject to administrative review under RCW 34.05.461. Olympic did not seek a timely review under WAC 480-09-760 relating to interlocutory orders.

2. Whatcom Creek Expenses; Determinations of Prudence.

264 All parties agreed that the direct expenditures relating to the Whatcom Creek explosion and its aftermath should be excluded from consideration. We have not been asked and we express no opinion on whether, if asked to do so, the Commission would consider any portion of those expenses for ratemaking purposes. Evidence of record indicates that there are a number of pending insurance claims, several pending lawsuits, and considerable potential financial exposure, and that it is not possible to predict the result of all these matters with sufficient certainty for ratemaking purposes.

265 Tesoro argues that no indirect consequences of imprudent operations should be included. It proposes no adjustment to indicate what operations should be deemed imprudent and to quantify the effect of the proposal. The record is insufficient to determine the nature and extent of any imprudence that might be associated with any of the relevant Company actions, and the record is insufficient in most instances to separate Whatcom Creek's indirect consequences from consequences of other matters, such as the failure of the ERW pipe seam during hydrotesting and recent increases in regulatory scrutiny. In short, we will not reject expenditures on the basis

of imprudence unless a case for imprudence is established. Consequently, we reject the Tesoro allegations and the Tosco proposal to remove from Olympic's case as improper $1.2 million of indirect costs although we will review proposed individual adjustments separately.

266 Some of the parties made allegations of Company negligence in actions relating to three matters: the Whatcom Creek leak and explosion, the bursting of an electrostatic resistance weld during hydrostatic testing, and the construction or operation of the Bayview batching facility.

267 The Commission does not consider issues related to prudence—or any other theory that would prevent Olympic from including expenditures in rates on the basis of its negligence or other improper action—in any of our decisions relating to those matters. Direct effects of the Whatcom Creek incident have been excluded by agreement, and indirect effects may be tied to other events or matters, as well. Bayview was not in operation long enough to determine its long-term usefulness or the existence or extent of any associated problems. The record did not produce sufficient evidence relating to the underlying events, and the parties did not argue the issue sufficiently on brief, that the matter is ripe for decision.

268 The Commission does not foreclose such matters from consideration in future proceedings, for application to future rates.

3. Summary of the Positions of Parties

269 Table 2 summarizes the positions taken by the Company and opposing parties regarding the total cost of service on a total company basis. The Company's amounts are presented based on its updated "Case 2," which uses a test period of the 12 months ending September 30, 2001.

TABLE 2: OLYMPIC PIPE LINE COMPANY
TOTAL COST OF SERVICE – TOTAL COMPANY RESULTS
PER OPL AND OPPOSING PARTIES
VARIOUS METHODS AND BASE OR TEST PERIODS
(In Thousands of Dollars)

					TOSCO	
Ln #	**Description**	**OPL Case 2 FERC Method (TOC)**	**WUTC Staff DOC Method Total Company**	**TESORO DOC Method**	**TOC Method**	**DOC Method**
	(A)	(B)	(C)	(D)	(E)	(F)
1	Allowed Total Return	$12,313	$4,552	$5,998	$8,080	$6,009
2	Income Tax Allowance	6,864	2,097	2,005	3,706	2,333
3	Oper. Exp. Excluding Depr.	33,446	27,734	25,182	34,844	34,844
4	Depreciation Expense	2,798	2,276	2,798	2,798	2,798
5	Amortization of AFUDC	255	81	314	203	203
6	Amort. of Deferred Return	859	0	0	628	0
7	**Total Cost of Service**	**$56,535**	**$36,740**	**$36,297**	**$50,259**	**$46,187**
8	Throughput (In Thousands bbls/yr)	103,165	108,324	121,349	129,953	129,953

270 Tosco stated in its brief that it does not take a position regarding Olympic's total cost of service. Tosco only proposes certain adjustments to the Company's cost of service calculations, which Tosco recommends be added to the adjustments proposed by other parties. In Table 2, columns (E) and (F) reflect the changes to the Company's cost of service when effect is given to Tosco's recommended adjustments.

271 Table 3 summarizes the Commission Staff's proposed total Company and Washington Intrastate *pro forma* results of operations for the 12 months ending December 31, 2001.

TABLE 3: OLYMPIC PIPE LINE COMPANY

***PRO FORMA* RESULTS OF OPERATIONS - TOTAL COMPANY AND WASHINGTON INTRASTATE**
FOR THE 12 MONTHS ENDED DECEMBER 31, 2001
(In Thousands of Dollars)
PER WUTC STAFF

		Total Company		Washington Intrastate	
Ln #	**Description**	**Total Net Operating Income**	**Total Rate Base**	**Total Net Operating Income**	**Total Rate Base**
	(A)	(B)	(C)	(D)	(E)
1	**Actual Results of Operations**	($9,198)	$64,454	($6,482)	$23,358
2	Rate of Return – Per Books %		-14.27%		-27.75%
	Restating Adjustments				
3	Reclassification	4	0	(119)	0
4	Remove Non-Operating Rate Base	0	(551)	0	(200)
5	Remove Casualty Loss	11,456	0	6,154	0
6	Reclassify Capitalized Construction. Payroll	(7)	433	8	157
7	Correct December Depreciation & Rate Base	238	(7,759)	86	(2,812)
8	Remove Employee Relocation Expenses	155	0	62	0
9	Normalize OTM Expense	1,830	1,286	785	466
10	AFUDC	(61)	4,093	(22)	1,483
11	Amortize Employee LT Disability Buy Out	81	0	32	0
12	Remove D. Cummings WC Pay	65	0	26	0
13	Remove Advertising, Charity, Lobbying	84	0	31	0
14	**Total Restating Adjustments**	$13,844	($2,498)	$7,045	($905)
15	**Restate Results of Operations**	$4,646	$61,956	$562	$22,452
16	Rate of Return – Restated %		7.50%		2.51%
	Pro Forma Adjustments				
17	Revenue @ 108,323,000 bbls/yr Throughput	5,519	0	2,085	0
18	Remove Bayview Investment & Expenses	770	(20,533)	296	(7,441)
19	Remove FERC Interim Rates	(3,602)	0	(678)	0
20	Power & DRA	(1,601)	0	(580)	0
21	Oregon Income Taxes	(66)	0	0	0
22	Management O/H Fee	(7)	0	(3)	0
23	Normalized Oil Loss	1,653	0	599	0
24	None	0	0	0	0
25	Plant In Service 2001 NRP	(121)	6,759	(44)	2,450
26	Insurance Expense	(356)	0	(191)	0
27	Remove Sea-Tac & Impacts	346	(9,689)	140	(3,511)
28	Pro Forma Interest Expense	(1,417)	0	(513)	0
29	Plant In Service 2002 NRP	(347)	23,017	(126)	8,341
30	**Total Pro forma Adjustments**	$772	($445)	$984	($161)
31	**Pro forma Results of Operations**	$5,418	$61,511	$1,546	$22,291
32	Rate of Return – Pro Forma		8.81%		6.94%
33	**NOI (Excess)/Deficiency**	($866)	0	$103	
34	**Results At Proposed Rates**	$4,552	$61,511	$1,650	$22,291
35	Rate of Return – After Rates		7.40%		7.40%

272 Table 4 summarizes the Commission Staff's proposed Washington Intrastate *pro forma* results of operations for the test period.

TABLE 4: OLYMPIC PIPE LINE COMPANY
PRO FORMA RESULTS OF OPERATIONS - WASHINGTON INTRASTATE
FOR THE 12 MONTHS ENDED DECEMBER 31, 2001
(In Thousands of Dollars)
PER WUTC STAFF

Ln #	Description	Total Net Operating Income	Total Rate Base	Rate Of Return %
	(A)	(B)	(C)	(D)
1	**Actual Results of Operations**	($6,482)	$23,358	-27.75%
	Restating Adjustments			
2	Reclassification	(119)	0	
3	Remove Non-Operating Rate Base	0	(200)	
4	Remove Casualty Loss	6,154	0	
5	Reclassify Capitalized Construction. Payroll	8	157	
6	Correct December Depreciation & Rate Base	86	(2,812)	
7	Remove Employee Relocation Expenses	62	0	
8	Normalize OTM Expense	785	466	
9	AFUDC	(22)	1,483	
10	Amortize Employee LT Disability Buy Out	32	0	
11	Remove D. Cummings WC Pay	26	0	
12	Remove Advertising, Charity, Lobbying	31	0	
13	**Total Restating Adjustments**	$7,045	($905)	
14	**Restate Results of Operations**	$562	$22,452	2.51%
	Pro Forma Adjustments			
15	Revenue @ 108,323,000 bbls/yr Throughput	2,085	0	
16	Remove Bayview Investment & Expenses	296	(7,441)	
17	Remove FERC Interim Rates	(678)	0	
18	Power & DRA	(580)	0	
19	Oregon Income Taxes	0	0	
20	Management O/H Fee	(3)	0	
21	Normalized Oil Loss	599	0	
22	None	0	0	
23	Plant In Service 2001 NRP	(44)	2,450	
24	Insurance Expense	(191)	0	
25	Remove Sea-Tac & Impacts	140	(3,511)	
26	Pro Forma Interest Expense	(513)	0	
27	Plant In Service 2002 NRP	(126)	8,341	
28	**Total Pro forma Adjustments**	$984	($161)	
29	**Pro forma Results of Operations**	$1,546	$22,291	6.94%
30	**NOI (Excess)/Deficiency**	$103		
31	**Results At Proposed Rates**	$1,650	$22,291	7.40%

273 The Commission Staff audited the Company's books and records and identified the Company's actual results of operations and average of monthly averages rate base for the twelve months ended December 31, 2001. The difficulties encountered by Staff and others in auditing, verifying and receiving timely and responsive discovery have been discussed elsewhere in this order. The Commission accepts the Commission Staff's representation that the test period results Staff portray are sufficiently reliable to measure the Company's revenue requirement in this proceeding.

274 After identifying the Company's recorded results for the test period, the Commission Staff made several restating and *pro forma* adjustments. The Staff then converted their audited results into a FERC USoA format. The Staff first reviewed the Company's total company results and then, using allocation factors, allocated total company amounts into Washington intrastate amounts. The Staff used the same allocation methodology employed by the Company, which uses throughput and mileage statistics. However, since Staff's proposed test period and *pro forma* throughput assumptions differ from the Company, the Staff's separation factors are different from the Company's. Staff assigns Other Revenues to intrastate at 39.73%. Operations & Maintenance Expenses and Rate Base were allocated to intrastate using an allocation factor of 36.24%, and General Expenses were allocated to intrastate using a factor of 53.72%. Because the allocation factor for General Expenses is higher than the factor for Operations and Maintenance Expenses, Staff's analysis indicates a higher revenue deficiency for intrastate results compared to total company and interstate results. In fact, on a total Company basis, Commission Staff's analysis reflects a revenue excess rather than deficiency.

275 The Commission adopts the allocation factors used by the Commission Staff to identify the intrastate results-of-operations for the test period. Intrastate results will be used to measure any revenue deficiency or excess the Company has.

276 The Commission Staff's intrastate *pro forma* statement shows a "per books" or as-recorded intrastate net operating income of a negative $6,481,960, a net intrastate rate base of $23,358,238, and an intrastate per books rate of return of a negative 27.75% for the calendar year 2001 test period. The Commission Staff's results of operations statements then portray restating and *pro forma* adjustments, which Staff proposes be made to the Company's test period as recorded results of operations. *WAC 480-09-330(2*).

B. Restating and *Pro Forma* Adjustments.

1. Restating actual adjustments

277 "Restating actual adjustments," is an accounting term-of-art used to revise the booked operating results for any defects or infirmities that may exist in actual recorded results, which can distort test period earnings. Restating actual adjustments are also used to adjust from an as-recorded basis to a basis that is acceptable for ratemaking purposes. Examples of restating actual adjustments are adjustments to remove amounts more appropriately attributable to a prior period, to eliminate below-the-line[48] items that were recorded as operating revenues or expenses in error, to adjust from book estimates to actual amounts, and to eliminate or to normalize extraordinary items which have been recorded during the test period. *WAC 480-09-330(b)*.

2. *Pro forma* adjustments

278 "*Pro forma* adjustments" give effect for the test period to all known and measurable changes that will occur prospectively that are not offset by other factors. *Pro forma* adjustments are used to adjust to prospective conditions.

279 Four adjustments proposed by the Commission Staff are affected by the Commission's decisions herein. Table 5 summarizes the Staff's intrastate results of operations, first listing those adjustments adopted by the Commission and then listing the four adjustments the Commission has either rejected or modified herein.

[48] "Below-the-line" is a regulatory term indicating that an item of revenue or expense should not be considered for ratemaking purposes.

TABLE 5: OLYMPIC PIPE LINE COMPANY
PRO FORMA RESULTS OF OPERATIONS - WASHINGTON INTRASTATE
FOR THE 12 MONTHS ENDED DECEMBER 31, 2001
(In Thousands of Dollars)
COMMISSION ADOPTED AND REJECTED ADJUSTMENTS

Ln #	Adj #	Description	Total Net Operating Income	Total Rate Base	Rate Of Return %
		(A)	(B)	(C)	(D)
1		**Actual Results of Operations**	($6,482)	$23,358	-27.75%
		Adopted Adjustments			
2	RA-01	Reclassification	(119)	0	
3	RA-02	Remove Non-Operating Rate Base	0	(200)	
4	RA-03	Remove Casualty Loss	6,154	0	
5	RA-05	Correct December Depreciation & Rate Base	86	(2,812)	
6	RA-06	Remove Employee Relocation Expenses	62	0	
7	RA-07	Normalize OTM Expense	785	466	
8	RA-08	AFUDC	(22)	1,483	
9	RA-09	Amortize Employee LT Disability Buy Out	32	0	
10	RA-10	Remove D. Cummings WC Pay	26	0	
11	RA-11	Remove Advertising, Charity, Lobbying	31	0	
12	PA-01	Revenue @ 108,323,000 bbls/yr Throughput	2,085	0	
13	PA-03	Remove FERC Interim Rates	(678)	0	
14	PA-04	Power & DRA	(580)	0	
15	PA-05	Oregon Income Taxes	0	0	
16	PA-06	Management O/H Fee	(3)	0	
17	PA-07	Normalized Oil Loss	599	0	
18	PA-08	None	0	0	
19	PA-09	Plant In Service 2001 NRP	(44)	2,450	
20	PA-10	Insurance Expense	(191)	0	
21	PA-11	Remove Sea-Tac & Impacts	140	(3,511)	
22		**Total Adopted Adjustments**	$8,364	($2,124)	
		Rejected Adjustments			
23	RA-04	Reclassify Capitalized Construction Payroll	8	157	
24	PA-02	Remove Bayview Investment & Expenses	296	(7,441)	
25	PA-12	Pro Forma Interest Expense	(513)	0	
26	PA-13	Plant In Service 2002 – NRP	(126)	8,341	
27		**Total Rejected Adjustments**	($335)	$1,057	
28		**Total Adopted & Rejected Adjustments**	$8,028	($1,067)	
29		**Pro Forma Results of Operations**	$1,546	$22,291	
30		**NOI (Excess)/Deficiency**	$103		
31		**Results At Proposed Rates**	$1,650	$22,291	7.40%

C. Discussion of Restating and *Pro forma* Adjustments.

1. RA-1 Reclassification

280 Commission Staff reclassifies certain operating expenses by moving certain amounts from one account line to another. Most of these reclassifications have no effect on net operating income at the total company level. However, because some amounts were moved from Operation and Maintenance Expenses to General Expenses, and because the allocation factor to intrastate results is much higher for General Expenses than O&M Expenses, there is an effect on intrastate net operating income. Other adjustments sponsored by Staff have a similar effect, causing a larger proportional impact on intrastate results because of the allocation process. In addition to the reclassification from one expense account to another, Staff removed an amount of $5,412 from operating expenses because it was an issuance cost and was therefore a financial cost rather than an operating expense. The Company did not specifically contest this adjustment in its rebuttal testimony.

281 The proposed adjustment decreased the intrastate net operating income by $118,550. This adjustment is appropriate and is adopted by the Commission.

2. RA-2 Remove Non-Operating Rate Base

282 Commission Staff removed $551,000 from rate base in order to remove "Noncarrier" property from rate base. The Company identified this amount as noncarrier property in its filed annual report to the Commission for the year 2001. This adjustment reduces the intrastate rate base by $199,682. The Company did not specifically contest this adjustment in its rebuttal testimony. The adjustment is appropriate and is adopted by the Commission.

