

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND PILOTS,

Respondent.

DOCKET TP-190976

INITIAL BRIEF ON BEHALF OF COMMISSION STAFF

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I. INTRODUCTION

1 This case is the inaugural marine pilotage rate case before the Utilities and Transportation Commission (Commission) and it involves a balancing of regulatory authority between the Commission and the Board of Pilotage Commissioners (Board). When the legislature transferred regulatory authority over marine pilotage to the Commission, it did so in a limited way, in that it only transferred the authority to set tariff rates. All other authority regarding pilotage service, training, and policies remain with the Board. In crafting its recommendations, Commission Staff (Staff) has attempted to be mindful of this division of authority and expertise.

2 Staff recommends that the Commission reject Puget Sound Pilot's (PSP) recommendation to fund 61.6 pilots. Funding 61.6 pilots would exceed the 56 total pilot licenses that the Board has authorized for the Puget Sound pilotage district. Additionally, the target assignment level (TAL) of 118 that PSP relies on to support its recommendation involves implicit policy determinations that are properly reserved to the Board, and the Board has recently declined to adopt a TAL of 118. Staff also recommends the Commission reject PSP's recommended TAL and pilots to fund because it attempts to recover revenue related to its unrecorded historical callback liability. Staff opposes recovery of revenue associated with the historical callback liability because it results in double recovery and retroactive ratemaking to the extent it attempts to recover revenue for assignments completed and paid for under a prior tariff. Additionally, Staff believes that the problem regarding callbacks is rooted in PSP's bylaws and that in the absence of changes to PSP's bylaws and controls over callbacks, providing additional revenue related to callbacks will

simply continue a “self-perpetuating”¹ system of accumulating callback liability with higher rates.

3 Staff also recommends that the Commission reject PSP’s recommended distributable net income (DNI) of \$500,000. Although PSP has provided financial information from other pilotage districts, the information is incomplete and portions are unverifiable, and therefore Staff believes it is inappropriate for comparison. Even if the information were appropriate, PSP has not provided any method or reasoning used to recommend a DNI of \$500,000 based on a comparison to the other pilotage districts.

4 Staff’s recommends a TAL of 143.4, which results in 52 funded pilots, and DNI of \$400,855, both of which were derived using historical information published by the Board. Staff further argues that the Commission should adopt Staff’s proposed rate design, which reasonably distributes costs among ratepayers and appropriately acknowledges risk. Staff also maintains that the Commission should remove PSP’s transportation expense adjustment, adjust PSP’s depreciation expense and recovery period as recommended by Staff, and reject the Pacific Merchant Shipping Association’s (PMSA) argument regarding recovery of expenses associated with the legislature’s appropriation for the Board’s self-insurance premium. Finally, the Commission should order PSP to file future rate cases using full accrual GAAP accounting, order PSP to discuss transitioning to a funded pension plan, with stakeholders, and decline to implement a multi-year rate plan.

¹ Carlson, TR. Vol. III 345:23.

II. LEGAL STANDARDS

5 When establishing rates for marine pilotage service,² the Commission shall ensure that the tariff provides rates that are fair, just, reasonable, and sufficient for the provision of pilotage service.³ As the party that filed the revised tariff, PSP bears the burden to demonstrate that the current tariff rates are not fair, just, reasonable, and sufficient.⁴ The statutory requirement that rates be just and reasonable is “incapable of precise judicial definition,” and a reviewing court will afford the Commission great deference in reviewing its rate decisions.⁵ Furthermore, “[t]he economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result.”⁶ Finally, the Washington Supreme Court has explained that “administrative agencies are creatures of the Legislature, without inherent or common-law powers and, as such, may exercise only those powers conferred by statute, either expressly or by necessary implication.”⁷

6 While the legislature has transferred marine pilotage rate-setting authority to the Commission, the Board retains authority to regulate all other aspects of marine pilotage. The Board is authorized to “[p]rovide for the maintenance of efficient and competent pilotage service on all waters covered by [Chapter 88.16 RCW]; and do such other things as are reasonable, necessary, and expedient to insure proper and safe pilotage upon the waters

² As an initial observation, while the legislature empowered the Commission to regulate marine pilotage rate-setting by creating a new section in Title 81 RCW (81.116), the legislature did not update the existing definitions within Title 81 RCW to apply to marine pilotage. Specifically, the legislature did not amend the definition of “public service company” at RCW 81.04.010(16), which defines a “public service company” as including “every common carrier.” RCW 81.04.010(11) defines the term “common carrier” and has not been amended to include marine pilotage. Therefore, the Commission should rely on its general authority and acquired expertise, rather than its statutory authority in Title 81 RCW (other than RCW 81.116) because marine pilotage does not fall within the statutory definition of a “public service company,” and as such the Commission’s statutory authority arguably does not apply to the Commission’s adjudication of this proceeding.

³ RCW 81.116.020(3).

⁴ RCW 81.116.030(5).

⁵ *PacifiCorp v. Wash. Utils. & Transp. Comm’n*, 194 Wn. App. 571, 587-88, 376 P.3d 389 (2016).

⁶ *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 313, 109 S. Ct. 609, 102 L. Ed. 2d 646 (1989).

⁷ *Skagit Surveyors and Eng’rs, LLC v. Friends of Skagit County*, 135 Wn.2d 542, 558, 958 P.2d 962 (1998).

covered by this chapter and facilitate the efficient administration of this chapter.”⁸ To that end, the legislature has granted the Board broad rule-making authority to implement Chapter 88.16 RCW,⁹ and has specifically directed the Board to establish a pilotage training program¹⁰ and requirements¹¹ for state licensed marine pilotage applicants. The Board is also responsible for “determin[ing] from time to time the number of pilots necessary to be licensed in each district of the state to optimize the operation of a safe, fully regulated, efficient, and competent pilotage service in each district.”¹² Furthermore, the legislature has directed the Board to monitor and regulate pilotage fatigue issues and provide for rest periods.¹³

III. TOTAL DISTRIBUTABLE NET INCOME AND RATE DESIGN

7

One of the central issues in this rate case is the appropriate amount of compensation or total distributable net income (TDNI) that the pilots will have an opportunity to earn under the tariff rates.¹⁴ Under Staff’s proposed approach, TDNI is calculated by determining the distributable net income (DNI)¹⁵ that an individual pilot will have an opportunity to earn and the number of pilots to fund in the tariff.¹⁶

⁸ RCW 88.16.035(1)(i).

⁹ RCW 88.16.035(1)(a).

¹⁰ RCW 88.16.035(1)(b)(ii).

¹¹ RCW 88.16.035(1)(b)(iii).

¹² RCW 88.16.035(1)(d).

¹³ RCW 88.16.103. The Board has also created a Fatigue Management Committee (FMC) to study and develop policy recommendations regarding pilotage fatigue issues. Exh. IC-37X at 88-90. *See also*, RCW 88.16.035(1)(h).

¹⁴ Sevall, Exh. SS-1T at 5:18 – 6:2.

¹⁵ As used in in the rate equation, references to “distributable net income” (DNI) should be understood as the target distributable net income for a pilot after expenses, rather than a guaranteed distributable net income. However, to avoid any confusion with the term “total distributable net income” (TDNI), Staff uses DNI to refer to the target distributable net income.

¹⁶ Sevall, Exh. SS-1T at 6:8-12.

A. Number of Pilots

8 Staff and PSP have proposed a relatively similar method for determining the number of pilots to fund in the tariff.¹⁷ Under that method, the number of pilots is determined by dividing the projected vessel traffic for the rate effective period (2020)¹⁸ by a TAL, or “the average amount of pilotage service, in assignments, that an average pilot is expected to perform in the rate year.”¹⁹ Once a base number of pilots is determined, then the number is adjusted to account for other considerations, such as including funding for an “administrative pilot,” a pilot that takes on relatively extensive administrative responsibilities in lieu of performing the typical number of pilotage assignments.²⁰ PSP recommends that the Commission set the number of pilots to fund based on a TAL of 118,²¹ while Staff recommends a TAL of 143.4.²²

1. The Commission Should Reject PSP’s Proposed TAL of 118 Because Accepting the Proposed TAL Would Usurp the Authority of the Board to Regulate Pilotage

9 The Commission should reject PSP’s recommended TAL of 118 because its recommendation requires the Commission to make determinations that infringe on the Board’s authority to regulate pilotage in at least three ways. First, the Board has set the maximum available pilot licenses at 56, meaning that even assuming that each license has been given to a pilot, PSP’s proposed tariff would fund an additional 6 pilots that could not

¹⁷ Sevall, Exh. SS-6T at 4:4-12, Khawaja, Exh. SK-1T at 9:11-16.

