BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. BREMERTON-KITSAP AIRPORTER, INC., C-903 Respondent.	DOCKET NO. TC-001846 RESPONDENT'S POST-HEARING BRIEF IN OPPOSITION TO STAFF COMPLAINT

I. PRELIMINARY STATEMENT

On November 27, 2000, Bremerton Kitsap Airporter, Inc. (hereinafter "BKA" or "Respondent") filed with the Washington Utilities and Transportation Commission ("Commission" or "WUTC") a request for a general rate increase seeking an increase of approximately 10% in rates that had been in effect since early in 1991. On December 27, 2000, the filing was suspended by the Commission pending receipt of additional supporting information from the company. Following a prehearing conference on April 3, 2001 and retention of counsel, BKA, on May 15, 2001, sought leave from the Commission to withdraw the rate increase. On July 25, 2001, administrative law judge Marjorie R. Schaer issued an order denying the request for withdrawal of the rate increase over the objection of the WUTC staff and ordered a second prehearing conference for August 9, 2001. At the subsequent hearing, BKA was finally granted leave to withdraw its rate increase proposal, and the proceeding was converted into a complaint proceeding with the WUTC staff assigned the burden of proof against the present rates approved by the Commission and assessed by Respondent over the past decade. Hearing on the complaint was held on the complaint in Olympia on December 12 and 13, 2001

before administrative law judge Schaer and post-hearing briefs are now filed on the record thereof.

II. ISSUES PRESENTED IN THE PROCEEDING

To counsel's knowledge, this is the first time staff has countered a withdrawn rate increase petition with an overearning complaint in a transportation case. This then is a highly unconventional action where the Commission staff has sought to convert a rate increase proceeding filed by an auto transportation company and subsequently withdrawn, into a complaint proceeding against decade-old rates established by the company. The staff position is premised on the allegation that BKA's present rates are unreasonably high, despite their comparative affordability in relation to other prevailing airporter rates, and the claim that the Respondent has been "overearning" for a number of years. In maintaining its complaint, the staff has also alleged that the Respondent has paid excessive remuneration to its owner over recent years and has managed to achieve unreasonably high levels of profitability despite maintaining static rates for over ten years. As outlined in the second prehearing conference order of September 19, 2001, the issues framed by the staff complaint are: (1) the appropriateness of the owners' allowance and (2) whether the company's present rates were too high.

The prefiled and live testimony in this case has resolved numerous disputed issues, but has also sharpened focus on four remaining major accounting issues that are framed by the staff's response to Bench Request No. 6. They are: **restating adjustments** for amortization of a Labor & Industries premium refund over a three-year period, for affiliated interest rents, and for officer's salary and related payroll taxes, and a **pro forma adjustment** made by Respondent's accounting expert, Weldon T. Burton, which added rate case legal and accounting fees and expenses of $100,000 to Respondent's rate base.

The testimony offered by staff in this proceeding also spotlighted three additional recommendations/issues that remain to be resolved by the Commission. First, the staff, through

its testimony at Exhibit 1, page 36, proposes a freezing of officer's salary authorized by a prospective order in this case at a finite dollar amount, as well as an outright ban on bonuses to be paid to the company President, Richard Asche, over the next three years. Second, is the recommendation that this auto transportation company be "punished" for an alleged past five years of "overearning" by suffering a 4% increase in its target operating ratio for the next three years from 93% to 97%. Exhibit 1, pp. 30-31. Finally, the staff offered testimony both orally and in its written submissions (Exhibit 1, p. 36, and at Tr. 194-205), which advocates a "special reserve account" be imposed on BKA such that over the next three years, any revenues generated by operations in excess of the unprecedentedly high 97% operating ratio automatically siphon into this "special reserve" account to be used to defray and/or mitigate future rate increases. Supposedly supporting all three elements of staff's position recommending this three-year probationary treatment of Respondent, is its interpretation of RCW 81.04.360, which it argues expressly or inferentially sanctions the prospective probationary treatment of BKA it has advocated in this proceeding.

III. DISPUTED ACCOUNTING ISSUES

ISSUE ONE: AMORTIZATION OF LABOR AND INDUSTRIES PREMIUM REFUND RECEIVED IN TEST YEAR

During the period October, 1999 through September, 2000 (the ratemaking test period applicable to this filing), Bremerton-Kitsap Airporter, Inc. ("BKA") received a refund through its participation in a former employer retroactive rating group for industrial insurance premiums paid to the Washington Department of Labor and Industries in the amount of $10,767. While the amount of the refund is not in dispute, BKA and the staff dispute the treatment of that refund in the rate base. Colbo Restating Adjustment No. 4 at Exhibit 1, p. 11 leaves one-third of the refund in the test period to reduce expense and amortizes the remaining two-thirds of $7,178 over the next two years. BKA accountant, Weldon Burton, on the other hand, by his Restating Adjustment No. 5, Exhibit 32, pp. 6,7, removes the entire $10,767 refund amount from the test

year revenues on the premise that this amount consists of premiums paid outside the test period and cannot be matched or reconciled to refund proceeds in the test period, Exhibit 32, pp. 6,7, ll. 24-25; 1-3. Mr. Burton's opinion is based upon the fact that there is no evidence that this refund is or will be recurring, and is not linked to any actual expense reduction in the test period.

DISCUSSION:

As the Commission has noted in Dockets UG-001606; UG-001607, In re: WUTC v. Avista Company, 2000 LEXIS 558 (Sept. 2000), "[t]he purpose of a test year, and of restating and pro forma adjustments to test year data is to develop a 'normal' level of expenses that is expected to match the company's expenses in the rate year. Once set, levels of expense vary, and are expected to vary from those established . . . " Avista at 92.

The Avista order also went on to deny recovery of expenses for events that appeared to be "non-recurring," i.e. there was no reason to expect that they would happen again in the rate year, and concluded that the Commission would follow "the general rule against including out-of-period, non-recurring expenses in rates." Avista at 93.

It is upon this rationale that Mr. Burton removed credits for industrial insurance premium refunds that related to payments outside the test period, rejecting any restating adjustments for Labor and Industries premiums in the test year expense base. There is also no evidence that any such refunds will be forthcoming to Respondent in future years, and alternatively, there was testimony from Mr. Burton that in the calendar year 2000, industrial insurance premium expenses increased (Tr. 334). Richard Asche, BKA president, testified that since the demise of the retroactive rating group which issued the refund on the test period, no further refunds from the successor entity had been received up to the date of his testimony almost eighteen (18) months later. Tr. 298, ll. 18-21. Lacking any evidence the premium refund was a recurring event, and recognizing the premiums at issues were paid outside the test period, it is inappropriate to reduce Respondent's expenses and to require amortization of the remaining premium credit over two additional years.