3. RA-3 Remove Casualty Loss

283 In adjustment RA-1, the Staff's reclassification adjustment added $1,113,421 to the Casualty Loss account. This proposed Staff adjustment RA-3 removes the booked amount to the Casualty Loss account and the amount added to the account by adjustment RA-1. At Staff's fully proformed results of operations the balance in the Casualty Loss account is zero. This adjustment removes direct costs related to the

Whatcom Creek incident, which are not included for ratemaking purposes by any party in this proceeding. The effect on intrastate net operating income is an increase of $6,153,917. The Company did not specifically contest this adjustment in its rebuttal testimony. The adjustment is appropriate and is adopted by the Commission.

4. RA-4 Reclassify Capitalized Construction Payroll

284 At the total company level, the Staff reclassified expenses, capitalized $444,000, and depreciated $10,878 of the $444,000 capitalized. The adjustment increased intrastate net operating income by $8,032 and increased rate base by $156,963.

285 The Commission has reviewed this adjustment. If the depreciation adjustment of $10,878 is excluded from the adjustment, the remainder of the adjustment, at the total company level, has a zero impact on net operating income. Hence, in "capitalizing" the $444,000, Commission Staff did not remove any amount from operating expenses and capitalize it. Staff's testimony indicates that the Company had already capitalized the amount in December 2001. Staff's rate base is presented on an average-of-monthly-averages basis until adjusted to an end-of-period rate base by proposed adjustment PA-09, "Plant In Service 2001 – NRP."

286 The Commission does not understand the basis of the capitalization and depreciation of the $444,000. The Commission therefore adopts the portion of the adjustment which reclassifies the expenses, but rejects the portion of the adjustment that capitalizes and depreciates the $444,000. If there is a record reference which explains this adjustment, the Commission Staff may refer us to it and ask for reconsideration of the Commission's decision.

287 Although the adjustment, as revised by the Commission, has no total company impact on net operating income, there is an intrastate increase in net operating income of $10,594 because of the effects of the allocation process.

5. RA-5 Correct December Depreciation & Rate Base

288 Commission Staff proposes an adjustment in order to correct booked recording errors that affect the average-of-monthly-averages rate base calculation. In addition Staff removes the Cross-Cascades project from plant-in-service because it is still CWIP. This reduces rate base at the total company level by $7,759,280.

289 Commission Staff also proposes an adjustment to booked depreciation expense related to the excess plant that is removed from rate base. Mr. Colbo removed the excess amount of depreciation expense booked in December 2001 by subtracting the November 2001 level from the December 2001 level. The difference became the adjustment. Implicit in this adjustment is the assumption that the November 2001 level of depreciation was normal and did not include the excess depreciation expense. This is a reasonable approach.

290 This adjustment increased intrastate net operating income by $86,133 and decreased rate base by $2,811,963.

291 The record is clear that the Cross-Cascades project is either CWIP or an abandoned construction project. The Company called the project a "shelved" project. In either case, it is appropriate to remove the amount from plant-in-service and from rate base. The Cross Cascades project is not used and useful. The Staff's proposed adjustment is appropriate and is adopted by the Commission.

6. RA-6 Remove Employee Relocation Expense

292 The Commission Staff removes employee relocation expenses of $238,674 at the total company level because these amounts were related to a change in the ownership of the Company. We have addressed this matter above at paragraph 145 and accept the proposed adjustment. The adjustment RA-06 increases intrastate net operating income by $62,084.

7. RA-7 Normalize One Time Maintenance (OTM) Expenses

293 The Company booked $3,295,502 of "One-Time-Maintenance" (OTM) expenses during the year 2001 test period in its Outside Services accounts. Even more of these OTM costs were booked in the Company's proposed base period. Commission Staff examined the Company's 2002 budgeted amounts for similar expenses and based on the 2002 distributions, capitalized 40%, amortized 58% over five years, and expensed 2% of these 2001 Company-expensed amounts. In addition, Staff adds $32,428 in depreciation expense related to the 40% capitalized amount. The adjustment increases

intrastate net operating income by $785,456 and increases rate base by $465,964. This adjustment is contested by the Company in rebuttal testimony.

294 The parties do not dispute Olympic's right to include as costs of its operations in the calculation of rates a number of expenditures variously called "one-time" and "major." The parties do vigorously dispute how to account for those expenditures—whether they should be directly expensed, whether they should be "normalized" (amortized) over a period of years, or whether they should be capitalized for recovery against revenues while the rates on which they are based are in effect.

295 Olympic argues that these items are properly classified as maintenance expenses consistent with classifying instructions of the FERC Uniform System of Accounts, and that they therefore should be expensed—that is, considered entirely to be part of the test year's operations, rather than apportioned over a longer period in the manner that Commission Staff recommends. In the alternative, Olympic asks that they be considered as recurring and as an indication of the ongoing level of expenditures in future years and therefore proper for inclusion as recurring expenses.

296 Commission Staff proposes to adjust the expenditures to match the expenditure with the benefit, by "normalizing" a portion of the expenditures and by capitalizing a portion. Olympic did not provide detail of its 2001 one-time maintenance expenditures, so Staff used 2002 budgeted items as a guide to calculate the proportion of the 2001 expenditures that should be expensed, normalized, or capitalized. Staff proposes an adjustment apportioning 2% to expense, 40% to capitalization, and 58% to normalization with amortization over a five-year period. In addition, Staff opposed the inclusion of certain costs that the Company proposed for inclusion but did not support.[49]

297 Tesoro argues that Olympic has clearly not supported the $5.6 million in expenditures included in the Company's proposed test period.[50] It notes that the Company has not presented any breakdown of what these expenditures supported. It urges that $4.3 million is a carry-over item that results in double-counting. It asks rejection of all of

[49] These included overhead payments to BP, which Staff deals with under Adjustment PA-6, amortization of transition costs (*see*, discussion of transition costs and Adjustment RA-6), exclusion of an environmental accrual that includes amounts associated with Whatcom Creek and the Sea-Tac terminal, and a sum for legal and other professional services, which the Commission deals with separately. *See* Mr. Colbo's exhibit 2001T, pp. 22-23.

[50] The use of different test periods by Olympic and Staff results in references to different amounts.

these items for ratemaking purposes. Tosco urges rejection as well, identifying items that Tesoro calls attention to and arguing that the total includes two months of budgeted items.

298 Commission Staff answers that the expenditures are clearly not normal pipeline maintenance, so should not be expensed for ratemaking purposes. Staff includes here projects that must receive itemized Board approval. Staff emphasizes that it does not challenge the propriety of these items, even without Company itemization, but rather accepts them as proper business-related expenditures. The only issue is how to match the expenditures properly with revenues.

299 The Commission accepts the Commission Staff proposal as the only suggestion for which there is record support. As we noted above, neither GAAP nor the USoA are designed to account for ratemaking decisions. Whether or not the items are correctly categorized in either of those systems of account does not answer whether the items are correctly categorized for ratemaking purposes. The Company has not always complied with their requirements, in any event.

300 Staff's use of 2002 budgeted projects as a means to categorize the expenditures is not optimum. It is born of necessity. The result of disallowing that practice could be the disallowance of all of the expenditures for failure of the Company to justify them. Rather than suffer that consequence, recognizing the necessity for funding of expenditure for safety and system integrity purposes and the necessity for a resolution of the issue, we find acceptable the Staff's approach to categorization under the circumstances.

301 This avoids a need to normalize all expenditures exceeding a "normal" level, allows for proper recovery over the life of some improvements, provides for a return on capitalized expenditures, and is fair to the Company.

302 We also find acceptable the results of Commission Staff's categorizations. They satisfactorily identify the proportion of items that must be capitalized, the items that must be normalized, and the items that may be expensed. If Olympic can demonstrate and quantify a recurring level of expenditures or provide better detail about the nature and purpose of expenditures, it is free in a future proceeding to provide the detail and the justification to support its views. Apart from generalized testimony about the informal observations of managers, Olympic did not on this

record provide the support that would justify such a proposal—it could not even provide the details from its own accounting system about items for the year 2001 that it claims directly as expenses, to verify their nature.