¹⁸ Although PSP proposes a 3-year rate plan as part of its filing covering 2020-2022, Staff notes that it only provided a projected vessel forecast for 2020 in its testimony. Dr. Khawaja states that “the size and speed of the recovery could take multiple paths and that changes to those projections are likely. Thus, rather than known and measurable changes, any attempted adjustments to the projections made in November 2019 would be nothing more than speculation about what will occur.” Khawaja, SK-3T at 14:16-20.

¹⁹ Sevall, Exh. SS-1T at 7:5-9.

²⁰ Sevall, Exh. SS-1T at 12:16-21; Khawaja, Exh. SK-1T at 9-11:16.

²¹ Khawaja, Exh. SK-1T at 8:21 – 9:17.

²² Sevall, Exh. SS-1T at 9:15-19.

exist.²³ Moreover, setting the level of funded pilots greater than the maximum number of pilot licenses authorized by the Board could be interpreted as infringing on the Board's authority to "determine . . . the number of pilots necessary to be licensed . . . to optimize the operation of a safe, fully regulated, efficient, and competent pilotage service[.]"²⁴

10 Second, to the extent that PSP's recommended TAL and number of pilots to fund are the result of safety and fatigue management considerations, such policy determinations are properly reserved for the Board. PSP states that its number of pilots, and by extension its recommended TAL, is driven by fatigue management concerns and a desire to minimize the number of callback assignments.²⁵ PSP further states that "[c]allbacks . . . are not ideal as they represent time pilots are working off duty and may create situations of pilot fatigue, an important safety consideration."²⁶ The Board retains authority to "insure proper and safe pilotage," and has established a Fatigue Management Committee to consider issues related to pilot fatigue.²⁷ Therefore, the Commission should not adopt PSP's proposed TAL because the Commission has neither the expertise nor the authority to make determinations regarding pilotage safety and fatigue concerns.²⁸

11 Third, the Board has recently declined to adopt a TAL of 118. At the July 18, 2019, regular Board meeting, PSP asked the Board to "vote to set the TAL at 118."²⁹ The minutes from the July 2019 meeting further state that "the TAL had not been changed since 2010,

²³ Carlson, Exh. IC-1T at 16:4-6.

²⁴ RCW 88.16.035(1)(d). Staff further recommends that the Commission not set the number of funded pilots below the number of active licensed pilots, because funding fewer pilots than are providing pilotage service would result in an insufficient and unreasonable amount of compensation.

²⁵ Khawaja, SK-1T at 8:18-20, Transcript Vol. III at 192:9-14.

²⁶ Khawaja, SK-1T at 6:3-5.

²⁷ RCW 88.16.035(1)(i); Carlson, Exh. IC-37X at 88-90.

²⁸ This is not to suggest that the Commission should entirely disregard safety and fatigue concerns in the context of pilotage rate-setting. However, to the extent that explicit safety and fatigue policy recommendations are embedded in PSP's recommended TAL, adopting PSP's proposed TAL would require the Commission to make policy determinations that exceed its statutory authority and intrude on the Board's functions.

²⁹ Carlson, Exh. IC-32X at 8.

where it was set [by the Board] at 145.”³⁰ While the Board did not ultimately vote on changing the TAL to 118, it did vote on a motion to establish a TAL of 127. The vote failed with 2 in favor, 6 opposed, and 1 abstention.³¹ Having failed to persuade the Board to set the TAL at 118, PSP now asks the Commission to indirectly do, through the rate-setting process, what the Board declined to do less than five months before PSP filed its rate case. The Commission should reject PSP’s invitation to override the Board’s decision to keep the TAL at 145.

2. Callbacks

12 PSP explains that it calculated its proposed TAL of 118 by including 11 additional pilots to its total pilot count to simulate a reduction in callback assignments.³² PSP also states that its proposed TAL is designed to include additional compensation for callback assignments.³³ The Commission should reject the proposed TAL because including additional costs related to callback assignments from prior years is unreasonable and results in retroactive ratemaking and double recovery of costs associated with callback assignments.

a. Callbacks Under PSP’s Bylaws

13 Although callback days are used in other pilotage districts,³⁴ the term has a specific application and function under PSP’s bylaws.³⁵ PSP’s bylaws define a callback day or “comp day” as “a day of work that is ‘earned’ and attributed to a Pilot as a result of him/her

³⁰ Carlson, Exh. IC-32X at 8. *See also* Carlson, Exh. IC-35X at 5 (“PSP did in fact move for the TAL to be re-established at 118 assignments per pilot as part of the BPC’s 065 hearing in 2019.”).

³¹ Carlson, Exh. IC-32X at 11.

³² Khawaja, Exh. SK-1T at 6:18 – 9:4; Khawaja, Exh. SK-3T at 8:1-3.

³³ Khawaja, Exh. SK-3T at 7-9.

³⁴ Nielsen, Exh. JJN-1T at 3:7-19, *see generally* Carlson, Exh. IC-34X.

³⁵ vonBrandenfels, Exh. EVB-5X.

working a day during his/her Respite Period or Vacation Period as further described in Section 16.4.4.1 herein.”³⁶ Section 16.4.4 regarding Compensatory Days states:

16.4.4.1 In the event that a Pilot works an Assignment(s) outside of his/her Work Period, he/she shall be deemed to have earned a compensatory day (“Comp Day”).

16.4.4.2 In the event that a Pilot takes a day off during the Pilot’s assigned Work Period, then, at the election of the Pilot, either: (1) the Pilot can replace that day off with a previously earned Comp Day; or (2) the Pilot’s (Member’s) total Duty Days for that month shall be deemed reduced by two (2) Duty Days. In the event that that Pilot takes a day off during the Pilot’s assigned Work Period, and in the event that that Pilot does not have a Comp Day to replace that day off, then that action may be considered by the Board of Directors to be misconduct, and be subject to the terms of Section 17 herein.

16.4.4.3 The Board of Directors may elect to forego the requirements of Section 16.4.4.2 in the event that a Pilot, due to exceptional circumstance, has used all available Comp Days, but requires additional days off from his/her Work Period(s). In such instance the Pilot’s total Duty Days shall be deemed to be reduced by two (2) Duty Days for each day off during his/her assigned Work Period.³⁷

14 PSP’s bylaws also describe how PSP distributes the revenue it collects from providing pilotage service in Section 16.5 Allocation of Total Pilotage Service Fees:

16.5.1 The Total Pilotage Services Fees, except as otherwise specifically described herein, and except as otherwise determined by the Board of Directors from time to time or on a case to case basis, shall be evenly divided between the Members and credited to their individual accounts (the “Equal Income Share”).³⁸

16.5.2 In the event that a Member’s Equal Income Share is to be reduced pursuant to the terms of Section 16.4.4.2 herein, then the Total Pilotage Services Fees shall be divided by the Combined Duty Days to determine the daily rate of income (the “Daily Rate of Income”), and the Member’s Equal Income Share shall be reduced by the Daily Rate of Income multiplied by the Duty Days forfeited as described.³⁹

³⁶ vonBrandenfels, Exh. EVB-5X at 3.

³⁷ vonBrandenfels, Exh. EVB-5X at 16.

³⁸ The term “Equal Income Share” is also defined in PSP’s bylaws as “the Total Pilotage Service Fees evenly divided between the Members and credited to their individual accounts as further described in Section 16.5 herein.” vonBrandenfels, Exh. EVB-5X at 3.