ACCOUNTING ISSUE TWO: AFFILIATED RENTS ADJUSTMENT

The parties also remain significantly differed on the issue of affiliated interest rent adjustments. By his testimony, Bob Colbo at Exhibit 1, pp. 19,20 (as illustrated by the adjustments on Exhibit 23 relating to Colbo Restating Adjustment No. 6), removes a total of $22,930 from above the line expenses to reflect the $37,070 figure staff calculates as the actual costs plus return incurred by the investor affiliate in constructing BKA's terminal in Port Orchard. During the test period, the company books reflected actual rent paid of $60,000, somewhat below the fair market value rent set forth in Exhibit 30 of $63,744 per year.

The adjustment to net investment cost plus return rather than fair market value was predicated on the staff interpretation of the mandates of RCW 81.16.030, as set forth below:

81.16.030. Payments to affiliated interest disallowed if not reasonable.

> In any proceeding, whether upon the commission's own motion or upon complaint, involving the rates or practices of any public service company, the commission may exclude from the accounts of the public service company any payment or compensation to an affiliated interest for any services rendered or property or service furnished, as described in this section, under existing contracts or arrangements with the affiliated interest unless the public service company establishes the reasonableness of the payment or compensation. In the proceeding the commission shall disallow the payment or compensation, in whole or in part, in the absence of satisfactory proof that it is reasonable in amount. In such a proceeding, any payment or compensation may be disapproved or disallowed by the commission in whole or in part, if satisfactory proof is not submitted to the commission of the cost to the affiliated interest of rendering the service or furnishing the property or service described in this section.

DISCUSSION:

Bob Colbo testified for staff that it was his interpretation of the above provision that the affiliated rent expense[1] is derived by calculating the original cost of the facility and adding a return and thereby revising the actual rent paid to the amount of that calculation. Tr. 176, L. 24. Because the operational headquarters in this instance are owned by BKA's shareholders, under

[1]Respondent notes that the underlying lease in question through oversight, was not submitted to the Commission for review and approval by the Commission under RCW 81.16.020 until approximately December 14, 2001. Review of prior rate filings by the Respondent, including the current rate docket in 1991, discloses that the staff was fully aware of the affiliated relationship and there is no evidence BKA was ever asked to file the present lease agreement for formal approval and failed to comply.

the staff's affiliated interest theory, the per books rent is restated by more than a third with a reduction from $60,000 to $37,070 as shown on Exhibit 6.

Despite this unilateral reduction in rent, however, Mr. Colbo noted the arm's length reasonableness of the rent assessed the regulated company, beginning at Tr. 180, line 10:

> Q. . . . And if this company, if Bremerton-Kitsap Airporter had rented the terminal in Port Orchard from a third party and not its owner, based on the information you have, would there have been any reduction whatsoever in the rent Bremerton-Kitsap Airporter paid to the property owner?
>
> A. Not if it was in place.
>
> Q. So the $60,000 would have been allowed in rates?
>
> A. If that was arrived at in an arm's length transaction between the lessee and the lessor, that would have been allowed.
>
> Q. And, based on the appraisal that you saw submitted with the testimony of Mr. Asche, do you have any reason to doubt that the rental payment of $60,000 is an arm's length amount?
>
> A. No.

While Respondent acknowledges that the Commission has recognized in selected utility cases cited by the staff that the Commission has opted for the lower of the competitive market price or the affiliate's cost plus a fair return, even under this alternative analysis of affiliated rents, the staff's analysis of allowable return is low. The staff's view, as reflected on Exhibit 23, fails to measure the full amount of outstanding debt on the property upon which the staff return analysis is calculated. During the test period of October 1999-September 2000, as Mr. Asche testified, he used bonuses to pay off personal debt he had incurred from BKA for funding regulated plant acquisition and improvement costs (Exhibit 24, page 5). BKA thus asserts, based on Data Request responses submitted to the staff as well as excerpts from Mr. Asche's personal income tax returns, that the actual debt amount upon which the return under Exhibit 23 should have been calculated was $31,158, rather than the $130,900 figure used by Mr. Colbo. The actual debt at the beginning of the test period was $133,564 and was repaid to BKA by Mr. Asche from the December 1999 test period bonus. During August 2000, Mr. Asche

borrowed $30,280 to bring his total borrowings to $31,158 from BKA to construct additional improvements to the terminal, which were not put into service until November 2000 (outside the test period). Under this analysis, using cost plus fair return, the conclusion reached by Exhibit 23 should be recalculated as follows:

Expenses	$ 16,929	
Return at 15%	35,103	(Tr. 176, ll. 5-11)
Affiliated rents	$ 52,032	
Affiliated rents calculated by staff	$ 37,070	
Net increase in rent expense under cost plus fair return premise	$ 14,962	

The above revision, again, is based on the staff-proposed cost plus reasonable return premise, using reduced and more accurate debt figures in the test year which are supported by BKA's shareholder's records. BKA still advocates use of the fair market value, or rather the per books rent amount of $60,000 as the correct expense in the test year. However, if the Commission adheres to the policy of making a pro forma adjustment for affiliated rents to the lesser of fair market value or cost plus reasonable return advocated by staff, Respondent believes the figure in Exhibit 23 and in revised Exhibit 6 is more appropriately set at $52,032 for the reasons set forth above.

ISSUE THREE: OWNER'S ALLOWANCE AND RELATED PAYROLL TAX EXPENSE ADJUSTMENTS

Other than the legal and accounting expense issue, no issue matters in net dollar amount more than the owners allowance/officer's salary expense line item. As the attached "Respondent's Post-Hearing Brief Exhibitt 1" reflects, BKA has proformed $138,881 for "salaries-officer," whereas the staff has allowed only $66,000 in officer's salary. That is a difference of $72,881 which is more than the entire owner's allowance/officer's salary line item allocation by the staff.

BKA filed testimony as described in Exhibit 32, pp. 7-8, which concurred in a substantial reduction in the per book officer's salary in the test period. It originally proformed officer's salary in a reduced amount of $108,362 based on a calculation staff had performed in a previous rate increase in 1998 under Docket TC-981332. In that proceeding, the same staff auditor, Bob Colbo, had initially set BKA's shareholder salary at $82,500, which was then adjusted upward by Mr. Burton with an inflation and benefits package allotment. See, Tr. 311 and Exhibit 32, pp. 7-8. The original proformed calculation by Mr. Burton was slightly below Mr. Asche's average annual compensation since the inception of his business of $110,366 (Exhibit 29).

On the eve of hearing, Mr. Burton discovered that in addition to the preliminary staff report in TC-981332, another draft staff report in a proceeding referenced in Exhibit 9, page 9, TC-980036 existed, which had previously been sought but not provided by Data Request, and which report, by auditor Peter Caballero, was admitted as Exhibit 22. The draft report reflected an officer's salary of $105,735 for regulated operations which Mr. Burton then subjected to a similar inflation and benefits package adjustment (Exhibit 39) to arrive at a calculation of owner's salary of $138,881 which is reflected on revised Exhibit 32, p. 7. The effect of these changes on the proforma income statement were admitted as Exhibits 34-36. Mr. Burton testified about the content of these changes and the effect on his restatement of the results of operations at Tr. 315-318.

