

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND PILOTS,

Respondent.

DOCKET NO.
TP-190976

INITIAL POST-HEARING BRIEF OF PUGET SOUND PILOTS

September 10, 2020

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I. PRELIMINARY STATEMENT

A. Introduction and summary

1 The Washington Legislature transferred the ratesetting authority for marine pilotage tariffs to the Commission with the overarching intent that it develop and apply a clear and well-defined ratemaking methodology in establishing pilotage rates. But unlike many other states, it established that authority without the benefit of clear, articulated standards that must be considered in establishing rates that are fair, just, reasonable and sufficient. The regulation of pilotage service and ratesetting in the public interest has existed in the United States for well over one hundred and fifty years¹ leading to a number of well-considered principles that should be met when establishing pilotage tariffs. In this case of first impression, Puget Sound Pilots (“PSP”) requests that the Commission recognize that in the public interest of maintaining a safe, competent, efficient and reliable pilotage service, fair, just, reasonable and sufficient rates must compensate pilots commensurate with their skill, training, experience, and workload at a level that will be sufficient to attract and retain highly skilled pilots based upon the income earned by pilots of similar qualifications. The Commission should also ensure pilot income that fairly compensates pilots for all of their contributions of expertise and professional service, and permits PSP to continue all of its operational and administrative functions as well as maintain adequate infrastructure. Because PSP’s proposal would accomplish each of these goals consistent with the public interest and without jeopardizing Washington’s position as an able competitor for waterborne commerce, PSP respectfully requests that the Commission approve its tariff and rate plan in this proceeding, adopt its proposed revenue requirement and rate design, and recognize the methodology proposed by PSP by which its revenue requirement was determined.

¹ See *Smith v. Swift*, 49 Mass. 329, 331 (1844)(addressing that the governor of Massachusetts had authority to appoint pilots and determine their fees; *Olsen v. Smith*, 195 U.S. 332, 341, 25 S. Ct. 52, 53, 49 L. Ed. 224 (1904)(addressing the authority of states to regulate pilotage and pilotage rates); *Anderson v. Pac. Coast S.S. Co.*, 225 U.S. 187, 189, 32 S. Ct. 626, 627, 56 L. Ed. 1047 (1912)(discussing state regulation of compulsory pilotage and pilotage rates in California).

B. Key proposals for resolution

2 The Commission has been asked to resolve a number of key issues on which PSP, PMSA and Staff diverge.² Those issues include, but are not limited to: (1) the ratesetting methodology by which a revenue requirement will be calculated; (2) the appropriate policies to be applied in handling issues in the transition from the “black box” ratesetting of the BPC to the objective regulatory ratesetting doctrines applied by the Commission; (3) the treatment of various expense items adjustments proposed by Staff; and (4) the appropriate policies to be advanced in rate design. PSP and Staff agree on a formula by which the revenue requirement should be determined, but not the methodology by which its individual elements should be calculated, while PMSA requests the Commission approve alternative methodologies.

i. Total Distributable Net Income Factors

3 The largest and most significant component of any pilotage revenue requirement is the compensation to pilots for their contribution to the overall pilotage service, including the direct provision of service to vessels, their operational and administrative contributions, and their career-long dedication to expert shiphandling and knowledge of local pilotage waters in the pilotage district. Thus, the two most consequential elements of the revenue requirement that the Commission should determine are the number of pilots to be funded in the rate year (the “implied pilots count”) and the distributable net income projection that should be included in the revenue requirement for each of those pilots (the “Distributable Net Income” projection).

4 PSP proposes that the Commission consider not just the number of pilots that were licensed in the past and their average workload in determining the number of pilots that are needed, but reach an independent determination as to the number of pilots that are required to move ships on time under the traditional pilot’s rotation schedule followed by PSP. By doing so, the Commission will safeguard pilotage in Washington against the attrition due to early retirements and candidates who opt to train elsewhere that can result from inadequate income, as well as the diminished safety conditions such attrition would create, by establishing rates that compensate

² Pacific Yacht Management asserted no positions on any of the primary issues addressed in this brief.

pilot association members' professional service contributions at prevailing income levels, with additional compensation for work performed by off-watch pilots.

ii. Transition issues

a. The appropriate treatment of the accrued unfunded Callback Day liability and the prospective funding of Callback assignments on a going forward basis

5 The Commission should also determine how to address PSP's accumulated Callback Day liability in rates in two ways. First, the Commission should find that the accumulated Callback Days do not represent a double payment, and are instead a transition issue that results from a strikingly different ratemaking process. Second, on a going-forward basis, the Commission should acknowledge that Callbacks represent additional work performed by pilots as a result of staffing controlled by the BPC at levels below peak demand. By funding pilots at a peak (or near-peak) demand level, the Commission will ensure that additional compensation for this work is included in the revenue requirement and that funding occurs at the time the assignment is performed.

b. Preservation and discussion of the pilot pension by interested parties

6 The mutually negotiated pension under which PSP currently operates has also been made the subject of this proceeding. PSP's long-term liabilities under the pension exist because industry, PSP and the BPC agreed to them and the Commission should continue to fund them. After this proceeding, any change to the pension system should only be considered after further engagement by all stakeholders. Thus, PSP is more than willing to accept Staff's recommendation that comprehensive discussion take place regarding possible changes without jeopardizing the current pensioners' and members accrued benefits, while PMSA's position that the deferred compensation pension should not be funded "or externalized" in rates should be summarily rejected.

iii. Expenses

7 With respect to PSP's operational expenses, PSP and Staff largely concur on the allowed expenses and adjustments, with two exceptions addressed here. PSP contests Staff's reduction of

PSP’s pro forma adjustments to ground transportation expenses as well as Staff’s adjustment to PSP’s depreciation schedules. PMSA, instead, asserts that only those expenses it unilaterally deems “essential” should be included in the revenue requirement, and labels a number of PSP’s actual expenses that were uncontested by Staff as “non-essential.” The Commission should reject PMSA’s simplistic characterization of these expenses and accept all categories of expense included by PSP in its pro forma statement of expenses.

iv. Rate Design

8 Finally, PSP used the opportunity posed by this first general rate proceeding to propose a new rate design that replaced certain features of the current BPC tariff in favor of an updated rate design that tempered some of the huge disparity in the rates disparately sized vessels are assessed under the current tariff structure. Staff appears to agree with the overall tariff structure, but applies to it certain policies that fail to fully recognize the justifications for why larger vessels are expected to pay more, resulting in smaller vessels paying a disproportionate higher share of the cost of service. The Commission should therefore reject Staff’s rate design scheme and approve a tariff that utilizes the principles PSP sponsors.

II. LEGAL STANDARDS

9 The ultimate outcome of a general rate proceeding must be prospective rates that are fair, just, reasonable, and sufficient. This means the Commission must adopt “rates that are *fair* to customers and to the Company’s owners; *just* in the sense of being based solely on the record developed in a rate proceeding; *reasonable* in light of the range of possible outcomes supported by the evidence; and *sufficient* to meet the needs of the Company to cover its expenses and attract necessary capital on reasonable terms.”³

10 Rates that are sufficient permit a public service company to earn rates that will enable it to earn a return that falls with the “zone of reasonableness” determined by the rate of return for companies with comparable corresponding risks, and assess whether the rate of return is sufficient to assure

³ *WUTC v. Avista Corp.*, Dkts. UE160228 and UG 160229, Order 07, ¶ 49 (Feb. 27, 2017)(emphasis added).

investor confidence in the firm’s capital structure and to maintain creditworthiness and ability to attract capital on reasonable terms.⁴

11 Although these standards may vary in their application to different industries, they apply equally to ratesetting for pilotage service. For example, the Florida court of appeals concluded that “[t]he difference between the regulation of pilotage rates and those of other ‘utilities’ is primarily the difference between setting rates of return for highly capital intensive businesses such as those providing electricity, telephone or water and a business/profession which is essentially service oriented.”⁵

12 Courts and ratesetting authorities have also found that in order to serve the public interest, pilotage rates “must provide a reasonable net personal income to the pilot in keeping with their skills, training, experience and the conditions under which their work must be performed” and “enable the pilots to provide and maintain sufficient stations, boats and communication facilities with personnel to man them.”⁶ The public interest also requires that pilot rates are sufficient to ensure that appropriate staffing is possible in order to provide a safe and reliable pilotage service without delays.⁷ Thus, rates should ensure that pilot income is objectively sufficient to attract candidates and avoid attrition of licensed pilots.

III. RATEMAKING METHODOLOGY

13 The most fundamental step the Commission should take in this proceeding is to approve a ratemaking methodology by which revenue sufficiency may be measured and future tariff submissions are guided. Although the parties disagree about various inputs and benchmarks to be considered in the overall revenue requirement which were described by Captain George Quick,⁸

⁴ *People's Org. for Washington Energy Res. v. Washington Utilities & Transp. Comm'n*, 104 Wn.2d 798, 811, 711 P.2d 319, 327 (1985); *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 88 S. Ct. 1344, 20 L. Ed. 2d 312 (1968).

⁵ *S. Florida Cargo Carriers Ass'n, Inc. v. State, Dep't of Bus. & Prof'l Regulation*, 738 So. 2d 391, 397 (Fla. Dist. Ct. App. 1999).

⁶ *Hendrix v. Louisiana Pub. Serv. Comm'n*, 262 La. 420, 438, 263 So. 2d 343, 349 (La. 1972).

⁷ *See Am. Great Lakes Ports Ass'n v. Schultz*, 962 F.3d 510, 517 (D.C. Cir. 2020)(holding that peak staffing model furthered safe pilotage which is in the public interest); *S. Florida Cargo Carriers Ass'n, Inc. v. State, Dep't of Bus. & Prof'l Regulation*, 738 So. 2d 391, 400 (Fla. Dist. Ct. App. 1999)(holding that the public interest in having qualified pilots available to respond promptly to vessels needing their service is the most important factor and that the average net income of pilots is the single most important item that will be impacted by a rate change).

⁸ Exh. GQ-5T. 2: 14-16.

PSP and Staff appear to have reached consensus on the basic revenue requirement formula for establishing marine pilotage rates at the Commission of $RR = Exp + Dep + Int + (T)DNI$.⁹

14 PMSA's witness, John Ramirez, did testify that a return on rate base methodology should apply for marine pilotage, but the label is where any similarities end. Mr. Ramirez offered an altogether anomalous view of that methodology, which Captain Quick characterized as "...lacking in any accepted national pilotage ratemaking adherence"¹⁰ and which Staff witness Danny Kermode pointed out in his Cross-Answering testimony was riddled with misperceptions about some basic precepts of return on rate base methodologies including Mr. Ramirez's incorrect premise that that rate base includes "capital costs such as interest on debt and return on equity."¹¹

15 In summary, Ramirez predicates his analysis on a return on rate base methodology recommendation identifying two components of his anticipated return: 1) treatment of a fair return on pilotage labor/services as a salary expense; and 2) a fair return on equity capital. Both such components as presented by Mr. Ramirez were thoroughly distinguished/discredited by Mr. Kermode.

16 As to the first Ramirez component, both Mr. Kermode and PSP's expert Dr. Khawaja pointed out some fundamental flaws in Mr. Ramirez's analytical construct that invalidate his rationale on its face. In settling on an artificially low (and inaccurate) imputed assessment of his fair return on pilotage labor of \$162,000, Mr. Ramirez assumed an "excess profit" of close to \$250,000 per pilot based on DNI reported by PSP in its 2018 audited Financial Statement. