**BEFORE THE STATE OF WASHINGTON**
**ENERGY FACILITY SITE EVALUATION COUNCIL**

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| **In the Matter of Application No. 96-1,** | **)** |
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| **Olympic Pipe Line Company** | **)** |
| | **)** |
| **Cross Cascade Pipeline Project** | **)** |
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**EXHIBIT _____ (FH-T)**

**REBUTTAL TESTIMONY OF FRANK HOPF**

**ISSUE: PURPOSE & NEED; ECONOMIC IMPACT**

**SPONSOR: OLYMPIC PIPE LINE COMPANY**

**Q.** **Would you please state your name and indicate the purpose of your rebuttal testimony?**

**A.** My name is Frank Hopf. I am the vice president and manager of Olympic Pipe Line Company ("Olympic"). I submitted prefiled direct testimony on or about September 1, 1998 in this matter. The purpose of this rebuttal testimony is to respond to certain statements contained in the prefiled testimonies of Ed Whitelaw (Tidewater) and Thomas H. Wise (Counsel for the Environment) dated February 12, 1999.

**Q.** **What topics will your rebuttal testimony cover?**

**A.** My rebuttal testimony is intended to respond to the following topics:

- Whether the potential reversal of the Boise/Chevron line will have any impact on market conditions in Eastern and Central Washington;
- The role that petroleum "shippers" play in this market and their relationship to the proposed pipeline;
- Whether the proposed pipeline would have a positive impact on price competition for petroleum products in Eastern and Central Washington, and whether there will be a public benefit as a result;
- Whether the proposed pipeline would affect the claimed "multi-source, multi-delivery petroleum system" which purportedly exists in Washington today; and
- Whether the four Puget Sound refineries would be the primary beneficiaries of the proposed pipeline.

**Q.** **Have you reviewed the testimony of Ed Whitelaw, submitted by Tidewater?**

**A.** Yes.

**Q. Do you agree with Professor Whitelaw's testimony regarding to what extent the potential reversal of the Boise/Chevron line will affect supply and demand? (See Whitelaw at page 11, line 1.)**

**A.** No. Professor Whitelaw states that the reversal of the Boise/Chevron line "could create a demand for an additional 25,000 bpd of product in Pasco." Yet, in the same breath, he states that "it is just as likely that it would cause excess demand of only 6,000 bpd in Pasco." In fact, a reversal of the Boise/Chevron line does not "create" demand for product in any particular locale. Demand for the shipment of refined product is driven by the shippers, whose business is to make sure that product is transported to locations where consumers are demanding the products. A decision to reverse the Boise/Chevron line is in response to an existing or projected demand elsewhere; a reversal of that line does not "create" the demand. In fact, that is why Chevron might reverse that line, namely to transport product from the west to Boise so Chevron can better serve their Boise-area consumers' demands. The fact that the Boise/Chevron line may be reversed is further support for the proposed Cross Cascade Pipeline, because supply options to Eastern Washington will be reduced if the Boise/Chevron line is reversed.

**Q. Do you agree with Professor Whitelaw's testimony regarding the role which shippers play when analyzing the proposed pipeline? (See Whitelaw at pages 11-12.)**

**A.** No. Each assumption by Professor Whitelaw on this topic is wrong. The marketing of gasoline is driven by the ultimate consumer -- the person who uses refined product and will purchase it each day. However, it is not the ultimate consumer (nor is it the petroleum companies per se) who determine how and where refined petroleum products will be transported. Rather, it is the suppliers, our "shippers" who make that decision. A

supplier will be able to sell a certain amount of product each day to certain geographically dispersed consumers. The supplier becomes a shipper who buys capacity on various modes of transportation in order to make sure that product reaches the intended gasoline station or other outlet. The shippers determine how to supply the various markets in Washington. The shipper contracts with transporters of petroleum products and pays them to move product from refinery to market. Transporters of petroleum product include pipeline companies such as Olympic, barge companies such as Tidewater, and trucking companies. The ultimate consumer doesn't care how the product gets transported to the ultimate destination. For instance, the ultimate consumer does not care how the oranges reach the grocery store, whether by plane, train or automobile. But the grocery store does care -- the grocery store wants the least expensive and most reliable mode of transporting the product to the store. In the same way, shippers choose the most cost effective and reliable method of transporting refined petroleum product to the destinations which they supply.

**Q. In his testimony, Professor Whitelaw suggests that the proposed pipeline "could reduce competition for petroleum products in Eastern Washington." (See Whitelaw at pages 21-22.) Does this make sense to you?**

**A.** Professor Whitelaw's testimony on this point is unsupportable. Indeed, nothing could benefit the consumers of Washington more than price competition between transporters of energy, such as petroleum products. Let me explain.

First, by transporting 60,000 barrels per day in the proposed Cross Cascade Pipeline, Olympic will realize its maximum allowable regulated rate of return and still offer a 40% decrease in the cost to shippers of transporting their product. In our opinion, this cost

savings to shippers can be passed on to the distributors and again to the ultimate consumer at the pump. If the demand for transportation services on Olympic does not reach 60,000 barrels per day, Olympic would most likely not increase its price to shippers. Rather, Olympic can offer the same tariff, accepting less profit than permitted, but ultimately more total profit than would be achieved if it were to increase its tariff. Increasing the shipping costs may result in losing shippers as customers, who would elect other modes of transportation because of price competition.

Second, shippers generally prefer to ship via pipeline -- as opposed to other modes of transport -- because of safety, reliability and inventory cost concerns. Pipeline deliveries are very predictable and regular. Deliveries by barging or by trucking can be highly variable. Destinations which rely principally on shipments by barge or truck face the potential risk of undersupply due to variable factors that impact delivery schedules, such as river or road closures due to weather. Because of uncertainties in the quantity and timing of resupply, product destinations must carry more inventory than is necessary to support average daily sales volumes. Maintaining an inventory is expensive and increases the cost to the ultimate consumer. Because of the higher degree of reliability in the timing and quantity of deliveries when shipments are made by pipeline, product destinations are not required to maintain high inventories which comparatively reduces the ultimate cost to the consumer.

Third, Professor Whitelaw's testimony regarding the "threshold-delivery quantity" and the applicable economic consequences is erroneous. The threshold to which Professor Whitelaw refers is actually equivalent to the total current demand now supplied by Olympic to Eastern Washington. That product is supplied by Olympic's existing pipeline

to Portland, with portions offloaded en route and transported to Eastern Washington by truck, and the remainder offloaded in Portland and transported by barge to Pasco. That same product will still be delivered to Eastern Washington, but delivered at a much lower cost (a 40% reduction). The point is that the proposed pipeline will reduce the cost of supplying the same product to Eastern Washington. Regardless of the type of product which is being supplied to a given marketplace, whenever you can reduce the cost of supplying that product to the marketplace a significant benefit to the ultimate consumer is achieved. Whenever the cost of supplying a major product is reduced, the result is not decreased competition. Rather, there is a tremendous increase in price competition. That is what would happen here. By achieving a 40% reduction in the cost of supplying petroleum products to Eastern Washington, Olympic is greatly increasing price competition, thereby forcing other suppliers of petroleum product to reduce their prices in order to compete. The ultimate consumer is the ultimate winner. Otherwise, you do not have an efficient marketplace.

**Q.** **Professor Whitelaw suggests that the proposed pipeline would necessarily eliminate a "multi-source, multi-delivery petroleum system" which purportedly exists in Washington today. (<u>See</u> Whitelaw at pages 21-22.) Do you agree with this prediction?**

**A.** We will still enjoy a multi-level system -- but at a reduced cost and, therefore, with increased price competition. Moreover, taking product which was ultimately destined for Eastern Washington out of the existing pipeline to Portland will free capacity in the existing pipeline to serve Tacoma, Olympia, Southwestern Washington and the Portland market. Other methods of supply currently service those markets, and those sources of supply are more expensive than transporting product to Portland by pipeline. Therefore,

the Puget Sound, Southwestern Washington and Portland markets will enjoy a reduction in the cost of transporting petroleum products as well, which will enure to the benefit of the ultimate consumer in those locations. There will now be increased price competition in the south Puget Sound, Southwestern Washington and Portland, just as price competition will occur in Central and Eastern Washington.

**Q. Have you also reviewed the testimony of Thomas H. Wise, submitted by Counsel for the Environment?**

**A.** Yes.

**Q. Do you disagree with the testimony of Mr. Wise to the same extent as your disagreements with Professor Whitelaw's testimony?**

**A.** Yes. For example, Mr. Wise apparently does not acknowledge that the current system of transporting product to Eastern Washington is variable, depending on weather and other conditions. Heavy snow, high winds, icing of the rivers, river lock repairs, and river drawdowns will all impact the current methods of transporting product to Eastern Washington. The inventory of product that currently exists in Eastern Washington would only be sufficient to supply that market for a few days if there were an interruption in the availability of barge or truck transport of petroleum products. The same is not true when product is transported by pipeline, as that mode of transport is not subject to the same variables as trucking and barging. Back in 1981, Olympic Pipeline was the only transportation system that never had to shut down because of the fallout from the Mt. St. Helens eruption.

**Q.** **Mr. Wise states that four Puget Sound refineries will be the "primary benefactors [sic] of the new pipeline." (Wise at page 5.) Do you agree with this proposition?**

**A.** Mr. Wise's testimony regarding the "primary benefactors [sic] of the new pipeline" is incorrect. Mr. Wise completely ignores the fact that the Cross Cascade Pipeline will reduce the cost of shipping product to Eastern Washington by 40%. Everyone benefits when the cost of supplying a large quantity of product is reduced. This encourages price competition, which ultimately benefits every ultimate consumer. The only non-beneficiary of such price competition will be the current monopolist who will lose its monopoly position, i.e., Tidewater Barge Lines. Tidewater will be forced to compete on price in order to persuade shippers to continue to transport their product by barge.

**Q.** **Mr. Wise offers testimony regarding the business of petroleum product shippers. (<u>See</u> Wise testimony at pages 8-9.) In your opinion, has Mr. Wise demonstrated that he understands the business of petroleum product shippers, who they are, and how they interact with petroleum product owners and Olympic Pipe Line Company?**

**A.** No. Shippers commit to pay for transportation on a pipeline whether they use it or not. Shippers first ensure that they have a guaranteed supply of product before they commit to a mode of transportation. With a pipeline, they make this commitment by entering into a "throughput and deficiency agreement," pursuant to which they purchase a certain capacity of the pipeline on a daily basis. The shippers who can most comfortably enter into throughput and deficiency agreements are refineries -- because they have guaranteed supplies of product. The shippers who have actually entered into throughput and deficiency agreements for the new pipeline did so based on a promotion which Olympic offered early in the EFSEC process to ensure that Olympic sold sufficient capacity on the proposed pipeline. Olympic has not offered this promotion since January 1, 1997.

**Q. Mr. Wise states that, in his opinion, a "large majority of the product shipped on the proposed pipeline will likely be shipped by the four Puget Sound refinery shippers." (See Wise at page 7.) Is it true that the refineries will be the largest "shippers"?**

**A.** The largest shipper may not be the Puget Sound refineries, but instead a shipper who trades for product. The same product that currently travels to Eastern and Central Washington via the existing modes of transportation will eventually travel to Eastern and Central Washington via the new pipeline. Only shippers who have a market to supply in Eastern Washington -- via sales agreements -- will purchase capacity on the new line. Shippers with markets in Portland or Southwestern Washington will not ship on the new pipeline.

**Q. Like Professor Whitelaw, Mr. Wise speculates regarding the possible impact of the potential reversal of the Chevron/Boise pipeline. Do you agree with Mr. Wise's predictions on this topic?**

**A.** No. Mr. Wise's testimony is flawed like Professor Whitelaw's. The Yellowstone Pipe line has run near its capacity from the refineries (Billings) to Bozeman of 60,000 barrels per day. Yellowstone first serves markets in Bozeman, Helena, and Missoula, and what is left is available for Spokane and Moses Lake. Since the Western Montana markets have been consuming over 30,000 barrels per day of Billings refinery product, the true ability to deliver product to Spokane/Moses Lake cannot be more than the 30,000 barrels per day in 1992. Deliveries from 1992 to the 1995 disruption of the Missoula to Spokane dropped to about 27,000 barrels per day, presumably because Western Montana consumption increased.

While drag reducing agents can increase how quickly product moves into Spokane, the true capacity of the Yellowstone system can only be increased if:

(1) Western Montana product consumption decreases; or

(2) Billings area refineries have a major expansion combined with a capacity expansion of the line segment from Billings to Missoula; or

(3) Product currently being supplied to the Salt Lake City market from Billings is withdrawn and the Billings to Missoula Yellowstone line capacity is increased.

None of these options have a very high probability of happening.

**END OF TESTIMONY**

I declare under penalty of perjury that the above testimony is true and correct to the best of my knowledge. Executed this _____ day of March, 1999.

Frank Hopf