Staff's questioning of Mr. Burton focused on the fact that both staff reports in proceeding TC-981332 and TC-980036 were preliminary or otherwise contained in draft reports that were never formally adopted by the Commission (Tr. 321). Staff also sought to identify the proposed basis for the proformed officer's salary as apparently a calculation based on 8% of gross sales (Tr. 320) which Respondent believes may have been an accepted general benchmark for officer's salary compensation allowance for BKA based on compilations of prior rate cases (see i.e. Exhibit 9, p. 9).

DISCUSSION

Mr. Burton testified on cross-examination that the revised $138,881 figure was, in his 25 years of regulatory accounting experience, a reasonable compensation figure for Mr. Asche (Tr. 321, l. 17), based on the revenues and operating margin of BKA. These conclusions were juxtaposed against a study that Kim Dobyns, a staff employee, had performed of public/county transit agency executive compensation for this litigation at Exhibit 9, pp. 11-15, and further described in Exhibit 19. This study seeks to reconcile job characteristics of public transit officials with that of Richard Asche as an executive of a privately-held, regulated intrastate airporter company.

Both in its prefiled testimony and in the cross-examination of Robert Colbo, staff attempted to defend the present case's substantially lower officer's salary figure on the basis of the Dobyns survey and analogous analyses of duties of other regulated companies and public transit officials. The staff nevertheless acknowledged the value of such comparisons in validating the $66,000 expense line item is limited at best.

At Tr. 145, Mr. Colbo answers in response to how he arrived at his line item for officer's salary in this case:

> A. The $66,000 – it is difficult to do. What I had to rely on was Ms. Dobyns' survey, which was exclusively dealing with CEO types of transit entities that were strictly involved with CEO type activities at a high level of multidimensional, multifunctional, several types of service operatings, op rooms [sic], large entities. And their average salary for those entities whose annual revenues are less than $10 million was $66,000 plus dollars. That was the source of – to my way of thinking that confirmed my number for Mr. Asche.

However, itemization or even formulaic quantification of the elements the auditor used to arrive at the officer's salary figure in this record proved illusive. While staff, in its later examination of Mr. Burton, seemed to implicitly criticize its own previous owner compensation benchmarks that were tied to a percentage of revenue for regulated companies (Tr. 320), it could

only offer in rejoinder a related analysis of gross revenues in attempting to equate public transit official salaries with that of Richard Asche.

The staff's position also surprisingly entailed a "demerit" or "deduct" element when a regulated private business owner performed ministerial, menial tasks if called upon by operational circumstance. Indeed, Robert Colbo admitted that the salary of an owner would be reduced if he performed tasks that others could perform (assuming their availability.) "If it's a regulated small company and you could hire someone else at those lower rates to do those menial tasks, then yes." Tr. 147.

This perspective can hardly be reconciled with maximizing operational and personnel efficiencies of the regulated company. Clearly, this view would encourage the hiring of surplus hourly personnel to perform sporadic tasks rather than recognize that a small regulated business owner willingly seeks to pitch in to get a job done, even if that requires him or her to sporadically perform "menial" tasks. As Richard Asche testified, and as the success of his company attests, he was willing to forgo any salary for the first two years of BKA's operations (Exhibit 24, p. 3) and frequently make sacrifices of his personal time to perform any and all tasks required in running the company (Exhibit 24, p. 8). This is a major reason the company grew and financially prospered. Under Mr. Colbo's analysis, however, a small regulated business owner should be punished for saving overtime and/or temporary staff costs by performing the work himself.

There is no dispute that the justification for the $66,000 staff owner's allowance in BKA's rate base is a "gray area." Mr. Colbo so characterized it at least twice in his testimony (Tr. 148, l. 12; Tr. 149, l. 7). Nevertheless, the justification offered by staff of this pejorative compensation level in light of previous staff proposals for company revenue requirements underscores the disconnect between the successful operation of this airporter company with its undisputedly low revenue per mile rates (Exhibit 31), the total absence of complaints as to the present rate levels of BKA (Tr. 205, 206), and the unjustifiably low salary allowance for

Mr. Asche of $66,000. While the staff fails to see any correlation between the success of the regulated business and executive compensation levels (Tr. 326, ll. 18-20), there should be no question that the viability of a closely held regulated business depends to a large degree on the conduct of operations directed and/or performed by the chief operating officer.

Staff's view in contrast would compensate Mr. Asche at a level totally removed from his success as an owner of a regulated auto transportation company with low rates and high operating efficiencies. It would draw parallels to public transit officials supported by federal and state grants and taxpayer dollars whose jobs have little relationship to fiscal performance and whose operations and rate levels are not subject to economic regulation. The view of staff would deduct compensation where others could perform "menial" tasks performed by the corporate officer. It would also involve an unspecified offset where the owner takes a winter vacation in Arizona (Tr. 129).

In all, there appears to be no percentage of revenue benchmark, no general list of CEO duties or any other objective criteria which will or can justify an owner's allowance in staff's view in this case. Sixty-six thousand dollars is a "gray area" line item existing in a theoretical vacuum which has no relevance apparently to managerial, operational or fiscal efficiencies. Staff's allowance has simply failed to propose just, fair and sufficient rate levels in this case to include a reasonable line item expense for officer's salary, and its justification to "back into" the objectively insufficient allowance for officer's salary demonstrates its failure to meet its burden of proof on this very material issue. The Commission should therefore reject staff's officer's salary of $66,000 and adopt that proposed by the company of $138,881 as set forth in Exhibit 32.

<u>Payroll Tax Adjustment Differences In Officer's Salary Calculation.</u>

As noted on the attached Reconciliation of Differences/Results of Operations, the staff and the Respondent also propose differing calculations for payroll taxes and Labor & Industries premiums based on their recommended officer's salary restating adjustments. The latter adjustment was addressed in accounting issue one, above, and is caused by the amortization

versus removal treatment of the L&I premium line item by the two witnesses. On the basis of the differing allowances for officer's salary, the payroll tax distinction arises in calculation of the 1.45% federal Medicare tax on gross wages for the employer and employee under § 3101 and § 3111 of the Internal Revenue Code. The 1.45% Medicare tax is assessed on gross wages without limit. The bases for the respective calculations are found at Burton Restating Adjustment No. 5 at Exhibit 32, p. 7, which reduces the per books officer's compensation with a corresponding reduction in Medicare tax in the amount of $4,091 (1.45% of $282,119 = $4,091). Correspondingly, Bob Colbo, by his Restating Adjustment No. 5 in his Revised Pro Forma (Exhibit 6, p. 2, L.26), calculates that reduction as $6,884 based on his recommended officer's salary removal of $355,000.[2]   BKA asks that the Commission adopt the payroll tax calculations advocated by Weldon Burton based on his quanification of officer's salary and the appropriate payroll tax computation applicable to that amount.

ACCOUNTING ISSUE FOUR: DISPUTED PRO FORMA ADJUSTMENTS FOR LEGAL AND ACCOUNTING FEES FOR RATE CASE COSTS

As originally presented in the prefiled rebuttal testimony of Robert Colbo on November 27, 2001 (Exhibit 17, p. 2 ll. 10-20), the parties also sharply disagree on the inclusion of rate case legal and accounting costs in the Respondent's rate base. Staff's initial filing on October 3, 2001 had made no pro forma allowance for these costs. Weldon Burton's prefiled testimony, Exhibit 32, pp. 12-13, focused on this omission from staff's adjustments and had proposed a $100,000 adjustment (Exhibit 34) to include professional expenses incurred in defending Respondent in this proceeding. On the date of Mr. Burton's original testimony filing of November 9, 2001, Respondent had incurred a total of $26,480.86 in fees and costs in the proceeding. Significantly, as Mr. Burton testified, this figure did not include any costs or fees assessed BKA until the date of May 15, 2001, when BKA originally sought leave to withdraw its rate increase proposal.

[2] It appears, however, that Mr. Colbo used a 1.94% Medicare tax rate rather than a 1.45% rate. That would actually, by Mr. Colbo's reduction, result in a payroll tax adjustment of $5,148 which is 1.45% of $355,000, meaning his payroll tax reduction is apparently too high by $1,736.

Thus, all expenses BKA seeks to recoup in its rate base for legal and accounting fees, as adjusted, remove any legal and accounting fees and costs associated with the prosecution of its original rate increase filing.

At the hearing, Exhibit 42 was admitted into the hearing record which is the company's December 6, 2001 response to Staff Data Request No. 34. That updated document reflects a total of $62,804.90 in legal and accounting fees incurred from May 15 – November 30, 2001 in invoices issued in the defense of the complaint in this proceeding. That figure is to be supplemented, as Exhibit 42 expressly reserves, with final cost and fee totals which again Mr. Burton pro formed at $100,000, as reflected by Exhibits 34 and 36 and which, when added to the per books amount of $8,555 in the test period, arrive at the total pro forma proposed rate figure shown in Column H, Exhibit 34 also demonstrated in the "Respondent's Post-Hearing Brief Exhibit 1" attached hereto.

DISCUSSION:

Similar to the difficulties posed by the staff's lack of objective standards for developing officer's salary allowance criteria, its position on rate case legal and accounting cost allowance also proved difficult to objectify. Staff's initial testimony was to deny inclusion of all legal and accounting costs in defense of this rate case complaint in BKA's rate base. Why is this position advanced? Apparently on a number of grounds which Mr. Colbo lists as: (1) the company's "long history of unsupported rate applications" (2) the "estimated" nature of the $100,000 expense, and (3) his opposition to expensing the rates over a twelve month period by implying that rate case costs would be recurring. (Exhibit 17, p.2).

At hearing, however, Mr. Colbo acknowledged that it was standard practice for the Commission to allow reasonable legal and accounting costs incurred by a regulated company in the rate base "in normal circumstances." (Tr. 186, L. 23). The staff's position opposing recoupment of any legal and accounting expense in the defense of this complaint was defended by Mr. Colbo at Tr. 187 on the following bases:

> The five prior years of overearnings, the listing of prior filing of this company where routinely they have been withdrawn or denied except for in 1991. I just think it's a waste of everybody's time to -- I think this case should never have been filed in the first place. There was no revenue requirement. I think the whole thing was – there has been overearnings, I think the company can absorb whatever legal expenses there are.

In a nutshell, staff here distills its view of legal and accounting fee recoupment. There can be little doubt that this perspective is based on a five-year look-back by the staff, and a present day adjustment for historic operations it deems inappropriate and/or excessive. (Tr. 189, 11. 6-11). Mr. Colbo also acknowledged that he was unaware of the staff ever advocating complete disallowance of a company's legal and accounting costs before hearing (Tr. 191, l. 4). As will be discussed with respect to staff's concluding recommendations in this complaint case, this is classic retroactive ratemaking for a rate case expense which is fully eligible for pro forma adjustment.

Staff also offered a fallback argument on rebuttal and at hearing, opposing any adjustment first, but alternatively favoring a five-year amortization of legal and accounting rate case expense. This secondary position was subject to the acknowledgment by Mr. Colbo that the normal policy would be to amortize the rate case professional expenses over three years. (Tr. 189). Again, his more punitive five-year amortization, although disclaimed as a coincidence (Tr. 190, l. 8),[3] is seemingly being tied to his five-year overearning theory supposedly authorized by RCW 81.04.360, and representing yet another unprecedented sanction of Respondent.

Previous Commission decisions have typically granted legal and accounting costs as allowable expenses in the regulated company's expense base and frequently ordered them to be amortized over a three year or less interval. See i.e. UW-950174, In re: WUTC v. Washington Water Supply, Inc. d/b/a Whidbey West, 1996 Wash. UTC LEXIS 18 (1996) (rate case legal costs shall be amortized over three years); Docket No. U-83-20 WUTC v. The Toledo Telephone Company, Inc., 1983 Wash. UTC LEXIS 18 (1993) (the rate case expense is to be amortized

[3] Mr. Colbo's testimony on this was equivocal as he expressly acknowledged that part of the reason he sought to deny legal and accounting costs in this case was because of perceived five years of overearning. (Tr. 189, l. 11).

over a two year period); In re U-81-41, WUTC v. Puget Sound Power & Light Company, 1988 Wash. UTC LEXIS 146, 32 (1988) ("Other expense items are routinely authorized in ratemaking, such as unusual weather related expense adjustments and *rate case expenses*." (Emphasis added))

Respondent has addressed Mr. Colbo's concerns that "actual" not estimated legal accounting expense costs (Exhibit 17, 11. 15-16) be provided, and through its Exhibit 42, indicated it would supplement those data with totals to include the costs incurred in filing of this brief. Staff has also not challenged the legitimacy or size of these expenses, merely argued for disallowance on the basis of past rate filings by BKA that were submitted and then withdrawn (Tr. 187), as described in Exhibit 9, page 9. However, on further examination of that Exhibit, since the time the present rates were adopted over ten years ago in Docket Nos. TC-910646 and 911279, a total of four rate filings, including the present proceeding, have been submitted by BKA, which averages one filing every 2 ½3 years. This is not in any way excessive for a company subject to economic regulation by this Commission.

There appears to be little doubt that the staff's advocacy of total disallowance of BKA's rate case legal and accounting costs reflects its premise that the Respondent should and can be sanctioned by its unilateral interpretation of RCW 81.04.360. Despite the absence of any evidence that this Respondent has wasted resources by a "long history of making ill-advised rate applications," (Exhibit 1, p. 37, L. 9), or otherwise acted in bad faith in seeking lawful rate adjustments under RCW 81.28.080, the staff advocates yet another unprecedented sanction of Respondent in disallowing legitimate rate case expenses through its opposition to Mr. Burton's pro forma adjustment to Respondent's expenses. The Commission should reject such punitive actions, allowing Respondent to recoup legitimate rate case expenses preferably over 12 months, but in the alternative, amortized over the maximum 2-3 year cycle of rate filings supported by this record.

IV. STAFF POLICY/RATEMAKING THEORY RECOMMENDATIONS

Flowing out of the four remaining disputed accounting issues in the proceeding are the Commission staff's concluding recommendations for disposition of this complaint which were first articulated at Exhibit 1, pp. 36, 37. These recommendations will be addressed by Respondent separately, as despite their relatively brevity in staff testimony presentation, they have very material and far-reaching policy and operational implications for Respondent, and indeed, for its continued viability.

A. The Proposal to Cap Officer's Salary at $66,000 and Prohibit BKA From Issuing Bonuses.

Of the three concluding policy/operational recommendations presented by staff, this proposal appeared the vaguest in terms of explanation or proffered defense. No precedent or analogous support for this proposal was ever suggested by the staff. Additionally, no rationale for the theory was advocated, save for the single sentence that "[t]his will simply insure that the company properly accounts for the excess revenues." Exhibit 1, 36, ll. 14-15. Weldon Burton has responded in his testimony, (Exhibit 32, p. 18 11. 1-4), that he was unaware of any precedent for such a recommendation and believed that such was contrary to Commission ratemaking policy analysis.

While noting that a related strategy of increasing profits by cutting back on specific regulated operating expenses carries risks, the Commission has previously stated "[t]here is nothing per se improper about the owner trying to squeeze out more profit by cutting back on the regulated company's expenses." Order M.V.G. No. 1639, In re Superior Refuse Removal Companies, App. No. GA-896 (Jun. 1993). In fact, operating ratio ratemaking establishes a particular target revenue requirement based on allowed "above-the-line" individual operating expenses which are not isolated or frozen, but fluid in the context of a regulated company's operational stewardship. If the company is more efficient than anticipated in maintaining certain expenses below what its expected expenditures are estimated to be, there is no prohibition, as the

Commission has duly noted, in deriving additional profit (that might be reflected i.e. in officer's compensation) beyond that approved in the regulated company's expense base.

Here, in advocating "freezing" officer's salary and precluding bonuses, the staff is charting a decidedly different ratemaking approach. That view is one of isolating one expense line item and precluding any other operating efficiency from being reflected in owner compensation. Again, the staff has defended this premise on the basis of guaranteeing "accounting for excess revenues." Exhibit 1, p. 36.

Even if that objective is valid, there are other, broader regulatory mechanisms to accomplish that goal. While the Commission has historically established officer's compensation through approved rates, to Respondent's knowledge, it has never precluded any additional officer's compensation above that approved in the regulated transportation company's expense base from being satisfied through operating profits or shareholder return. It has also never placed an outright ban on payment of compensation above the anticipated expense level represented by the "officer's salary" line item. It has never told a regulated transportation company "this much and not a penny more" on a particular expense item. It has never subjected a regulated transportation company to an absolute expense limit that the overall basket of other regulatory expenses could not absorb. In short, this unsupported, unprecedented recommendation should be summarily rejected by the Commission as contrary to Commission policy and law and as intrusive micro-management of the day-to-day operating discretion of a regulated company.

B. The 97% Operating Ratio Mandate: Invoking Retroactive Ratemaking.

Yet another unprecedented remedy advocated by the staff in this proceeding was its recommendation that BKA be singled out for a revenue requirement yielding a 97% operating ratio for a period of three years after the order on its complaint is effective. (Exhibit 1, p. 36, ll. 20-22). Mr. Colbo admitted the unprecedented nature of this calculation when he says at Tr.

194, “I’m not aware of any operating ratio that high for an auto transportation company.” The basis of this unilateral earnings sanction is once again expressly attributed by Mr. Colbo to his conclusion that RCW 81.04.360 provides an exception to “retroactive ratemaking” and authorizes prospective penalties in the form of lowered earnings for a regulated company found guilty of his rendition of overearnings under law. See, Exhibit 1, p. 31, 11. 5-12. Indeed, the staff does not dispute the retroactive effect of this operating ratio recommendation, and even acknowledged, at Tr. 192:

> Q. And by doing that, aren’t you in effect taking away from future revenues and reducing rates, taking away from future revenues based on historic operating experience?
>
> A. Yes, for the next three years.

From BKA’s standpoint, the staff’s theory of RCW 81.04.360 and alleged overearnings has a number of legal flaws, addressed below. Factually, it also appears to be a somewhat self-fulfilling prophecy to the extent that is relies on the staff’s own adjustments to BKA’s test year results of operations to arrive at its five-year “overearnings” conclusion, possibly before the ultimate conclusion is reached. In other words, some of the criteria upon which the staff arrived at its conclusion that BKA had been overearning, is based on the staff’s restating adjustments that lead to the conclusions first addressed at Exhibit 1, p. 27 and summarized in Exhibit 15, staff’s five-year recap of Respondent’s results of operations. According to Mr. Colbo’s testimony at Tr. 135, Exhibit 1, p. 37, l. 4, that cumulative amount of overearnings is $1,155,000.[4]

Yet, assuming the $1,055,000 figure is accurate by staff’s calculation, it is still based upon five years of restating adjustments to the “officer’s salary” single expense line item. BKA attempted to raise this “chicken and egg” issue at Tr. 135 when it asked Mr. Colbo whether he

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[4] That total may be in error. See, Exhibit 1, p. 28, ll. 11, 12 and Exhibit 15, which at line 51, column g, totals $1,055,000.

made any adjustment to owner's compensation based on his conclusion that the company had overearned for five years and he indicated, "no." (Tr. 135, l. 16). It is clear, however, that deriving the five-year figure by which staff now claims BKA overearned necessarily involved the imputation of its recommended officer's salary as a constant over the five year period, and that increasing that amount in any one of those past five years would accordingly reduce the resulting excess earnings figure.

The $66,000 salary figure is pivotal to the computation of the overall alleged excess earnings, and unquestionably predetermines the size of the earnings excess if it is not adjusted to a more realistic level. It is thus a highly volatile rendition of reasonable earnings subject to wide variation if one critical element is modified. This effect again raises the issue of whether the overearning analysis becomes self-fulfilling under staff's view of the numbers.

1. The Staff's Interpretation of RCW 81.04.360 is Flawed, Unprecedented and Unquestionably Implicates Retroactive Ratemaking.

There is no dispute in this proceeding that the applicable ratemaking standard for regulated intrastate auto transportation companies is the 93% operating ratio (Exhibit 4, p. 5) and as referenced in testimony and various Initial and Final Orders referring to this Respondent filed in the staff's case and admitted, as Exhibits 11-13. As previously noted, the staff, in this proceeding, seeks to implement rates yielding a 4% higher target operating ratio and expects that small 3% target revenue margin to be in place with no allowance for performance efficiencies yielding excess proceeds from rates for three years.

However, staff's rationale and justification for imposing such a draconian standard upon Respondent is not supported by applicable law, despite its concerted effort to construe applicable statutes to buttress its position. In effect, the Commission should not here mandate a new set of rates for BKA with retroactive recognition to previous rate levels which the staff now alleges have yielded excessive operating earnings.

2. The Commission Cannot Prescribe a Rate with Retroactive Force.

The broad and controlling principle in Washington is that rates cannot be given effect retroactively beyond the date of filing of a complaint. Standard Oil Co. of California v. Department of Public Works, 185 Wash. 235, 239, 53 P.2d 318 (1936) (damage action regarding rates demanded and collected by carriers upon oil shipments that were allegedly unreasonable, but these rates were published and established rates on file with the Department of Public Works at the time of collection); Puget Sound Navigation Co. v. Department of Public Works, 157 Wash. 557, 289 Pac. 1006, 1008 (1930). "A claim against a rate, lawful at the time of collection, seeks in effect the giving of retroactive force to a rate schedule, which cannot be done beyond the date of the filing of the complaint challenging the rate." Id.

RCW 81.04.250 requires that rates be just and reasonable. RCW 81.28.040 prescribes that rates be filed and published with the Commission before their effective date, so that (1) everyone concerned may have notice with an opportunity to challenge them, and (2) the Commission may suspend them. Rates are also subject to challenge after their effective date by affected parties. So long as they remain effective and unchallenged, they are presumed to be reasonable. Standard Oil, 185 Wash. at 238. All carriers are mandated to charge rates as specified in their filed schedules in effect at the time and are prohibited from charging or collecting other or different rates. Puget Sound Navigation Co. v. Department of Public Works, 157 Wash. 557, 289 Pac. 1006, 1008 (1930).

> We think that the statute law, when read and considered as a whole, leads to the view, and we must now hold, that when a rate is filed, published and permitted to become effective by the Department, it is and remains until challenged in the manner provided by statute the lawful rate and the only lawful rate to be charged and collected. Otherwise, the carrier would never know what his lawful earnings were and could never allocate its earnings to betterments and dividends without the possibility of being embarrassed by delayed orders to make restitution.

Standard Oil, 185 Wash. At 239.

The U.S. Supreme Court has applied these principles in the context of the Federal Energy Reserve Commission and recognized it as the "filed rate doctrine." In Arkansas Louisiana Gas

Co. v. Hall, 453 U.S. 571, 578, 69 L. Ed. 2d 856, 101 S. Ct. 2925 (1981), the Supreme Court held that "[n]ot only do courts lack authority to impose a different rate than the one approved by the Commission, but the Commission itself has no power to alter a rate retroactively. The Court further held that "[w] hen the Commission finds a rate unreasonable, it shall determine the just and reasonable rate . . . to be *thereafter* observed and in force." Id.

More recently, the Washington Supreme Court has cited the Arkansas Louisiana Gas decision with approval and held that "filed rate doctrine" makes any filed and approved rate per se reasonable and beyond challenge. Tenore v. AT&T Wireless Servs., 136 Wn.2d 322, 331, 962 P.2d 104 (1998). Accordingly, retroactive rate adjustments are barred by the "filed rate doctrine." Id. at 350 (footnote 87 citing Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571).

This Commission has found in a recent proceeding that adjusting current rates to make up for past deficiencies in tariffed rates is prohibited as retroactive ratemaking:

> The Commission determines that it is legally barred from granting PSE's petition to amend the accounting order in Docket No. UE-010410 under the doctrine of retroactive ratemaking. "The retroactive ratemaking doctrine prohibits the Commission from authorizing or requiring a utility to adjust current rates to make up for past errors in projections." Town of Norwood, Mass. v. FERC, 53 F.3d 377, 381 (D.C. Cir. 1995). With few exceptions (not applicable here), under RCW 80.28.020 the Commission is charged with setting rates on a *prospective* basis. Under RCW 80.28.050, every electrical company is required to file with the Commission tariffs showing the rates charged for service. Under RCW 80.28.080, no electrical company is permitted to charge a rate for service that deviates from its tariffed rate. Here, PSE proposes to reach back in time to alter the tariffed CIC rate.
>
> Retroactive rate making involves surcharges or ordered refunds applied to rates which had been previously paid, constituting an additional charge applied after the service was provided or consumed. The evil in retroactive rate making as thus understood is that the consumer has no opportunity prior to receiving or consuming the service to learn what the rate is or to participate in a proceeding by which the rate is set. **The Commission agrees that retroactive rate making, as thus understood, is extremely poor public policy and is illegal under the statutes of Washington State as a rate applied to a service without prior notice and review.** (Emphasis added).

In re the Application of Puget Sound Energy, UE-010410, 2001 Wash. UTC LEXIS 396, pp. 3-4, (November 9, 2001).

As the Commission could expect, Federal courts have held similarly with respect to retroactive ratemaking:

> The retroactive ratemaking doctrine, . . . focuses on how the current rate is determined. Under this doctrine, the Commission is prohibited from adjusting current rates to make up for previous over- or undercollections of costs in prior periods. The retroactive ratemaking doctrine is thus a logical outgrowth of the filed rate doctrine, prohibiting the Commission from doing indirectly what it cannot do directly. The Commission may not allow a utility to "recoup past losses," City of Piqua v. FERC, 198 U.S. App. D.C. 8, 610 F. Supp 950, 954 (D.C. Cir. 1979) nor may it force a utility to reduce its current rates to make up for overcollections in previous periods. See FPC v. Hope Natural Gas Co., 320 U.S. 591, 595-96, 618, 88 L. Ed. 333, 64 S. Ct 281 (1944) . . . To allow such adjustments would cause current rates to be either unreasonably high or low. **The Commission may not disinter the past merely because experience has belied projections, whether the advantage went to customers or the utility; bygones are bygones**. (Emphasis added).

Associated Gas Distributors v. FERC, 898 F.2d 809, 810 (U.S App. Ct. D.C. 1990); see also PUC of California v. FERC, 988 F.2d 154, 161 (U.S. App. Ct. D.C. 1993) (even charges that are imposed prospectively, and therefore satisfy the filed rate doctrine, are improper under the retroactive ratemaking doctrine if they are based on a prior period); United Cities Gas Co. v. Brock Exploration Company, 995 F. Supp. 1284, 1293 (D. Kan. 1998) (the ban against retroactive ratemaking has a statutory and constitutional basis).[5]

3. RCW 81.04.360 Does Not Provide for Penalties or Otherwise Sanction Retroactive Ratemaking.

Even if the Commission were somehow permitted to prescribe rates with retroactive force, RCW 81.04.360 does not sanction retroactive ratemaking, contrary to staff's view, but instead provides for an upward adjustment of the carrier's rate for a reserve fund to cover new plant and consumer benefits investments going forward, to ensure adequate service to consumers. RCW 81.04.360 expressly provides:

> Excessive earnings to reserve fund

[5] Predictability is an underlying purpose of both the filed rate doctrine and the rule against retroactive ratemaking. PUC of California, 988 F.2d at 163.

> If any public service company earns in the period of five consecutive years immediately preceding the Commission order fixing rates for such company a net utility operating income in excess of a reasonable rate of return upon the fair value of its property used and useful in the public service, the Commission shall take official notice of such fact and of whether any such excess earnings shall have been invested in such company's plant or otherwise used for purposes beneficial to the consumers of such company and may consider such facts in fixing rates for such company.

The plain language of the statute provides that the Commission can consider excess income over previous years in determining whether the carrier is entitled to an upward adjustment above and beyond a reasonable rate of return, as required under 81.04.250.[6] RCW 81.04.250(3) specifically considers (separate from depreciation under 81.04.350) the provision of maintenance or renewal of facilities or equipment as well as reasonable profit to the carrier.[7] RCW 81.04.250(3) evidences that RCW 81.04.360 is an upward adjustment on top of and apart from the Commission's requirement to set a reasonable rate of return (including profit) for a carrier. If the Commission determines, pursuant to RCW 81.04.360, that an insufficient or sufficient amount of excess income has been utilized for investment in plant and consumer benefits, it may adjust any reserve fund amount it would have or may have prescribed <u>in addition to a reasonable rate of return</u>.[8]

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[6] In prescribing and authorizing just and reasonable rates, the Commission may consider the following:

> . . . (3) to the carrier's need for revenue of a level that under honest, efficient, and economical management is sufficient to cover the cost (including all operating expenses), depreciation accruals, rents, and taxes of every kind) providing adequate transportation service, <u>plus an amount equal to the percentage of that cost as is reasonably necessary for the provision, maintenance, and renewal of the transportation facilities or equipment</u> and a reasonable profit to the carrier.

(Emphasis added).

[7] The Commission cannot set an unjust and unreasonable rate. Cost of service to a carrier is one element in the determination of just and reasonable rates, not controlling except to the extent of indicating a minimum below which a rate may not legally be made. <u>Allied Daily Newspapers of Washington v. Washington Public Serv. Comm'n</u>, 44 Wn.2d 1, 265 P.2d 270 (1953).

[8] This is separate from the immediately preceding statute, RCW 81.04.350, "Depreciation and Retirement Accounts," which provides for the depreciation of existing assets as a separate upward adjustment consideration apart from reasonable rate of return. The question being, should a reserve fund amount be provided in the rates going forward considering the circumstances and utilization of any excess income by the carrier over the past five years?

RCW 81.04.360 provides for an annual renewal fund, built into the carrier's rates, on which the carrier can draw for necessary maintenance on and replacement of plant and consumer benefits. Puget Sound Elec. Railway. v. Railroad Comm'n of Washington, 65 Wash. 75, 81-83, 117 Pac. 739 (1911).

> It is unquestionably true that the railway company is not bound to see its property gradually deteriorate in value and earning power, without making provision out of its earnings to keep its usefulness unimpaired; and that it can properly charge an annual sum to care for necessary depreciation and waste, and have such sum allowed in any determination of what is a proper return upon its investment to be approximated in fixing its rates of carriage.

Id. at 81-82.

An annual reserve and renewal fund should be allowed for plant and investment and consumer benefits moving forward, apart from any depreciation of existing assets. Even if the carrier chose not to invest excess income into the business, it is still a matter of how much, if any, reserve funds should be allowed in the carrier's rates prospectively. The Commission can also consider whether the carrier used any excess income for plant and consumer benefit investment in its determination of the amount of rate increase allowable for the reserve fund. Even if the carrier failed to use excess income in the past for plant investment, that will not necessarily affect the Commission's decision on whether the carrier deserves any additional upward adjustment of its rate for renewals and reserves going forward to continue the provision of adequate service to its consumers. The statute is not concerned with a retroactive penalty based on excess income that may have been derived from approved and filed rates.
RCW 81.04.360 is designed for "Excessive earnings to reserve fund," for plant investment and consumer benefits going forward.[9]

[9] A "reserve fund" is a fund set aside to cover future expenses. See Black's Law Dictionary, sixth edition 1991, page 906. A "replacement reserve" is a fund set up for the replacement of machinery and equipment. Id. The reserve fund in RCW 81.04.360 is synonymous with the replacement reserve.

As noted, RCW 81.04.350, covering depreciation accounts, provides that the Commission has the power to consider depreciation of assets and set rates accordingly, and that the Commission has similar power and authority over all reserve accounts. RCW 81.04.360, the succeeding section, provides for a reserve fund and grants the Commission similar jurisdictional power and authority to consider plant investment and consumer benefits in the same manner that it considers depreciation in prescribing an upward adjustment for just and reasonable rates.

4. RCW 81.04.360 is Not Factually Applicable to This Case.

The above legal issues concerning whether the Commission can set rates with retroactive force and whether consideration of past investment of excess income is permissible, are separate considerations from the Commission's statutory requirement to set a reasonable rate of return for a regulated carrier. In so doing, it becomes an evidentiary issue in considering setting any upward adjustment above a reasonable rate of return. As noted, considerations of what investments have been made over the past five years can be taken into account and evaluated with respect to what rate recovery and increase will be allowed in prospective rates.[10]

Thus, even if RCW 81.04.360 is construed as applicable in a standard rate case as a permissible consideration when setting rates under normal circumstances, it is ultimately inapplicable to the facts and circumstances of a complaint-driven Commission staff penalty attack on the Respondent for excess income derived pursuant to previously unchallenged rates that were filed, approved and effectuated by the Commission more than a decade ago.

C. The Special Reserve Account Concept is Vague and Unworkable as Proposed.

Apparently linked to the threshold 97% operating ratio theory is the related and concluding notion put forth by the staff in pre-filed and oral testimony that seeks to create a special account to serve as a form of receptacle for excess proceeds beyond the 97% operating

[10] On this issue, BKA would submit this record clearly demonstrates a pattern of reinvestment of excess revenues by the Respondent over more than a five-year period in modernizing plant and equipment which staff itself seemed to recognize, i.e., in its concurrence in a four-year depreciable life for airporter vans which its revised Exhibit 6 and cover letter of December 5, 2001 reflect.

ratio. "The company should place all revenue that exceeds what would be required to generate a 97.00 percent operating ratio into a special credit account that will be used to lower rates in the future." (Exhibit 1, ll. 15-18). When Respondent testified about objections to and various uncertainties about this special account, the staff responded on rebuttal in Exhibit 17 that "any type of escrow account opened and maintained by the company would be suitable, "Exhibit 17, p. 5, and simply that the company would deposit any excess revenues in excess of a 97% operating ratio into that account. "When the company filed a rate case, any money contained in the account would be used to offset any revenue requirement otherwise derived." Exhibit 17, page 5, ll. 23, 24.

This altogether facile rendition of the reserve account concept was further explored at the hearing, beginning at Tr. 194, line 18 and running through line 13 of Tr. 205. In all, the staff seemed to be proposing a three-year reserve account maintained by the company at any bank, whose funds would be infused by the company writing a check to itself backed by any proceeds generated below the 97% operating ratio, based on company-calculated annual results of operations. The fund would be used to lower rates (Tr. 200).

While apparently the staff envisioned the use of this fund to defray or otherwise mitigate the effect of a rate increase, the disposition of the fund if there was no rate increase sought by the company over that interval was not resolved.

At Tr. 201, Mr. Colbo testified:

A. Well, if there was no rate filing, the money would just be in the account.

Q. Well, then what would happen at the end of the three year life that you expect for this fund? Would it go back to the owner?

A. Give me a minute. I don't have an immediate answer on that.

The staff clearly has not resolved various material contingencies or even basic mechanics such as how lower rates would be triggered through the reserve account. The moving-target, fluid nature of this poorly-conceived concept involving the most basic parameters of its

operation, underscore its inadvisability. Along with the 97% operating ratio premise, the countervailing recommendation of a "special reserve account" should be abruptly rejected.

D. The Staff's Belated Attempts to Justify a 97% Operating Ratio Should Be Rejected.

The redirect testimony of Bob Colbo on the final day of hearing featured defense of contested calculations on revised Exhibit 6 in support of his "total return" calculation at lines 76-78, column "h," Tr. 230. That defense came in the wake of pointed questions to Mr. Colbo about the insufficiency of a 97% operating ratio, i.e. providing sufficient capital reserves for equipment replacement, and the description of the separate return element as either a return on equity, or for auto transportation companies subject to commission rate regulation, the portion of the operating ratio that is the margin "designed to cover interest, federal income taxes and profit." Tr. 207, 11, 22, 23.

Mr. Colbo, at Tr. 230, testifies that at line 72 of Exhibit 6, his total return at staff proposed rates is 8.29% or $28,967.[11] The $28,967 figure is divided by the total "Rate Base." Exhibit 6, line 74, column h to arrive at the 8.29% or $28,967 ÷ $349,453 = 8.29%.

However, the rate base Mr. Colbo calculated appears only to use the net depreciated value of the vehicle fleet and equipment and does not include the net depreciated value of the real estate or "plant"/terminal upon which BKA regulated operations are based. If in fact the net depreciated value of the equity portion of the real estate shown on Exhibit 23 in the rate base is added to the depreciated equipment valuation, the rate base value increases from $349,453 to $583,472 ($349,453 + $234,019). Dividing $28,967 Exhibit 6, L. 70, column h, by the larger asset base, including real estate, would apparently yield a reduced return on equity calculation of 4.96%. Moreover, using a more conventional return on equity definition as the product of the division of net income by stockholder equity, based on BKA's year 2000 ending financial

[11] His testimony is actually $29,967, but Exhibit 6 reflects the lower figure, which the subsequent calculation supports.

statement calculation of $1,102,830 (which statement was provided to staff in data request response No. 17), would yield an even lower 2.63% return on equity calculation based on:

$28,967 ÷ $1,102,830 (Exhibit 6, L. 70, column h) = 2.63%

Both 4.96% and 2.63% are hardly "total return margins" which provide sufficient capital to allow this company to maintain its current fleet replacement cycle of replacing all airporter vans every few years, Tr. 337.

Even with depreciation included for cash flow purposes, that original lower return of 8.29% would yield only 2 ½ vans replaced in the present fleet cycle (Tr. 337, L. 6), presuming all of the staff-allowed "total return" were used solely for van replacement, ignoring all other plant and equipment replacement needs of the company.

Moreover, returning to a focus on the 97% operating ratio advocated by staff only heightens the materiality of the difference between the standard 93% operating ratio and the 97% recommendation. As Weldon Burton summarized on cross-examination at Tr. 339, 11. 9-17:

> The difference we're referring to here is approximately 4% and for example purposes only, if I take Mr. Colbo's RC-6, page 1, and do a very quick calculation on his expense base of $1,368,816 with a 93% operating ratio, that indicates a revenue requirement of $1,471,845 as compared to $1,396,916, so we're talking about $75,000 of pure revenue to the bottom line. That's the difference between a 97% and a 93% operating ratio.

While staff thus may seek to "dress up" its highly restrictive 97% operating ratio recommendation with an alternative "total return" computation on Exhibit 6, BKA, as indicated, believes even that scenario is misleading and incomplete and generates materially lower overall return percentages than advertised.

Rather than "total return," Mr. Burton advanced his own alternative ratemaking methodology more consistent with operating ratio-based ratemaking. Exhibit 41 of his pre-filed testimony reflects a 94.06% "Lurito-Gallagher" operating ratio that would remain largely unchanged, even in light of his revised BKA pro forma income statement admitted as Exhibit 34. While the Lurito-Gallagher ratemaking methodology has not been adopted for the auto

transportation group as it has for the intrastate solid waste industry, Exhibit 41, calculated at Weldon Burton's revised pro forma revenue and expense levels, reflects a far more conventional return than does the staff's 97% operating ratio recommendation.

In short, staff's Exhibit 6 does not directly or indirectly support its punitive operating ratio recommendation. Respondent, instead, has demonstrated the material shortcomings and revenue diminution that operating ratio level would mean for its plant and equipment replacement and for any continued improvement in carrier operating efficiencies. Based on all of the numerous factual, computational and legal reasons noted above, the Commission should wholly reject staff's advocacy of a three-year sanction and marginalization of respondent to a 97% operating ratio/special reserve account status.

V. CONCLUSION

For the foregoing reasons, Bremerton Kitsap Airporter, Inc. urges that its restating and pro forma accounting adjustments as set forth in the attached Respondent's Post-Hearing Brief Exhibit 1 be adopted, and that the Commission reject the staff's unprecedented sanctions of respondent in seeking to impose officer's salary and bonus freezes, a three-year mandate of a 97% target operating ratio and a special reserve account status on its financial operations, and ultimately dismiss the complaint against Bremerton-Kitsap Airporter, Inc.

DATED this _____ day of February, 2002.

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document to all parties of record, by mailing properly addressed with first class postage upon the parties of record as follows:

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DATED at Seattle, Washington this _____ day of February, 2002.

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Kathleen Stanford