³⁹ vonBrandenfels, Exh. EVB-5X at 16-17.

15 According to the above sections, using a callback day allows a pilot to avoid forfeiting a portion of the pilot's equal income share if a pilot takes a day off during the pilot's assigned work period. Generally, if every pilot works their duty days and covers any absences with callback days, each pilot will receive an equal share of the pilot association revenue as provided by the bylaws.⁴⁰

b. Impact of Callbacks on PSP Operations

16 According to PSP, additional funding for callback days should be included in the tariff because the practice of burning callback days prior to retirement lowers the amount of income that is distributed to the pilots during the period in which callbacks are being burned. As stated by PSP:

Because the pilot's use of a Callback Day entitles her to one additional day of distribution, that pilot receives an equal share while the other pilots are paid the same distribution even though they worked more. Thus, whether there is additional distribution to the pilot when a Callback is earned, or there is additional compensation when the Callback Day is used, a cost in the form of decreased distribution to other pilots exists.⁴¹

17 PSP has also described the difference in impact, at the association level, between callbacks that are taken during the year and callbacks taken in anticipation of retirement:

The cost to PSP is the same whether a Callback Day is taken during the year or burned prior to retirement. The difference is in the level of burden on the Association in *absorbing* the cost. When [callback days] are spread out throughout the year they have a less noticeable impact, and because pilots still earn the same share of net income that way, it isn't as easy to notice the additional payment. But when a pilot remains on distribution for as much as two years while burning the significant number of Callback Days due to the present pilot shortage, it results in an obvious decrease in the income and increase in the workload of other pilots.⁴²

⁴⁰ Norris, TR. Vol. III 226:12-15 ("Okay. To my knowledge the bylaws dictate that the distribution of income is evenly among pilots; and so as part of our audit, we'd look at that."). See also Carlson, Exh. IC-35X at 9 ("Distribution [of pilotage revenue] is not mandatorily uniform. It is based upon the distribution formula in PSP's Bylaws, which can in theory vary. . . . However, we are not aware of any times when a pilot took off a scheduled work day without using a Callback Day. Thus, distribution of pooled income tends to be uniform in fact.").

⁴¹ Carlson, Exh. IC-4Tr at 5:7-12.

⁴² Carlson, Exh. IC-4Tr at 5:16-24.

18 PSP further clarifies that it has not sought recovery of callback days burned during the year, as opposed to those burned in anticipation of retirement, in part because “the cost to PSP of a pilot using a Callback Day cannot be calculated until it is used.”⁴³

19 Although Staff agrees with some aspects of PSP’s description of callbacks, Staff’s understanding of callbacks differs in at least two respects. First, Staff does not agree with PSP’s characterization of pilots burning callback days as earning an equal share while other pilots “worked more.”⁴⁴ As noted by PSP, because the association elects to pool its income, “each pilot who stands watch during his or her duty-period is paid the same *regardless of the number of assignments that each happens to work during that time. Even if some pilots work more assignments [. . .] the system is fair because each pilot works the same number of days on watch.*”⁴⁵ Understood in the context of the PSP bylaw income sharing formula, pilots burning callback days complete the same amount of work as other pilots because the callback pilots can claim the same number of days worked while on watch.⁴⁶ Even if a pilot burning callback works fewer assignments during a period relative to other pilots in the short term, PSP acknowledges that this outcome is not only expected, but also fair in the long term.⁴⁷ Furthermore, although a pilot burning callback days is not performing any new assignments, each callback day claimed represents the prior completion of an assignment that the pilot was otherwise not required to perform.⁴⁸

⁴³ Carlson, Exh. IC-4Tr at 6:4-5.

⁴⁴ Carlson, Exh. IC-4Tr at 5:9.

⁴⁵ Carlson, Exh. IC-4Tr at 2:21 – 3:2 (emphasis added).

⁴⁶ Khawaja, TR. Vol. III 188:21 – 189:4 (“Q: So PSP’s view regarding their payment is that their compensation is based upon duty days during a given month not based on the number of assignments worked by an individual pilot, thus no pilot receives income tied directly to the performance of a callback job. So that – you still agree with your testimony on that? A: I do.”).

⁴⁷ Carlson, Exh. IC-4Tr at 2:21 – 3:2.

⁴⁸ Carlson, Exh. IC-1T at 8:22-24 (explaining the pilots are not mandated to work when off-duty).

20

Second, Staff does not entirely agree with PSP’s statement that pilots’ burning callbacks results in a “cost” to PSP because a callback day only has value in the context of the PSP bylaws income sharing formula. While it is possible to structure a callback system to have a fixed value associated with a callback day,⁴⁹ PSP’s callback system operates as a function of PSP’s equal income share formula. However, the income sharing formula does not create an expectation of receiving a predetermined income, instead it entitles a pilot to an equal share of the association’s fees that are collected in a given period.⁵⁰ By extension, under the formula, no individual pilot receives income tied directly to the performance of a callback job.⁵¹ As such, the loss of revenue is not so much a “cost” associated with callbacks, but moreso the fact that pilots who are burning callbacks are not accepting assignments and thereby generating revenue for the association while still claiming an equal income share.⁵²

c. The Commission Should Reject PSP’s Proposed TAL Because it Improperly Includes Costs Intended to Recover Unrecorded Callback Liability

21

Based on its understanding of PSP’s bylaws and testimony, it is Staff’s opinion that including additional pilots into the revenue requirement through its proposed TAL to offset pilots’ burning callback days is unreasonable and would result in retroactive ratemaking and double recovery of costs associated with callback assignments. PSP agrees that all assignments are paid for when performed, but contends that the callback assignments did not

⁴⁹ Carlson, Exh. IC-34X at 17-18 (noting that Columbia River Bar Pilots receive \$2,000 for a callback day).

⁵⁰ Furthermore, although PSP has stated that the pilots should be compensated for “overtime,” PSP’s equal income sharing formula essentially precludes the availability of overtime. Norris, TR. Vol III. 228:12-21. Staff also maintains that the pilots as equity members of the association are not entitled to overtime given that they are not employees. Kermode, Exh. DPK-1Tr at 16:8-17.

⁵¹ Khawaja, TR. Vol. III 188:21 – 189:4.

⁵² Carlson, Exh. IC-1T at 10:17-21 (“Q: Do Callback Days create any liability for PSP? A: They do. Every pilot who uses a Callback Day is owed distribution from PSP revenues even though they are unavailable to move vessels. This increases the workload on remaining pilots while incrementally diminishing their earnings during the time the Callback Days are being used or Burned.”).

generate “additional income” beyond the tariff rates.⁵³ However, as Staff has argued, PSP already received tariff revenue when the vessel receiving the callback assignment paid for pilotage service.⁵⁴ There is no basis for the “additional income” that the pilots argue is required to make PSP whole; it is whole.

22 PSP’s revenue shortfall in the present arises from the fact that PSP distributed the income generated by the callback assignment to its members in the period it was collected instead of deferring the income for distribution in the period when the callback is claimed.⁵⁵ Had PSP deferred the income generated by the callback assignment to the period when the callback day was burned, there would be no need to increase the number of pilots included in the formula to set rates as proposed by PSP, because the deferred income would be available to offset the shortfall in revenue caused by pilots burning callback days. Having not deferred the original income associated with callback assignments, PSP now claims that there is a need to collect “additional income” based on the same previously completed callback assignments.⁵⁶ Staff maintains that including additional pilots in the rate equation to eliminate the loss of revenue potential caused by pilots burning callback days constitutes double recovery and retroactive ratemaking, because the same callback assignments are used to justify collection of past income as well as present increases to rates.⁵⁷ Consequently, the

⁵³ Carlson, Exh. IC-4Tr at 3:3-7 (“Importantly, when a pilot agrees to work an additional day to move a ship that would otherwise be delayed awaiting an on-duty pilot, additional labor is expended because the pilot will still work every day of his or her watch period, but there is no additional income to the association or to the pilot. It is true that the ship pays for pilotage service at the time it is rendered as Mr. Kermode states. But that is not *additional* income.”).