303 Finally, we reject Olympic's argument that all of the items must be expensed because an increased level of maintenance projects will be required in the future. Olympic did not prove its case. While it is likely that Olympic will be undertaking some increased level of maintenance in the future, that level was not quantified. It has spoken of the need for $66 million additional expenditures in three years, but it did not present a list of those items. To the extent that the items are included in the Company's case we have considered them, and we have not rejected any demonstrated expenditure. What is clear is that the recent past has been filled with projects related to the need for the Company to bring its entire line up to regulatory and BP operating standards and to fix things that have been identified as needing improvement. Olympic provided neither an itemized list and description of repeating projects nor any systematic or reliable way to quantify its ongoing level of one-time or major maintenance. We are left without any way to evaluate Olympic's contentions or to even quantify its evaluation of "more."

304 At the heart of this discussion is the distinction between the responsibilities of ratepayers and the responsibilities of shareholders. In regulated operations, it is the investor who provides the capital for operations, and then has the opportunity to receive a return on and of that capital through rate-of-return and depreciation. All of the Company's demonstrated one-time and major expenditures are allowed. We accept Commission Staff's proposal as the best way to match the expenditure with the nature and lives of the projects. Absent evidence, it would be improper to assume the indefinite continuation of this high level of expenditures by embedding them directly in rate calculations as expenses. Commission Staff's adjustment is appropriate and is adopted.

8. RA-8 AFUDC

305 In this adjustment, Commission Staff restates the Company's Allowance for Funds Used During Construction (AFUDC) for prior and current years using the recommendations of Staff's cost-of-capital witness, Dr. Wilson. Staff indicated that the Company has not actually been booking AFUDC but should be. This issue is discussed in detail elsewhere in this order. In that section the Commission adopts

Staff's proposed adjustment RA-8 and directs the Company to maintain certain accounting records. *Paragraph 167*. This adjustment decreases intrastate net operating income by $21,981 and increased rate base by $1,483,295.

9. RA-9 Amortize Long Term Disability Buyouts

306 The Company booked $185,766 of "Employee Long-Term Disability Buyouts." Commission Staff normalizes this amount by amortizing the amount over three years and including one-third of the costs in test period results by removing two-thirds of the expense. This adjustment increases intrastate net operating income by $32,205.

307 The Company did not specifically contest this adjustment in its rebuttal testimony. This adjustment properly normalizes test period expenses. The adjustment is appropriate and is adopted by the Commission.

10. RA-10 Remove Dan Cummings Whatcom Creek Payroll

308 Mr. Dan Cummings is Olympic's Government and Public Affairs Director. Mr. Cummings spent 65% of his time during the test period on matters related to Whatcom Creek. Consistent with the parties' agreed position that costs directly related to the Whatcom Creek accident should be removed, Commission Staff removed 65% of Mr. Cummings' salary from the test period. The adjustment increases intrastate net operating income by $26,072. Staff further indicates that Mr. Cummings's present job is not the same as it was during the test period, and includes responsibilities for BP in other endeavors. This offers further support for Staff's adjustment.

309 The Company did not specifically contest this adjustment in its rebuttal testimony, but apparently contests the adjustment on brief. The issue of the costs associated with the Whatcom Creek incident is discussed in detail in a separate section of this order. Consistent with the Commission's discussion therein, the Commission adopts Staff's proposed adjustment RA-10.

11. RA-11 Remove Advertising, Charity and Lobbying

310 Commission Staff in this proposed adjustment removes $24,000 in payroll and related lobbying expenses and $105,822 in advertising, lobbying, and charitable contributions from the account Other Expenses. These are costs of doing business, but costs that are more appropriately borne by stockholders rather than ratepayers. The Company did not specifically contest this adjustment in its rebuttal testimony.

311 The adjustment increases intrastate net operating income by $31,233. The adjustment is appropriate and is adopted by the Commission.

D. *Pro Forma* Adjustments:

1. PA-1 Revenue at 108,323,000 Barrels Per Year of Throughput

312 In this adjustment the Commission Staff increases intrastate and interstate operating revenues by 29.32% to reflect Staff's normalized throughput. The Commission discusses the issue of throughput elsewhere in this order, and adopts Commission Staff's proposed throughput of 108 million barrels per year.

2. PA-2 Remove Bayview

313 This Commission Staff adjustment removes the Bayview terminal investment from rate base, but allows the Company to accrue AFUDC on the balance until the facility is in full service. In addition, Staff removes test period operating expenses related to Bayview. Staff updates the power costs portion of the Bayview adjustment in its Exhibit No. 2010. This adjustment is contested by the Company. Staff's adjustment increases intrastate net operating income by $295,948 and decreases rate base by $7,441,054.

314 The issue of the Bayview Terminal is discussed at length elsewhere in this order, beginning at paragraph 151. Consistent with the Commission's decision in those discussions, the Commission rejects Commission Staff's adjustment PA-2 to remove Bayview.

3. PA-3 Remove FERC Interim Rates and Sea-Tac Revenues

315 By this adjustment, Commission Staff removes the revenues associated with the Sea-Tac Terminal, because that facility was sold. In this adjustment, Staff also removes the effect on the 2001 test period of the "interim" rates granted by the FERC in September 2001. The removal of the FERC "interim" revenues affects only the Staff's total company analysis and not Washington intrastate rates. This adjustment reduces total Company intrastate net operating income by $580,948. The Company did not specifically contest these adjustments in its rebuttal testimony.

316 Adjustment PA-3 is appropriate and is adopted by the Commission.

4. PA-4 Power & DRA Expenses

317 Commission Staff adjusts power expenses and Drag Reducing Agent ("DRA") expenses to a normalized prospective level using Staff's assumptions of throughput at a level of 108,323,000 bbls/yr. The level of throughput affects the level of power costs. Staff amends its power cost adjustment with Exhibit No. 2010, which replaced page 29 of Exhibit No. 2003C. Staff witness Mr. Colbo offers testimony on this proposed adjustment. This adjustment decreases intrastate net operating income by $580,023.

318 Adjustment PA-4 is contested because it is driven by Staff's throughput assumptions, which are contested by the Company. We have above accepted Staff's proposed throughput estimate. The adjustment is therefore appropriate and is adopted by the Commission.

5. PA-5 Oregon Income Taxes

319 In this adjustment, Commission Staff removes an Oregon Income Tax "credit" of $65,547. This adjustment affects only Staff's total company presentation. The amounts are not a part of intrastate results of operations. Therefore, this adjustment has zero effect on intrastate net operating income. The Company did not specifically contest this adjustment in its rebuttal testimony or briefs.

320 The adjustment appears appropriate and, in any case, has no effect on intrastate results of operations. The Commission adopts Commission Staff's adjustment PA-5.

6. PA-6 Management Overhead Fee

321 Although Commission Staff proposed the rejection of numerous amounts in the Company's presentation that were based upon budgeted amounts, for purposes of adjustment PA-6, Commission Staff accepts the Company's budgeted 2002 estimate of its BP Management Fee expenses, and adjusts test period expenses to that level. The adjustment decreases intrastate net operating income by $2,987. No party specifically contested this adjustment in rebuttal testimony or briefs. The fee appears to be set by terms of the management agreement, substituted Exhibit No. 48 in the record and, because the sum is thereby known and measurable, the adjustment is proper. The Commission adopts Staff-proposed adjustment PA-6.

7. PA- 7 Normalized Oil Loss

322 Commission Staff removes all of the booked test period oil loss expense of $2,542,978. Staff determined that the average annual oil loss expense for the years 1995 through 1998 was only $6,694, an "immaterial" amount. This is a normalizing adjustment to adjust to prospective conditions. The adjustment increased intrastate net operating income by $599,023. The Company did not specifically contest this adjustment in its rebuttal testimony or briefs.

323 This is a normalizing adjustment to adjust to prospective conditions. The adjustment is appropriate and is adopted by the Commission.

8. PA-8 None

324 The Staff makes no adjustment designated PA-8.

9. PA-9 Plant In Service 2001 –NRP

325 By this adjustment, Commission Staff adjusts from an average-of-monthly-averages (AMA) rate base to an end-of-test-period rate base. Staff explains that this adjustment is made because of circumstances unique to this case. The adjustment allows the Company to receive a full return on Non-Revenue Producing (NRP) plant

that was installed during the test period. The adjustment decreases intrastate net operating income by $43,724 and increases rate base by $2,449,586.

326 Beginning at paragraph158 above, the Commission discusses this issue and finds that, although a departure from the traditional rate base calculation, end-of-period treatment is warranted and appropriate in this case. As observed by Staff, the Commission has on a very few occasions adopted an end-of-period rate base. In this instance, the adjustment contributes to this Company's ability to serve its customers in the near future and contributes to rates that are fair, just reasonable and sufficient. Accordingly Commission adopts Commission Staff's adjustment PA-9.