⁵⁴ Kermode, Exh. DPK-1Tr at 14:8-22.

⁵⁵ Kermode, Exh. DPK-1Tr at 15:1-14, 17:7 – 18:2.

⁵⁶ PSP’s testimony states that if pilots had only worked normal assignments rather than callback assignments, there would be no revenue shortfall, suggesting that the revenue shortfall (and corresponding request for additional revenue) is properly attributable to the prior callback assignments. See Carlson, Exh. IC-4Tr at 4:17-19 (“Thus if no pilots worked Callbacks, every pilot would work the same number of days on average each month and share equally in the net income of the association.”).

⁵⁷ *SFPP, LP v. FERC*, 967 F.3d 788, 801-02 (D.C. Cir. 2020) (“The rule against retroactive ratemaking prohibits the Commission from adjusting current rates to make up for a utility’s over- or under-collection in

Commission should not adopt PSP’s recommendation to include additional pilots in the revenue requirement by adopting its proposed TAL.

23 Although PSP may argue that it was unable to defer revenue when a callback assignment was performed because its bylaws require the association to distribute all service fees to the pilots at the end of a period, the bylaws are controlled by PSP’s membership. Under section 19.1 of PSP’s bylaws, the bylaws shall be amended if a proposed amendment receives a two-thirds majority vote of the pilot members.⁵⁸ PSP’s bylaws were amended as recently as November of 2018.⁵⁹

24 PSP may also contend that the loss of revenue potential caused by pilots burning callback days is unfair to those pilots who are continuing to accept assignments and generate revenue, insofar as the pilots have less of an opportunity to earn the DNI used to set rates. Staff disagrees for three reasons. First, as noted above, the DNI that is embedded into rates is a target, meaning that there is no guarantee that an individual pilot will earn the DNI used to set rates. As the Commission has previously stated:

Regulatory agencies need not, and do not guarantee that a utility will recover its authorized return. “A regulated [utility] has no constitutional right to a profit” and regulation does not even ensure that the regulated company will produce net revenues. *Jersey Cent. Power and Light Co. v. FERC*, 810 F.2d 1168, 1180-81 (D.C. Cir. 1987) (*en banc*); *see also Nat. Gas. Pipeline Co.* [315 U.S.] at 590. Indeed, a rate is not necessarily unlawful even if it results in the company operating at a loss so long as it gave the company the opportunity to operate at a profit when approved.⁶⁰

prior periods.[]. The rule against retroactive ratemaking is a ‘corollary’ of the filed rate doctrine, [] under which a regulated entity may not charge, or be forced by the Commission to charge, a rate different from the one on file with the Commission for a particular good or service.”) (internal quotation and citation omitted).

⁵⁸ vonBrandenfels, Exh. EVB-5X at 22.

⁵⁹ vonBrandenfels, Exh. EVB-5X at 23.

⁶⁰ *Wash. Utils. & Transp. Comm’n v. Pac. Power & Light Co.*, Dockets UE-140762 & UE-140617 & UE-131384 & UE-140094, Order 08, 7-9, ¶ 19 n.19 (Mar. 25, 2015).

25 Staff maintains that the prior Board tariffs funded every assignment, including
callbacks, as does Staff's proposed tariff. Even if pilots elect to use callbacks, PSP still has
the opportunity to earn a reasonable profit under Staff's proposed tariff. A pilot's choice to
use a callback day under PSP's bylaws, to not accept revenue generating assignments, but
still claim an equal distribution share, does not demonstrate that the tariff provides for
insufficient funding.

26 Second, as explained by Staff, PSP has already earned the tariff revenue associated
with callback assignments when the assignment was performed.⁶¹ However, because PSP
distributed the resulting income in the period that it was collected, rather than deferring the
income to the period when the callback day was burned, pilots effectively over-distributed
income in those prior periods when callbacks assignments were performed. Therefore,
without a change to the association's bylaws which require a total and equal distribution of
service fees, the unrecorded liability that exists for previous callback days would only
grow.⁶²

27 Third, the revenue generating shortfall is a foreseeable and logical consequence of
how PSP has chosen to keep its books and structure its compensatory days and income
pooling under its bylaws. If a pilot can burn a callback day in a future period in order to not
work assignments on a given day, but nevertheless receive a share of pooled income for that
day, then necessarily there will be fewer available pilots in the future period to perform
pilotage assignments and generate revenue. However, PSP has not implemented controls
that would allow it to manage pilot availability and avoid shortfalls from too many pilots

⁶¹ Kermode, Exh. DKP-1Tr at 14:13-22.

⁶² *See also* Kermode, Exh. DPK-1Tr at 18:4-15 (arguing that PSP's callback liability is overstated because it values callbacks based on the most current period's DNI, rather than the DNI in the period when the callback assignment that generated the callback day was performed).

burning too many callbacks prior to retirement. At hearing, PSP testified that while it may ask pilots not to take callback days, it has no power to compel a pilot to work if the pilot can expend a callback day.⁶³ PSP also testified that it recently removed the limitation in its operating rules that capped the number of callbacks that a pilot could carry over to another year at 60 callback days.⁶⁴ This escalating reliance on callbacks has resulted in a self-perpetuating cycle, where the burning of callbacks requires other pilots to work callback assignments:

Q. So while you had six pilots taking comp days and not working while on watch, you had two pilots earning comp days by working while off watch; right?

A. Yes.

Q. So, in part, wouldn't you agree that the callback system is self-perpetuating, whereby taking old – taking an old comp day can create the need to create a new comp day?

A. Yes.

Q. In fact –

A. Yes.

Q. In fact, looking at examples 1, 2, and 4, in this same response to the UTC data request [28 to PSP],⁶⁵ each of those days also has comp days taken and comp days earned on the same day; wouldn't you agree?

A. Yes.⁶⁶

28 Finally, apart from the fairness issue, Staff notes that increasing revenues does not, in fact, solve the self-perpetuating cycle of callback accumulation in the absence of additional licensed pilots. In the absence of licensing additional pilots, which can only be done by the Board, PSP's proposal will not actually reduce reliance on callbacks because the reduced pilot distribution is the result of pilots burning callback days and not accepting assignments. Furthermore, to the extent that PSP's proposed TAL is intended to incentivize pilots to accept callback assignments in the future, the lack of a specific callback tariff rate

⁶³ Carlson, TR. Vol. III 343:4-22.

⁶⁴ Carlson, Exh. IC-1T at 10:22 – 11:8.

⁶⁵ Carlson, Exh. IC-42X at 3-7.

⁶⁶ Carlson, TR. Vol. III 345:18 – 346:8.

suggests that the incentive will not be effective. That is, if the value of all assignments increases, then there is no incentive for pilots to perform callback assignments because they have the same value as other assignments. As such, PSP's proposed TAL would replicate conditions under the current tariff, only at higher rates.⁶⁷

29 In sum, the Commission should reject PSP's proposed TAL, and by extension its recommended number of pilots, because both are based on safety and policy determinations that are within the regulatory authority of the Board and because the inclusion of additional revenue based on the asserted callback liability is unreasonable and constitutes double recovery and retroactive ratemaking.

3. **The Commission Should Include Funding for One Administrative Pilot**

30 Staff argues that PSP has not demonstrated that the association's work is so specialized that it could not be done by someone other than a pilot. While the administration of pilotage service undoubtedly requires the acquired expertise of a pilot, PSP has not shown that all of the tasks performed by the Vice President are so specialized that they must be done by a fully licensed pilot, rather than under the supervision of one. For example, Staff notes that PSP has made presentations regarding pilotage issues through its attorneys before the Board.⁶⁸ Additionally, while there may have been additional administrative work in anticipation of the tariff filing, Staff does not agree that the work justifies embedding an additional administrative pilot position in rates given the temporary nature of the initial filing work.⁶⁹ Therefore, Staff recommends that the Commission only include one administrative pilot in rates.

⁶⁷ Kermode, TR. Vol IV 583:6-15.

⁶⁸ Carlson, Exh. IC-32X, Moore, Exh. MM-1Tr at 112:25 – 113:6.

⁶⁹ Sevall, Exh. SS-6T at 5:1-14 (noting that historical MOU between PSP and PSSOA funded one administrative pilot).

B. Distributable Net Income and Rate Design

31 Staff and PSP have proposed different methods for calculating an individual pilot's
DNI that will be multiplied by the number of pilots funded in the revenue requirement. PSP
recommends that the Commission establish a DNI of \$500,000 per pilot,⁷⁰ while Staff
recommends funding a DNI of \$400,855 per pilot.⁷¹

1. Legal Standards

32 As noted above, the Commission enjoys substantial deference with regard to setting
reasonable rates.⁷² However, the Washington Administrative Procedure Act prohibits
agencies from exercising their discretion in a manner that is arbitrary and capricious.⁷³
Arbitrary or capricious agency action is action that is willful, unreasoned, and taken without
regard to the attending facts and circumstances.⁷⁴ The existence of contradictory evidence or
the possibility of deriving different conclusions from the evidence does not render an
agency's decision arbitrary and capricious.⁷⁵ Instead, a court will review an agency's
decision to determine whether the agency reached its decision through a process of reason.⁷⁶
The D.C. Circuit Court of Appeals has explained that "[a] reasoned justification requires
more than absence of contrary evidence; it requires substantial evidence to support a
decision."⁷⁷

⁷⁰ Carlson, Exh. IC-1T at 18:10-19.

⁷¹ Sevall, Exh. SS-6T at 6:1-3.

⁷² *PacifiCorp v. Wash. Utils. & Transp. Com'n*, 194 Wn. App. at 588.

⁷³ RCW 34.05.570(3)(i).

⁷⁴ *Nw. Sportfishing Industry Ass'n v. Wash. Dept. of Ecology*, 172 Wn. App. 72, 90, 288 P.3d 677 (2012).

⁷⁵ *Id.*

⁷⁶ *Id.* at 91.

⁷⁷ *Settling Devotional Claimants v. Copyright Royalty*, 797 F.3d 1106, 1121 (D.C. Cir. 2015).

2. PSP has Presented Incomplete Evidence Regarding Pilotage District Comparability and Offered Conflicting Opinions Regarding Pilotage Comparability.

33 PSP has presented evidence regarding pilot income in other pilotage districts,⁷⁸ but has failed to provide complete information regarding what individual components are included in other districts' compensation. The individual components of pilot compensation are important for a comparative income analysis because income from other pilotage districts may require adjustment if it contains components that PSP considers expenses. PSP has acknowledged in its testimony that these comparisons and adjustments are relevant.⁷⁹

34 Staff issued several DRs to PSP to determine whether the income figures in different pilotage districts, that PSP asserted were comparable, contained the same components that are included in a PSP pilot's DNI.⁸⁰ While PSP provided some additional information in response to Staff's requests, several of PSP's responses stated that it either did not have the information for a particular district or that it was in the process of attempting to acquire that information.⁸¹ In the absence of that information, Staff maintains that PSP has not sufficiently demonstrated that the purportedly comparable pilotage district incomes are reasonably comparable, because PSP cannot show that the allegedly comparable incomes contain the same components.

35 Additionally, PSP has offered different, and in some instances, contradictory opinions on what factors are relevant for the purpose of comparing pilotage districts and

⁷⁸ Carlson, Exh. IC-3.

⁷⁹ Carlson, Exh. IC-1T at 17:23 – 18:4 (“Q: In presenting the pilot income presented in Exh. IC-3, did you make any adjustments to their net income to reach a level that is comparable to PSP’s net income calculation? A: Yes, I did. For each group that had an available financial statement, we examined their benefits and added the expenses of those benefits to the net income where PSP does not receive the same benefits or subtracted them from income if the other pilot group did not receive benefits PSP does receive.”).

⁸⁰ Carlson, Exh. IC-34X.

⁸¹ Carlson, Exh. IC-34X *passim*.

which pilotage districts are comparable. For example, Captain Carlson testified that “[t]he only major differences between the different districts are the number of pilots that are required to complete the work required of them, and the individual workloads performed by their pilots.”⁸² In response to data requests from Staff regarding national pilotage comparability, Captain Quick explained in part that:

Although there is certainly a way to make a fair comparison among harbor pilots, river pilots and bar pilots based upon work hours or other metrics, and ultimately there could be ways to make comparisons among all pilotage groups, there are in fact differences in the responsibilities of pilots on the east coast compared to the gulf states and west coast.

...

I also did not consider the income earned by the Great Lakes Pilots. They work seasonal schedules, and thus are not typically compared to state pilot associations.⁸³

36 Moreover, during his testimony at hearing, Captain Quick stated that he believed that “ship mix” was also a relevant consideration for pilotage district comparison.⁸⁴ Captain Quick further stated that he was not familiar with Captain Carlson’s analysis in this proceeding, and that he did not think that Lake Charles was a comparable pilotage district to the Puget Sound, contrary to Captain Carlson.⁸⁵ Finally, Captain Nielsen from the Columbia River Pilots responded to PMSA’s data request regarding pilotage district comparability by noting that “vessels, scenarios, traffic, weather, and water conditions are considerations that make the pilotage grounds similar.”⁸⁶

⁸² Carlson, Exh. IC-4Tr at 52:16-18. *But see* Carlson, Exh. IC-1T at 17:23 – 18:4 (explaining adjustment to pilotage income to account for differences between included income components).

⁸³ Quick, GQ-8X at 5. Additionally, Staff notes that while Captain Quick provided several DNI figures and other information in response to Staff’s data requests, for some responses he did not provide documentation that would allow Staff to verify his responses. *See e.g.* Quick, Exh. GQ-8X at 3, 5-6.

⁸⁴ Quick, TR. Vol. III 293:3-5.

⁸⁵ Quick, TR. Vol. III 291:15-17 (“Q: Are you familiar, Captain Quick, with Captain Carlson’s testimony and exhibits in this proceeding? A: No, I’m not.”); *compare* Quick, TR. Vol. III 292:5-11 (“I don’t think Lake Charles is a comparable port.”) *with* Carlson, Exh. IC-3 (including “last comparable net income” from Lake Charles Pilots).

⁸⁶ Nielsen, Exh. JN-2X at 3.

37 Based on the incomplete information regarding the asserted comparable districts and the differences in opinion between and among various PSP witnesses regarding what factors make a pilotage district comparable, the Commission should determine that PSP has not demonstrated that the other pilotage districts are comparable to the Puget Sound pilotage district and therefore these other districts should not be used as a benchmark for pilot compensation.

3. The Commission Should Reject PSP’s Proposed DNI Because it has not Explained how it Calculated its Proposed DNI.

38 Regardless of whether the pilotage district information is appropriate for comparison purposes, PSP has not provided any rationale as to how or why its proposed DNI is reasonable relative to other districts. PSP testified that “[b]ecause of the size of the overall increase required by a request that would result if we were to set our distributive net income (‘DNI’) level at as high as \$541,204, we are instead requesting a more conservative DNI of \$500,000.”⁸⁷ However, PSP has not explained why a DNI of \$500,000 is appropriate in light of the different pilotage district incomes that it has argued are comparable. In other words, PSP has not identified any method or analysis that it used to arrive at a DNI of \$500,000 per pilot for the Puget Sound based on the factual circumstances of comparable pilotage districts relative to the Puget Sound.

39 At hearing, Staff asked PSP how it determined to recommend a DNI of \$500,000:

Q. . . . And on lines 18 to 19, you made a recommendation of a DNI of \$500,000 for a full-time equivalent; correct?

A. Yes.

Q. Do you recall how you arrived at that number.

A. I think what we were trying to do when we set that at 500 was to be reasonable. To not shoot for that – the extreme high end, but not shoot for

⁸⁷ Carlson, Exh. IC-1T at 18:16-19.

the low end. I think we were just trying to be responsible when we shopped for 500.⁸⁸

40 PSP’s recommended DNI of \$500,000 is arbitrary and capricious in the absence of a factual basis and credible methodological evidence for recommending that number. In *American Great Lakes Ports Association v. Zukunft*, the district court considered in part whether the Coast Guard’s adoption of a 10 percent adjustment to pilot compensation was arbitrary and capricious.⁸⁹ During its rate-setting proceeding for Great Lakes pilots, the Coast Guard decided to set rates for pilots based on a comparison to Canadian Great Lakes pilots, but invited additional comment on whether American pilots’ compensation should be adjusted due to organizational differences between American and Canadian pilots.⁹⁰ At the conclusion of the proceeding, the Coast Guard determined to use a 10 percent adjustment, rather than not including an adjustment or using a higher adjustment of 25 or 37 percent.⁹¹

41 Examining the record, the court observed that while a 10 percent adjustment had been proposed by the Great Lakes Pilotage Advisory Committee (GLPAC), “the GLPAC statements offered no rational basis for a ten-percent adjustment, as opposed to some higher or lower figure.”⁹² The court further opined:

Faced with this record, the Coast Guard now argues that it felt that neither the pilotage associations nor the shipping industries comments were convincing and therefore it “decided to leave the ten percent adjustment intact.” []. Essentially, the Coast Guard argues that it was invoking the wisdom of King Solomon by promulgating a compromise number – however, unlike the Coast Guard, King Solomon was not subject to the Administrative Procedure Act [(APA)]. []. Rate setting is of course not an exact science and perfection is not mandatory. []. But the Coast Guard is obligated to make reasoned decisions supported by the written record before it. []. It does not do so when it selects a figure that is entirely detached from any data or analysis, but

⁸⁸ Carlson, TR. Vol. IV 385:14-23.

⁸⁹ 296 F.Supp.3d 27 (D.D.C. 2017).

⁹⁰ *Id.* at 44-46.

⁹¹ *Id.* at 46.

⁹² *Id.*

merely happens to fall within a range of figures proposed by the commenters.⁹³

42 The court explained that while rate-setting does not require perfect precision, it does require a rational explanation that was lacking because there was “no attempt to explain the factual basis” for the 10 percent adjustment and no evidence that the Coast Guard “relied on any relevant or credible methodological evidence whatsoever in arriving at this figure.”⁹⁴ The court ultimately held that “the Coast Guard arrived at the ten-percent adjustment without engaging in reasoned [decision-making], and therefore its decision was arbitrary and capricious in violation of the APA.”⁹⁵

43 Consequently, the Commission should not accept PSP’s recommended DNI because its reasoning for recommending that number, “[t]o not shoot for that – extreme high end, but not shoot for the low end,” is the same reasoning that the district court in *Zukunft* rejected as arbitrary and capricious.⁹⁶

4. The Commission Should Adopt Staff’s Recommended DNI, TAL, and Rate Design.

a. Staff’s Method of Calculating TAL and DNI Reasonably Relies on Historical Information Provided by the Board Adjusted for the Rate Effective Period

44 In order to determine an appropriate DNI per pilot, Staff first considered data contained in Annual Reports published by the Board.⁹⁷ Specifically, Staff considered five years of data from 2014 to 2018 regarding the average assignments performed per pilot and the actual distributable net income per pilot.⁹⁸ Based on the five-year average of the average

⁹³ *Id.* at 47.

⁹⁴ *Id.* at 47-48.

⁹⁵ *Id.* at 48.

⁹⁶ Carlson, TR. Vol. IV 385:20-22.

⁹⁷ Sevall, Exh. SS-2r2 at Sch. 2.2r.

⁹⁸ Sevall, Exh. SS-2r2 at Sch. 2.2r.

assignments per pilot, Staff recommended setting the TAL at 143.4.⁹⁹ Similarly, Staff used the five-year average of the actual distributable net income per pilot to recommend a DNI of \$400,855, after adjusting for inflation of the reported amounts to the current period.¹⁰⁰

45 Recent Coast Guard rate-setting proceedings for Great Lakes pilotage provide some support for Staff's approach to calculating DNI. On April 6, 2020, the Coast Guard published its Final Rule regarding rates for pilotage service on the Great Lakes.¹⁰¹ As part of establishing rates, the Coast Guard considered what level of pilot compensation was appropriate.¹⁰² The Coast Guard explained:

For the 2019 ratemaking, the Coast Guard did not have access to current [American Maritime Officers Union (AMOU)] contract data and our research did not yield a better benchmark; therefore, target pilot compensation was determined by taking the 2018 number and adjusting it for inflation.

For the 2020 ratemaking, the situation with regard to compensation benchmarks has not changed. The Coast Guard still lacks access to current AMOU contract data and, as discussed in prior rulemakings, the Coast Guard does not believe that other American or Canadian pilot compensation data is appropriate to use as a benchmark at this time. The Coast Guard, however, has determined that based on its experience over the past two ratemakings that the level of target pilot compensation for those years provides an appropriate level of compensation for American Great Lakes pilots. The Coast Guard therefore, will not, at this time, seek alternative benchmarks for target compensation and for 2020 and future ratemakings will instead simply adjust the amount of target pilot compensation for inflation.¹⁰³

46 Similar to the Coast Guard, Staff has calculated pilot DNI by adjusting prior compensation levels for inflation.¹⁰⁴ While Staff based its adjustment on an average of actual income, rather than a target income as done by the Coast Guard, Staff asserts that the actual DNI is a reasonable substitute because it reflects amounts that the pilots were in fact

⁹⁹ Sevall, Exh. SS-2r2 at Sch. 2.1r2.

¹⁰⁰ Sevall, Exh. SS-2r2 at Sch. 2.1r2, Sch. 2.3r.

¹⁰¹ Quick, Exh. GQ-7X.

¹⁰² Quick, Exh. GQ-7X at 4.

¹⁰³ Quick, Exh. GQ-7X at 4.

¹⁰⁴ Sevall, Exh. SS-2r2 at Sch. 2.1r2, Sch. 2.3r.

able to earn under prior conditions set by the Board.¹⁰⁵ Staff presumes that the prior Board rates were reasonable during the periods they were in effect.¹⁰⁶ Nevertheless, Staff believes that the Coast Guard’s approach to determining pilotage compensation by adjusting past compensation for present inflation provides some precedent for Staff’s proposed DNI calculation.

47 Staff maintains that its recommendations do not infringe on the authority of the Board to regulate pilotage service because the data it relied on for its recommendations is the product of tariff conditions previously set by the Board. Staff believes that the data from the Board implicitly incorporates prior policy determinations made by the Board in setting previous years’ tariffs, as well as other changes to the provision of pilotage service made by the Board while the tariff was frozen. As such, Staff’s reliance on Board reported data properly respects the division of regulatory authority between the Commission and the Board by deferring to Board policy decisions as reflected in actual outcomes under Board tariffs while allowing Staff to apply its expertise in rate-setting analysis to those outcomes.

b. Staff’s Rate Design Reasonably Distributes Tariff Costs Amongst All Ratepayer Classes and Reflects Risks Among Different Vessel Sizes

48 PSP and Staff’s proposed rate design consists of two primary components, a base tonnage charge and a service time charge, as well as several line items that correspond to

¹⁰⁵ Furthermore, the record does not show that PSP is experiencing any significant issues retaining pilots and attracting trainee pilots, such that PSP would require additional revenue to address a recruitment and retention problem. Carlson, TR. Vol IV 381:17 – 382:4 (stating that there have been no PSP pilots that have given up their pilotage licenses to seek work in another pilotage district). See also, Moreno, SM-5X at 14 (“It is my understanding that there are approximately twelve hundred state licensed pilots in the United States. In my twenty nine years of piloting I am aware of roughly ten pilots who have left their district for another pilotage district.”).

¹⁰⁶ *McCarthy Finance, Inc. v. Premera*, 182 Wn.2d 936, 942, 347 P.3d 872 (2015). However, Staff maintains that there is no presumption that the prior rates will be reasonable for the purpose of this rate-effective period at issue in this proceeding.

specific events.¹⁰⁷ Under the proposed rate design, the gross tonnage rate operates similar to a base rate, while the service time rate operations similar to a usage rate.¹⁰⁸ However, PSP and Staff's rate designs differ in that Staff's rate design recovers pilotage compensation primarily through the service time component, rather than tonnage charge.¹⁰⁹

49 Staff maintains that its proposed rate design reasonably allocates costs among ratepayers and adequately reflects risks. While it is true that smaller vessels will pay more under Staff's proposed rate design, larger ships still pay more than smaller ships, reflecting the additional risks presented in the movement of larger vessels.¹¹⁰ Furthermore, as stated by Staff, the service time charge provides additional compensation in instances where ships must be piloted slowly due to the ship's characteristics or mechanical trouble, as well as in circumstances when a ship requires more than one pilot to be moved safely.¹¹¹ Although PSP critiques Staff's rate design for failing to adequately address risks,¹¹² PSP has not provided a risk matrix or other metric by which to evaluate the relative risk of ship movements.¹¹³

50 Furthermore, Staff argues that recovering pilot compensation through the service time component of the tariff is appropriate for two reasons. First, recovering pilot compensation through the service time charge more fairly compensates pilots for the actual labor that a pilot expends providing pilotage service. Second, recovering pilot compensation through the service time charge mitigates the trend identified by Captain Moore, whereby

¹⁰⁷ Sevall, Exh. SS-1T at 18:10 – 19:18.

¹⁰⁸ Sevall, Exh. SS-1T at 19:13-16.

¹⁰⁹ Moreno, Exh. SM-2T at 2:5-16.

¹¹⁰ Sevall, Exh. SS-1T at 20:8-9.

¹¹¹ Sevall, Exh. SS-1T at 20:6-13.

¹¹² Moreno, Exh. SM-2T at 2:16-18.

¹¹³ Moreno, Exh. SM-10X at 21; Moreno, TR. Vol. IV 414:6-15.

increasing vessel size resulted in increasing tariff revenues even in the absence of rate increases.¹¹⁴

51 As such, Staff recommends that the Commission adopt its proposed DNI, TAL, and rate design.

IV. ADJUSTMENTS

A. The Commission Should Adopt Staff's Changes to PSP's Depreciation Adjustment

52 Staff maintains that the useful life approach is appropriate because it ensures that depreciation costs are evenly recovered over the entire period an asset is used in service. As described by Staff in a prior Commission order:

In accounting, an asset's useful life and its annual depreciation expense are intrinsically linked. The service life is the expected period from which []services are obtained from the use of the facility.¹¹⁵

Such an approach also prevents intergenerational inequity, in that future ratepayers will be required to pay a fair share of the depreciation expenses. That is, the useful life approach reduces the likelihood that future ratepayers will be required to pay for assets that they do not receive service from or avoid paying a fair share of depreciation while the asset is still in service because it has already been fully depreciated by previous ratepayers.

53 Staff's approach does not violate the matching principle. While Staff understands that the test year presented in this case ended on June 30, 2019, Staff also notes that the rates produced as a result of this proceeding will not go into effect until late 2020. To illustrate, assuming that PSP is correct that the pilot boat *Puget Sound* has a 20-year depreciable life that ends in Jan. 2020, then the *Puget Sound* will have been fully depreciated under PSP's

¹¹⁴ Moore, Exh. MM-1Tr at 13:2 – 27:23.

¹¹⁵ *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-152253, Order 12, 13 ¶ 35 (Sept. 1, 2016).

approach by the time revised pilotage rates are in effect. Although PSP argues that the *Puget Sound* still had six months of depreciable life at the end of the test period, PSP did not explain whether pilotage rates in effect during this rate-setting proceeding include collection of depreciation expenses related to the pilot boat. Given that PSP does not allege that there was any interruption in the depreciation of the *Puget Sound*, Staff infers that existing pilotage rates do include recovery of depreciation for the pilot boats.¹¹⁶ If so, then including depreciation costs for the *Puget Sound* into rates for the rate effective period would embed depreciation costs for an asset that is already fully depreciated for at least an additional year.¹¹⁷ As such, Staff's approach properly excludes expenses that have been recovered during the course of the rate-setting proceeding.

54 At hearing, Staff asked PSP about the remaining useful lives of its two pilot boats, the *Puget Sound* and the *Juan de Fuca*.¹¹⁸ PSP responded that it did not have any opinion on the remaining useful lives of the pilotage vessels.¹¹⁹ Although PSP cites to 46 C.F.R. § 382.3 for the premise that a 20-year depreciable life should be applied to its pilot boats, PSP has not argued that the regulation controls in this proceeding or that the pilot boats fall within the scope of that regulation.¹²⁰ As such, Staff adheres to its original recommendation that

¹¹⁶ Staff is unable to expressly confirm whether and to what extent depreciation expenses were incorporated into tariffs set by the Board given the “black box” nature of the rate-setting, and consequently whether existing tariff revenues have already recovered costs associated with pilot boat depreciation beyond the test year.

¹¹⁷ RCW 81.116.030(1) (“Any person with a substantial interest may file with the commission a revised tariff with an effective date no earlier than thirty days from the date of filing and no earlier than one year following the effective date the tariffs in effect at the time of filing were established.”).

¹¹⁸ Burton, TR. Vol. III 211:1-18.

¹¹⁹ Burton, TR. Vol. III 211:1-18.

¹²⁰ 46 C.F.R. § 382.1 - Scope (“The regulations in this part prescribe the type of information that shall be submitted to the Maritime Administration (MARAD) by operators interested in carrying bulk and packaged preference cargoes, and the method for calculating fair and reasonable rates for the carriage of dry (including packaged) and liquid bulk preference cargoes on U.S.-flag commercial vessels, except vessels engaged in liner trades, which is defined as service provided on an advertised schedule, giving relatively frequent sailings between specific U.S. ports or ranges and designated foreign ports or ranges.”)

based on conversations with the pilots a four year remaining life for the *Juan de Fuca* is reasonable.¹²¹

55 Based on the above, the Commission should adopt Staff’s recommended changes to PSP’s depreciation adjustment and calculate a revised asset cost of \$322,034 to be depreciated over four years as described in Staff’s testimony.

B. The Commission Should Reject PSP’s Transportation Expense Adjustment

56 PSP contests Staff’s removal of adjustment R-17 to its transportation expenses, which involves \$156,809 associated with projected costs derived from a three-month transportation study done by PSP.¹²² PSP argues that the three-month study provides a sufficient basis to infer transportation costs for an entire year.¹²³

57 Staff maintains that PSP has not demonstrated that it is reasonable to infer transportation costs for an entire year based on a three-month study. Although PSP states that its study has a 95% confidence rating, or 5% margin of error,¹²⁴ PSP subsequently clarified that the 95% confidence interval applied only to the three-month data set, not the entire year’s estimate of costs.¹²⁵ Staff also asked PSP to “explain how the study addressed seasonal variation and provide any supporting documentation and calculations relied upon for the conclusion.”¹²⁶ PSP did not provide any additional documentation or calculations to show how it accounted for seasonal variation as part of its transportation study.¹²⁷

Consequently, in the absence of a reasonable basis to determine that PSP’s projection

¹²¹ LaRue, Exh. AMCL-1Tr at 10:1-2.

¹²² Norris, Exh. JN-6T at 5:7-16.

¹²³ Norris, Exh. JN-6T at 7:5-11.

¹²⁴ Norris, Exh. JN-6T at 6:12-18.

¹²⁵ Norris, Exh. JN-10X at 5.

¹²⁶ Norris, Exh. JN-10X at 4.

¹²⁷ Additionally, Staff questions whether the costs included in PSP’s adjustment of \$156,809 are reasonable, given that they represent a 13 percent increase to transportation expense as compared to 2019, when the largest increase in transportation expenses over the past five years was just over one percent. LaRue, Exh. AMCL-13.

adequately accounts for potential variations in activity outside of the three-month test period, the Commission should remove PSP's proposed transportation adjustment as recommended by Staff.

C. The Commission Should Not Exclude the Tariff Costs Related to the Board's Self-Insurance Premium

58 PMSA argues that the Commission should not allow PSP to include \$150,000 associated with the legislature's 2019-2021 fiscal biennium appropriations related to the Board's self-insurance premium.¹²⁸ The Commission should disagree.

59 In May 2019, the legislature passed ESHB 1160, which provided for the transportation budget for the 2019-2021 fiscal biennium.¹²⁹ As part of the budget, the legislature appropriated \$3,125,000 for the Board for self-insurance liability expenditures, subject to two conditions on the Board:

(a) Annually depositing the first one hundred fifty thousand dollars collected through Puget Sound pilotage district pilotage tariffs into the pilotage account; and

(b) Assessing a self-insurance premium surcharge of sixteen dollars per pilotage assignment on vessels requiring pilotage in the Puget Sound pilotage district.¹³⁰

60 The Board subsequently promulgated WAC 363-116-301 to recognize the conditions of the legislature's appropriation:

With respect to the passage of Engrossed Substitute House Bill No. 1160, Section 108, the board of pilotage commissioners is appropriated three million one hundred twenty-five thousand dollars from the pilotage account state appropriation solely for self-insurance liability premium expenditures. This appropriation is contingent upon two stipulated conditions:

(1) The Puget Sound pilots shall pay to the board, from its tariffs, one hundred fifty thousand dollars annually on July 1, 2019, and July 1, 2020.

¹²⁸ Moore, Exh. MM-1Tr at 109:14 – 110:15.

¹²⁹ Moore, Exh. MM-52X.

¹³⁰ Moore, Exh. MM-52X at 5.

These amounts shall be deposited by the board into the pilotage account and used solely for the expenditure of self-insurance premiums; and

(2) A self-insurance premium surcharge of sixteen dollars shall be added to each Puget Sound pilotage assignment on all vessels requiring pilotage in the Puget Sound pilotage district. The Puget Sound pilots shall remit the total amount of such surcharges generated to the board by the tenth of each month. The surcharge shall be in effect from July 1, 2019, through June 30, 2021. These amounts shall be in addition to those fees to be paid to the board pursuant to subsection (1) of this section and shall be deposited by the board into the pilotage account solely for the expenditure of self-insurance premiums.

These two directives are in effect beginning May 16, 2019, through June 30, 2021.¹³¹

61 PMSA opposes including the \$150,000 in the revenue requirement, arguing “PSP should continue to pay its \$150,000 share of BPC self-insurance premiums out of its own tariff revenues.”¹³² However, the appropriations bill requires the Board, not PSP, to pay \$150,000 into the pilotage account.¹³³

62 Other than the insurance premium appropriation, the Board “is a non-appropriated regulatory body; it receives no state or federal revenues for its day to day operations.”¹³⁴ Instead, “[a]ll expenses [of the Board] are covered by pilot license fees, vessel, exemption fees, and vessel surcharges,” which indicates that the Board generally derives revenue through the pilotage tariffs.¹³⁵ For example, RCW 81.116.020(4) states in part that the Commission “must include a tariff surcharge to fund the stipend the board of pilotage commissioners is authorized to pay pilot trainees and to use in its pilot training program under RCW 88.16.035.” Therefore, the reference to recovery through the tariff in the

¹³¹ WAC 363-116-301.

¹³² Moore, Exh. MM-42T at 43:6-8.

¹³³ Furthermore, PSP was dismissed from the lawsuit involving the Board that PMSA argues resulted in the increased insurance premiums. Kermodé, Exh. DPK-3T at 4:16-17; Moore, Exh. MM-42T at 42:12-23.

¹³⁴ Kermodé, Exh. DPK-6 at 63.

¹³⁵ Kermodé, Exh. DPK-6 at 63-64.

appropriations bill is more reasonably interpreted as identifying the mechanism for the Board to recover the expense, rather than assigning such expenses to be borne solely by PSP. By extension, the Board's reference to PSP in WAC 363-116-301 should be interpreted as directing PSP, which provides services and receives revenues under the tariff, to comply with the legislature's appropriations conditions, rather than requiring PSP to bear the costs as an organization.

63 Consequently, the Commission should allow the \$150,000 related to the Board's self-insurance premium in the revenue requirement.

V. ADDITIONAL RECOMMENDATIONS

A. The Commission Should Require PSP to File Future Rate Cases Using Full Accrual Accounting Consistent With GAAP

64 Staff would like to clarify that it is only requesting the Commission direct PSP to submit future tariff filings in accordance with GAAP using full accrual accounting. Staff is not recommending that the Commission order PSP to adopt GAAP for its audited financial statements. However, given the relative size of PSP's operations, which involves gross revenue in excess of \$30 million dollars, the Commission should require PSP to submit financial information to the Commission using GAAP accounting, similar to other large companies regulated by the Commission, in order to give the Commission a clear understanding of the association's current financial position.¹³⁶

B. The Commission Should Order PSP to Initiate Discussion Regarding Transitions to a Fully Funded Pension Plan

65 As with its recommendation regarding GAAP, Staff is not recommending that the Commission order PSP to make any changes to its pension in this rate case. However, Staff

¹³⁶ Kermodé, Exh. DKP-1Tr at 15:16 – 16:6.

is concerned about the long-term viability of a pay-go pension system. PSP’s current pension system is an unfunded system, meaning that benefits are paid out of present operating expenses, rather than from returns on invested assets.¹³⁷ As explained in its testimony, Staff is concerned that the current unfunded pension¹³⁸ is subject to a potential business risk that will be borne by ratepayers under the status quo.¹³⁹ Therefore, Staff recommends that the Commission require PSP to explore alternatives to an unfunded plan through discussions with stakeholders such as Staff, PMSA, and Pacific Yacht Management.

C. The Commission Should Not Adopt a Rate Plan

66 Although Staff has not proposed a rate plan, PSP has proposed a three-year rate plan,¹⁴⁰ and PMSA has suggested phasing in Staff’s proposed rates, if adopted, over the same three-year period described by PSP.¹⁴¹ However, neither PSP nor PMSA has provided vessel assignment projections for years two and three of the rate effective period of the three-year rate plan. As explained above, under both PSP and Staff’s proposed method, the number of pilots to fund is determined by dividing the projected number of vessel assignments by a TAL. Therefore, in the absence of a vessel projection for years two and three of the rate plan, there does not appear to be a reasonable basis to determine the number of pilots to fund in the tariff, and by extension, the appropriate amount of TDNI to include in the revenue requirement.¹⁴² Finally, Staff is concerned that because RCW 81.116.030(1) limits the ability to file tariff revisions to “no earlier than one year following the effective

¹³⁷ Kermode, Exh. DPK-1Tr at 20:4-14.

¹³⁸ As of December 31, 2019, the projected benefit obligation for PSP’s pension program was estimated at \$124,400,000. See Kermode, Exh. DPK-2.

¹³⁹ Kermode, Exh. DPK-1Tr at 21:18 – 23:2.

¹⁴⁰ Burton, Exh. WTB-1Tr at 14:10-12.

¹⁴¹ Moore, Exh. MM-42T at 30:6-7.

¹⁴² Furthermore, Staff agrees with PSP that due to the uncertainty regarding the COVID-19 pandemic, “the size and speed of the recovery could take multiple paths and that changes to those projections are likely. Thus, rather than known and measurable changes, any attempted adjustments to the projections made in November 2019 would be nothing more than speculation about what will occur.” Khawaja, SK-3T at 14:16-20.

date of the tariffs in effect at the time of filing were established,” PSP’s successive tariff revisions for each year of the rate plan would effectively preclude further tariff revisions during the rate plan effective period.¹⁴³ As such, Staff recommends that the Commission not adopt a rate plan because the record does not provide a reasonable basis to calculate the required number of pilots for years two and three of the rate plan and implementing the rate plan as proposed by PSP would limit the Commission’s ability to make additional changes to the tariff during the rate plan effective period.

VI. CONCLUSION

67 The Commission should adopt Staff’s recommendations as articulated above, in its prefiled testimony, and at hearing.

Respectfully submitted,

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¹⁴³ See Burton, Exh. WTB-8, Burton, Exh. WTB-09, and Burton, Exh. WTB-10.