10. PA-10 Insurance Expense

327 Commission Staff adjusts insurance renewals to the 2002 level. The adjustment increases these expenses to a total company *pro forma* level of $1,102,206. It should be noted that Staff's analysis on Exhibit No. 2003C, page 38, also shows that the 2002 level of insurance expense is double or triple the annual amounts expensed over the years 1996 through 2001—undoubtedly a response, in part, to the Whatcom Creek explosion. The adjustment reduces intrastate net operating income by $191,318. The Company did not specifically contest this adjustment in its rebuttal testimony.

328 The adjustment reflects prospective conditions and, in that sense, is appropriate. The Commission adopts Commission Staff's adjustment PA-10.

11. PA-11 Remove Sea-Tac & Impacts

329 The Commission approved the transfer of Olympic's Sea-Tac terminal at the Seattle-Tacoma International Airport to the Port of Seattle, airport operator, but specifically reserved jurisdiction to treat the ratemaking consequences of the sale in a later order. By adjustment PA-11, Commission Staff proposes to recognize the ratemaking consequences of the sale. This Commission Staff adjustment removes test period operating expenses and rate base investment associated with the Sea-Tac terminal. Adjustment PA-3, adopted above by the Commission, removed the revenues associated with the Sea-Tac facility.

330 The adjustment increases intrastate net operating income by $139,622 and decreases rate base by $3,511,256. Since the Sea-Tac facility has been sold, the plant and related revenues and costs must be removed to reflect prospective conditions. The Company did not specifically contest this adjustment in rebuttal testimony. The Commission adopts Staff's adjustment PA-11.

12. PA- 12 *Pro Forma* Interest Expense

331 Mr. Twitchell proposes a *pro forma* debt adjustment to bring federal income taxes in agreement with Staff's cost of capital recommendation. He contends that this is appropriate because the authorized fair rate of return is an after-tax return. The Company contests this adjustment because, among other things, Staff includes Bayview in the calculation of *pro forma* interest and the Company argues that Bayview should not be included if it is excluded from rate base.

332 The Commission above rejects the Commission Staff's proposed adjustment PA-02 to remove the Bayview facility from rate base. Hence, in the *pro forma* debt calculation, the amount of the Bayview investment should not be added to rate base, because it is already included in rate base.

333 Further, as discussed elsewhere, the Commission rejects Commission Staff's adjustment PA-13, which adds CWIP to rate base. Since CWIP is rejected as an element in rate base, the Commission will include CWIP in the base on which *pro forma* interest is calculated. This flows through the tax benefit of interest on construction, which the ratepayers pay through the amortization of AFUDC or the depreciation of actual capitalized interest.

334 The Commission recalculates the *Pro Forma* Interest Adjustment, incorporating all other decisions in this order that affect the adjustment. The Commission's recalculation of the *pro forma* interest adjustment is shown in Table 6:

TABLE 6: OLYMPIC PIPE LINE COMPANY
RECALCULATION OF PRO FORMA INTEREST ADJUSTMENT – PA-12
FOR THE 12 MONTHS ENDED DECEMBER 31, 2001

COMMISSION'S DECISION

Ln#	Description	Source	Amount	
	(A)	(B)	(C)	
1	Total Company Pro Forma Rate Base		$58,593,140	
2	Add: Construction Work In Progress		23,550,326	
3	Total Pro forma Rate Base and CWIP	Ln 1 + Ln 2	$82,143,366	
4	Washington Intrastate Allocation Factor		36.24%	
5	Intrastate Pro forma Rate Base & CWIP	Ln 3 X Ln 4	$29,768,756	
6	Weighted Cost of Debt		5.60%	
7	Total Intrastate Pro Forma Interest	Ln 5 X Ln 6	$1,667,050	
8	Total Company Actual Interest		$8,642,656	
9	Washington Intrastate Actual Interest	Ln 8 X Ln 4	$3,132,099	
10	Net Change in Interest Expense	Ln 7 – Ln 9	($1,465,048)	
11	Corporate Federal Income Tax Rate		35.0%	
12	Federal Income Tax Change	- Ln 10 X Ln 11	$512,767	
13	Net Operating Income Change	Ln 12 X -1	**($512,767)**	

335 The Commission's recalculated *pro forma* interest expense adjustment PA-12 decreases intrastate net operating income by $512,767. The amount of the recalculated adjustment is nearly equal to Commission's Staff's original adjustment of $513,478. This is true because the inclusion of the Bayview facility in rate base is offset by the exclusion of CWIP from rate base.

13. PA-13 Plant In Service 2002 – NRP

336 Through the testimony of Mr. Twitchell, Commission Staff adjusts rate base by adding the amount of CWIP to rate base on an end-of-period basis at December 31, 2001. The CWIP is related to construction that is due to be completed during calendar year 2002. The adjustment decreases intrastate net operating income by $125,607 and increases rate base by $8,341,396.

337 The Commission understands that by adjustment PA-9, Commission Staff adjusts to an end-of-period rate base, using end-of-period Plant in Service and Accumulated Depreciation, and by adjustment PA-13 Staff further adjusts rate base by adding CWIP to rate base at an end-of-test-period amount. As discussed earlier, the Commission adopts Staff's proposed adjustment PA-9.

338 Commission's Staff's adjustment P-13, "Plant in Service 2002 - NRP," includes CWIP in rate base on an end-of-period basis. Staff has "included in the rate base construction projects that are not in service by December 31, 2001. Staff recommends that because Olympic has experienced a loss of revenues and has had sizable increases in plant additions, the end-of-period 2001 CWIP balance, representing plant that will go into service in 2002, should be included in the rate base."

339 In our discussion of the Bayview facility, above (beginning at paragraph 151), we stated our reluctance to include CWIP in rate base under a depreciated original cost analysis because, by definition, CWIP is not used and useful in the utility's operations. We noted judicial reluctance to approve its inclusion, as well, under statutory provisions in Title 80, and stated our concern that in adopting a depreciated original cost analysis of the sort applied under Title 80 the Commission should adopt departures from the methodology with great caution. The decision to reject CWIP as an element in rate base applies here, as well, and we reject the Commission Staff's proposed adjustment PA-13 to include CWIP in rate base.

340 Table 7 summarizes the Commission's decisions regarding the Company's Washington intrastate revenue requirement.

TABLE 7 OLYMPIC PIPE LINE COMPANY
PRO FORMA RESULTS OF OPERATIONS - WASHINGTON INTRASTATE
FOR THE 12 MONTHS ENDED DECEMBER 31, 2001
(In Thousands of Dollars)
COMMISSION DECISION

Ln #	Adj #	Description	Total Net Operating Income	Total Rate Base	Rate Of Return %
		(A)	(B)	(C)	(D)
1		**Actual Results of Operations**	($6,482)	$23,358	-27.75%
		Adopted Adjustments			
2	RA-01	Reclassification	(119)	0	
3	RA-02	Remove Non-Operating Rate Base	0	(200)	
4	RA-03	Remove Casualty Loss	6,154	0	
5	RA-05	Correct December Depreciation & Rate Base	86	(2,812)	
6	RA-06	Remove Employee Relocation Expenses	62	0	
7	RA-07	Normalize OTM Expense	785	466	
8	RA-08	AFUDC	(22)	1,483	
9	RA-09	Amortize Employee LT Disability Buy Out	32	0	
10	RA-10	Remove D. Cummings WC Pay	26	0	
11	RA-11	Remove Advertising, Charity, Lobbying	31	0	
12	PA-01	Revenue @ 108,323,000 bbls/yr Throughput	2,085	0	
13	PA-03	Remove FERC Interim Rates	(678)	0	
14	PA-04	Power & DRA	(580)	0	
15	PA-05	Oregon Income Taxes	0	0	
16	PA-06	Management O/H Fee	(3)	0	
17	PA-07	Normalized Oil Loss	599	0	
18	PA-08	None	0	0	
19	PA-09	Plant In Service 2001 NRP	(44)	2,450	
20	PA-10	Insurance Expense	(191)	0	
21	PA-11	Remove Sea-Tac & Impacts	140	(3,511)	
22		**Total Adopted Adjustments**	$8,364	($2,124)	
		Commission Decision			
23	RA-04	Reclassify Capitalized Construction Payroll	11	0	
24	PA-02	Remove Bayview Investment & Expenses	0	0	
25	PA-12	Pro Forma Interest Expense	(513)	0	
26	PA-13	Plant In Service 2002 – NRP	0	0	
27		**Commission Decision Adjustments**	($502)	$0	
28		**Total Adjustments**	$7,862	($2,124)	
29		**Pro Forma Results of Operations**	$1,380	$21,234	
30		**NOI (Excess)/Deficiency**	$234		
31		**Results At Commission's Decision**	$1,613	$21,234	7.60%

E. Net-to-Gross Conversion Factor.

341 The net-to-gross conversion factor is used to determine the level of gross revenue that results from the Commission's identified intrastate net operating income deficiency or surplus that would be required to achieve any net operating income deficiency or excess determined by the Commission. Commission Staff proposes a net-to-gross conversion factor of 0.65 for interstate operations. This factor includes only a federal income tax rate, of 35%, and is calculated by subtracting 0.35 from 1.00. Staff proposes an intrastate net-to-gross conversion factor of 0.637481, which includes both a federal income tax factor at 35% and an intrastate gross-receipts tax factor of 1.926%.

342 The interstate net-to gross conversion factor of 0.65 and the intrastate net-to-gross conversion factor of 0.637481 are appropriate for calculating the revenue requirement, and are adopted by the Commission. Table 8 summarizes the calculation of the intrastate Net-To-Gross Conversion factor.

TABLE 8: OLYMPIC PIPE LINE COMPANY
CALCULATION OF NET-TO-GROSS CONVERSION FACTOR – WA. INTRASTATE
FOR THE 12 MONTHS ENDED DECEMBER 31, 2001

COMMISSION'S DECISION

Ln#	Description	Source	Amount	
	(A)	(B)	(C)	
1	Total Operating Revenues		1.000000	
2	Operating Expenses:			
3	Less: State Utility Tax @ 1.9260%		0.019260	
4	Total Revenue Sensitive Expenses	+ Ln 3	0.019260	
5	Taxable Income Before Federal Income Taxes	Ln 1 – Ln 4	0.980740	
6	Less: Federal Income Taxes @ 35.0%	Ln 5 X 35.0%	0.343259	
7	Net Operating Income Conversion Factor	Ln 5 – Ln 6	**0.637481**	
8	Conversion Factor Multiplier	1 / Ln 7	1.568674	

F. Calculation of Revenue Deficiency or Surplus.

343 Table 9 shows the calculation of Olympic's revenue deficiency, based on the decisions in this order.

TABLE 9: OLYMPIC PIPE LINE COMPANY
CALCULATION OF REVENUE REQUIREMENT – WASHINGTON INTRASTATE
FOR THE 12 MONTHS ENDED DECEMBER 31, 2001

COMMISSION'S DECISION

Ln#	Description	Source	Amount
	(A)	(B)	(C)
1	Total Washington Intrastate Pro forma Rate Base		$21,234,118
2	Authorized Overall Return		7.60%
3	Net Operating Income Requirement	Ln 1 x Ln 2	$1,613,793
4	Pro forma Net Operating Income		$1,379,428
5	Net Operating Income Deficiency or (Excess)	Ln 3 – Ln 4	$234,365
6	Net-To-Gross Conversion Factor		0.637481
7	Total Gross Revenue Deficiency or (Excess)	Ln 5 / Ln 6	**$367,643**
8	Total Pro forma Operating Revenues Before Rates		$14,563,221
9	Percentage Revenue Increase or (Decrease)	(Ln 7/Ln 8) x 100	**2.52%**
10	Total Revenue Requirement	Ln 7 + Ln 8	$14,930,864

XII. REFUNDS

344 It is apparent that the revenue deficiency we find results in rates that are considerably below the level of temporary rates approved in the interim proceeding. Olympic requested and the Commission ordered that these interim rates were subject to refund.

345 Olympic argues that the Commission retains discretion to order or decline to order refunds of its overcollections. It argues that the rates were ordered to address dire circumstances and a showing of immediate need, and that there is no evidence in this docket to demonstrate that the need was not real or the money not needed. Olympic argues that requiring a refund would cripple the Company.

346 Other parties all state the view that refunds should be required. Tesoro and Tosco both argue that the order mandated refunds. Commission Staff also reminds us that the interim order was conditioned on refunds.

347 We agree with the Company that the limited record of the interim proceeding did indicate dire circumstances that appeared to pose an imminent threat to safety. However, the evidence presented in this proceeding has demonstrated that Olympic's circumstances, while serious, posed no imminent threat to public safety. Under BP's management, the Company is improving its performance and has stabilized. While we do have discretion in this area, we believe that refunds of the excess interim rates are consistent with the Company's express request, and that they are within the terms of the Commission's Third Supplemental Order. We will order refunds, with interest set at the level of the overall rate of return established herein. The goal of this process is to complete a dollar-for-dollar refund to shippers, plus interest.

348 The Company, having failed to meet its burden to justify an increase at interim levels and having failed to demonstrate any other justification for keeping the money, must repay the money with interest. It has had the use of the money in the interim period and has benefited from it in that regard. We disagree that requiring refunds would cripple the Company; instead, we believe that the record of this proceeding amply demonstrates that the rate level that we find appropriate will allow a prudently run and efficient company to attract capital and to earn an appropriate return. In addition, our decisions regarding rate base, the time of its calculation, throughput, rate case timing, and many other matters recognize Olympic's challenges and accommodate them in a way that produces rates that are fair, just, reasonable, and sufficient.

349 Olympic must file, at the time that it files a tariff to implement the rate increase that we here authorize, a tariff rider that provides for the return of excess tariff collections by means of a discount, over a two-year period or its equivalent in estimated throughput, including interest at the overall rate of return authorized herein. Olympic

must provide work papers that demonstrate the accuracy and effectiveness of its refund, and must submit the refund tariff rider on the same schedule as the Company is required to file tariff implementing the rates authorized herein.

350 Per the terms of the interim order, collection of interim rates must cease on the date identified herein for filing tariffs in compliance with this order.

XIII. REPORTING REQUIREMENTS

351 It is essential that Olympic keep the Commission informed of important economic events. Until relieved of the obligation by Commission order or by letter from the Commission's Executive Secretary, Olympic must report on January 15, 2003, and no later than the fifteenth day of each successive calendar quarter upon the following matters:

(1) Status and level of any pressure restrictions imposed by regulators, and the actual average maximum operating pressure achieved by operating by month.
(2) Total throughput, including the three months prior to the month of the report, with actual data.
(3) Status of Bayview: Whether it is being used as a batching facility and, if so, the additional throughput gained through its use, by month.

352 In addition, the Company must report to the Executive Secretary of the Commission, under this docket number, no later than the close of the second business day following the event, any of the following that occur and the date on which they occur.

(1) Removal, imposition, reduction, or increase of pressure restrictions by regulatory authority or independent company action.
(2) First operations at full pressure for any portions of the system now subject to an 80% pressure restriction.
(3) The beginning of unrestricted systemwide operations at full pressure.
(4) Placement of Bayview into operation for its intended purposes.
(5) Changes in equity ratio.

XIV. INFORMATION AND PROCESS FOR OLYMPIC'S FUTURE GENERAL RATE CASE FILINGS

353 Olympic's presentation in this docket lacked basic information about the Company's condition and was not presented in a timely or clear manner. Until further order of the Commission, Olympic must file any general rate increase requests as though WAC 480-09-310 through 330 applied to it. Upon review of the filing, the Commission after recommendation of the Commission Staff will determine whether the filing meets the minimum acceptable standards for a filing as set out in pertinent rules. If the Commission determines that the filing fails to contain necessary information, the Commission may reject the filing as inadequate and require a refiling that cures the inadequacies.

354 Specifically, until relieved of the responsibility by Commission order, when Olympic files general rate requests with the Commission, Olympic must file as though all pertinent provisions of WAC 480-09-310 through 330, which are incorporated herein by this reference, apply to it. Olympic must file all work papers and background information with the Commission no later than the time it files its testimony and exhibits, and must file associated work papers when it files any later testimony throughout the proceeding. Olympic must also consult with Commission Staff and intervenors, in this or future dockets; must provide prior and known current intervenors with copies of the filing no later than the time of filing, and must work with them as far in advance as is feasible to assist Olympic in anticipating discovery requests and providing information even before the filing of data requests. Olympic should begin working with Commission Staff immediately on concluding this docket, to determine the kinds of information needed for a Staff review and audit, and on devising ways to acquire and provide information in advance of filing and in a timely manner thereafter.

355 Having discussed above in detail both the oral and the documentary evidence received in this proceeding concerning all material matters, and having stated the Commission's findings and conclusions upon contested issues and the Commission's reasons and bases therefore, the Commission now makes and enters the following summary of those facts. Those portions of the preceding detailed findings pertaining to the ultimate findings stated below are incorporated into the ultimate findings by reference.

XV. FINDINGS OF FACT

GENERAL

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

357 (2) Olympic Pipe Line Company ("Olympic") is engaged in the business of furnishing the transportation of refined petroleum products for the public by pipeline for compensation in intrastate commerce within Washington State.

358 (3) On October 31, 2001, Olympic filed with the Commission, a proposed Tariff No. 23 to replace its currently effective Tariff No. 22, with a stated effective date of December 1, 2001. The intended effect of the tariff revisions is an annual increase in the Company's revenue of approximately $8.74 million. The filing was assigned Docket No. TO-011472.

359 (4) By order entered November 16, 2001, the Commission suspended the tariff filing in Docket No. TO-011472, instituted a Commission Staff investigation, and ordered that hearings be held on the reasonableness of the revisions.

360 (5) Olympic's books and records and Olympic's evidence and testimony based thereon failed to provide adequate information about the financial condition of the Company for ratemaking purposes. The additional information and analysis presented by Commission Staff and other parties produced a record of sufficient quality for the Commission to make an adequate determination of the Company's results of operations and rate base for purposes of this proceeding. The Company's books and records are not sufficient to meet the Commission's needs in performing its economic regulatory oversight functions on an ongoing basis.

METHODOLOGY

361 (6) Oil pipelines and other public utilities, including wireline telephone local exchange companies, water companies, and electric companies, are

substantially similar in their significant attributes, including high fixed costs, low variable costs, and entry and exit that are not gated by the Commission.

362 (7) Olympic's proposed "FERC Methodology" is characterized by the use of a "trended original cost" or "TOC" rate base measurement. Olympic supported the proposal by contending that it promotes competition between pipeline companies and other modalities of transportation. No other pipeline competes with Olympic and such competition is not shown to be likely. Olympic has no effective competition from other modes of transportation because they are not competitive on price and not competitive on service.

363 (8) Olympic did not present objective evidence to support its contention in support of TOC that it would support intergenerational equity and that it would, better than other methodologies reflect pricing in unregulated enterprises.

364 (9) TOC methodology requires the deferral of a portion of a regulated company's return on equity. Olympic never deferred any income from prior periods on its books; Olympic never secured a Commission order permitting any such deferral.

365 (10) Olympic's proposed TOC methodology would use a "starting rate base" or SRB. SRB supplies a return on investment that has not been supplied by investors, and that has not been used to support property used in the pipeline business.

366 (11) Olympic in its filings with the Commission has not used methodologies that are consistent between filings with this Commission for which records are available, or between filings with this Commission and filings with the FERC. The Commission has never previously determined what methodology should be applied in setting Olympic's rates. Olympic's prior filings with the Commission have become effective by operation of law and have not been approved by the Commission.

TEST YEAR

367 (12) Olympic's direct and rebuttal presentations are based, in part, on estimated or budgeted amounts. Neither budgeted nor estimated amounts are sufficiently reliable under the circumstances shown on this record for the setting of rates. The amounts do not qualify as known and measurable. Olympic's proposed base period of the calendar year 2000 and its proposed test period of the 12 months ended September 30, 2001 is not adequate for the purpose of measuring the Company's prospective revenue requirement and is, therefore, rejected by the Commission.

368 (13) The period beginning January 1, 2001, and ending December 31, 2001, is an appropriate test period to examine for the Company's results of operations. Restating and *pro forma* adjustments to test year revenues, expenses, and rate base pursuant to findings and reasoning in the body of this Order will portray the Company's test year results of operation and rate base properly for regulatory purposes. Other base periods or test periods are not adequate for reference in this proceeding.

369 (14) Olympic has entered many of its obligations on its own books on a cash basis rather than on an accrual basis. Olympic has corrected some of such entries on a year-end basis rather than on a month-to-month basis.

RATE BASE

370 (15) Olympic has demonstrated that it will be making substantial investments over the next several years in its pipeline facilities. Use of a rate base valued at the end of test year level will address concerns about regulatory lag as Olympic seeks inclusion of specific investments in its rate base in the future.

371 (16) Olympic's Bayview Terminal ("Bayview") is a $23.2 million facility designed to permit "batching" operations, enhancing the efficiency of the pipeline. Bayview went into service shortly before the June 10, 1999, explosion. Since then, because of regulatory restrictions, Bayview has not been used for those purposes, although it has been used for other pipeline business purposes and it is complete and ready to return to service upon completion of a study that federal authorities require. Bayview will again be used in the near future.

372 (17) Olympic's adjusted Washington intrastate rate base is $21,234,000.

ADDITIONAL IMPROVEMENTS

373 (18) Olympic is engaged in a capital improvement program that will result in the addition of improvements for approximately three years. Witnesses described some of the specific projects to be made but provided no list; no estimate of costs; and no indication of Board of Directors project approval or other specific evidence of the work to be done. Olympic did not offer an adjustment to recover some of the asserted capital costs in rates as a result of this proceeding. Any such projects that are included in the test period are embedded in rates as expenses, normalized expenses, or capital additions in the calculation of rates in this docket.

CAPITAL STRUCTURE

374 (19) Olympic's existing capital structure, consisting of debt and accrued interest exceeding the book value of the assets of the Company, is imprudent because it restricts Olympic's ability, independent of its owners' willingness to provide funds, to secure the capital it needs at reasonable rates.

375 (20) Prior to 1999, Olympic maintained a capital structure consisting of 11% to 16% equity.

376 (21) Olympic proposes the use of its parents' capital structure in setting its rates. That capital structure has no relationship with Olympic's risks or with Olympic's operations. Because Olympic is funded exclusively with debt, and its owners' equity is nearly 87% of their capital structure, accepting the owners' equity ratio would impose the costs of unnecessary return and tax responsibilities for ratepayers and would not provide rates that are fair, just, reasonable and sufficient.

377 (22) The appropriate capital structure for Olympic's intrastate Washington operations for ratemaking purposes is 20% equity and 80% long term debt. This structure will provide Olympic with an incentive to add equity to its capital structure through the addition of cash or other value or the forgiveness

of debt, and will enhance the opportunity for Olympic to accumulate retained earnings that will also create equity. A higher equity ratio would unfairly burden Company ratepayers.

RATE OF RETURN

378 (23) An authorized rate of return on equity of 10% will provide investors with a return on equity commensurate with investments of similar risk and will provide Olympic, if prudently and economically managed, a return sufficient to attract capital at reasonable rates. The Commission finds the testimony and analysis of Dr. Wilson credible on the issue of rate of return on equity.

379 (24) Olympic's cost of debt for ratemaking purposes is found to be 7%. The Commission finds the testimony and analysis of Dr. Wilson credible on the issue of cost of debt.

380 (25) A rate of return of 7.6% on Olympic's rate base will maintain its credit and financial integrity and will enable it to acquire sufficient new capital at reasonable terms to meet its service requirements. Setting the authorized return at 7.6% will provide incentive to Olympic to increase the proportion of equity in its capital structure. The appropriate overall rate of return for Olympic is therefore 7.6%.

THROUGHPUT DETERMINATION

381 (26) Throughput of 108,323,720 bbls per year is the most credible estimate of record for throughput to be effective during the time the rates established herein are likely to be in effect. The calculation assumes continuation of the existing 80% pressure limitation. The estimate controls for excessive down time in earlier phases of repair, investigation, and recovery related to the Whatcom Creek explosion and the burst ERW pipe seam, but assumes an appropriate level of down time for construction and repair based on the limited information of record.

TEST YEAR REVENUES

382 (27) Olympic's adjusted test year revenues for ratemaking purposes are $14,563,221 before rate changes.

NET TO GROSS CONVERSION FACTOR

383 (28) The appropriate net to gross conversion factor for use in converting intrastate net revenue requirements to gross revenue deficiency is 0.637481.

REVENUE DEFICIENCY AND REVENUE REQUIREMENT

384 (29) A deficiency of $367,643 exists in Olympic's gross intrastate revenue, based on the adjusted results of operations during the test year of the 12 months ended December 31, 2001, and a rate base valued at December 31, 2002, under the Company's presently-effective rates, without consideration of interim rates, based upon the findings of revenue, net operating income, conversion factor, rate base, capital structure, and rate of return found appropriate herein. Olympic requires a rate increase of 2.52% to meet its revenue deficiency.

385 (30) The Washington Intrastate revenue requirement for Olympic Pipeline for the test period is $14,930,864, which is the amount of annual intrastate revenues after the application of the increase of 2.52% authorized in this order.

386 (31) Rates collected under the provisions of the Third Supplemental Order exceed the level of rates authorized in this order. Rates found appropriate are lower than the rates approved in the Commission's Third Supplemental Order for application during the interim period while the Commission considered the appropriate level of general rates. The Third Supplemental provided at Olympic's request that the interim rates be subject to refund if the rates established in this order were lower than the rates established therein. A refund of excess interim collections plus interest at 7.6% over a two-year period will minimize the cash-flow effect of the refund on Olympic's operations.

NEED FOR ADDITIONAL REVIEW

387 (32) The unavailability of certain documents and information in this proceeding and the prospective achievement of 100% pressure, implementation of software, investment of additional capital, and integration of Bayview into Olympic's operations all contribute to the need for another review of Olympic's operations in the context of a general rate proceeding to be filed no later than October 1, 2004.

FILING REQUIREMENTS

388 (33) Lack of adequate prepared testimony and exhibits and lack of adequate work papers at the outset of the proceeding, plus recurring difficulty in obtaining information during this proceeding and frequent changes in presentations hindered all parties' presentations, and impeded the Commission's ability to obtain a clear picture of the Company's operations and to resolve the issues in this proceeding. Resolution of those matters will improve the spred and accuracy of future proceedings.

XVI. CONCLUSIONS OF LAW

389 (1) Olympic Pipe Line Company ("Olympic" or the "Company") is a "public service company" as that term is defined in RCW 81.04.010, and a common carrier pipeline under RCW 81.88.030, and as those terms may otherwise be used in Title 81 RCW.

390 (2) Olympic has not sustained its burden to demonstrate that the "FERC methodology" it advocates is appropriate for use under the laws and policies of the State of Washington to determine whether Olympic's proposal for general rate relief would result in rates that are fair, just, reasonable and sufficient. The appropriate methodology for use in evaluating Olympic's need for an increase in its rates is the depreciated original cost methodology as described on this record.

391 (3) Rates that go into effect by operation of law are not approved by the Commission. *RCW 81.04.130, RCW 81.28.050, RCW 81.28.230*. The Commission is not in any way barred or estopped from establishing a methodology for the review of Olympic's operations for the purpose of

establishing rates. RCW 81.04.250, *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 86 L.Ed. 1037, 62 S. Ct. 736 (year).

392 (4) Olympic's proposed "FERC Methodology" for determining rates should be rejected because its use is not legally required, because it would provide a return on funds not actually devoted to the business, because Olympic did not and was not authorized to make accounting entries to implement it, and because Olympic failed to sustain its burden to prove its propriety and to persuade the Commission that doing so would be consistent with sound regulatory principles in the state of Washington. Accepting Olympic's proposed deferred returns and starting rate base would constitute retroactive ratemaking.

393 (5) The depreciated original cost methodology advocated by Commission Staff for evaluating Olympic's proposal enables the calculation of rates that are fair, just, reasonable, and sufficient.

394 (6) Olympic's Bayview batching and storage facility is appropriately included in rate base because it is ready for service and is excluded from service only temporarily by reasons of regulatory requirement.

395 (7) The test year adjusted results of operation and rate base herein found to be appropriate should be adopted for ratemaking purposes.

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396 (8) The rates for service in Olympic's existing tariff are insufficient to yield reasonable compensation for service rendered in the state of Washington by Olympic. Revisions of rates and charges to its tariffs made in accordance with the findings herein will yield a fair rate of return on Olympic's rate base and will be fair, just, reasonable and sufficient.

397 (9) The rates proposed by tariff revisions filed by Olympic Pipe Line Company on October 31, 2001, and effect on December 1, 2001, and suspended by prior Commission order, would result in rates that are not fair, just, reasonable, and sufficient. *RCW 81.04.250*. The proposed tariffs that Olympic has filed in this docket should be rejected in their entirety.

398 (10) An increase in Olympic's rates and charges in the amount of $367,643 for transporting petroleum products by pipeline in the state of Washington will produce rates that are fair, just, reasonable, and sufficient.

399 (11) Pursuant to the terms of the Third Supplemental Order, Olympic's interim rates expire on the date specified in this order for filing revised tariff sheets. Olympic should be ordered to discontinue the collection of rates under the Commission's Third Supplemental Order as of that date.

400 (12) Olympic should be ordered to refund the excess collections to shippers pursuant to the Third Supplemental Order. Olympic should be directed to file a supplemental tariff or tariffs calculated to return to shippers, dollar for dollar plus interest, over a two-year period, the excess monies collected under the terms of the Third Supplemental Order.

401 (13) Olympic should be directed to file a general rate case no later than October 1, 2004.

402 (14) In any future general rate proceeding as defined in WAC 480-09-300, Olympic should be required to comply with WAC 480-09-310 through 330 and with all pertinent rules relating to the gathering, recording, and presentation of information and to the issuance of and response to requests for data, as set out in paragraphs 353 and 354 of this Order.

403 (15) All motions made during the course of this proceeding that are consistent with the findings, conclusions, and Order herein should be granted; those that are inconsistent should be denied

404 Based on the foregoing findings, reasoning, conclusions, ultimate findings, and conclusions of law, the Commission makes and enters the following Order:

XVII. ORDER

405 (1) The tariff revisions filed by Olympic Pipe Line Company on October 31, 2001, in this proceeding are rejected in their entirety.

406 (2) Olympic is authorized and required to refile tariff revisions within seven business days after the date of this order to achieve an annual rate increase of 2.52% with a stated effective date of October 15, 2002.

407 (3) Olympic must discontinue the collection of interim rates authorized in the Third Supplemental Order on the date specified above for the filing of revised tariffs pursuant to the terms of this Order.

408 (4) Olympic must file temporary tariff revisions that are designed to return to individual ratepayers over a two-year period or a comparable measure of throughput the amount by which the customer's payments under interim rates exceeded the amount that would have been due under the rates authorized herein, plus interest at the rate authorized herein as the Company's overall rate of return. Olympic may consult with other parties in preparing this revision.

409 (5) The Commission Staff must, and other parties may, comment on Olympic's tariff filings by letter to the Secretary of the Commission no later than the close of business on the fourth business day following filing, Olympic and other parties may respond no later than the close of the second business day thereafter. The Commission will review the filings, and any comments and responses, if any, and determine whether to approve the filing pursuant to WAC 480-09-340.

410 (6) Material in support of the manner in which the tariffs are constructed and in which the revenues herein authorized for Olympic's pipeline operations is obtained shall be submitted simultaneously with the filing to which it relates. Each filing must be accompanied by a brief description of what the Company has accomplished by the filing and how it complies with the terms of this order.

411 (7) A notice of the filings authorized in this Order shall be posted at each office of Olympic in Washington, on or before the date of the filing with the Commission. The notice shall state when the filing is to become effective and advise that the filing is available for inspection at each such office. The notice shall remain posted until the Commission has acted upon the filings.

412 (8) Olympic must file a general rate proceeding no later than October 1, 2004.

413 (9) Olympic must comply with the provisions of paragraphs 353 and 354 of this order relating to its future requests for general rate increases. Among other things, it must file all future general rate increase requests as though WAC 480-09-310 through 330 apply to the filing, until relieved of the obligation by order of the Commission.

414 (10) Olympic must report immediately and periodically to the Commission regarding its operational status as set forth in paragraphs 351 and 352 of this Order.

415 (11) All motions consistent with this Order are granted. Those inconsistent with this Order are denied.

DATED at Olympia, Washington, and effective this 27th day of September, 2002.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MARILYN SHOWALTER, Chairwoman

RICHARD HEMSTAD, Commissioner

PATRICK J. OSHIE, Commissioner

NOTICE TO PARTIES: This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-09-810, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-09-820(1).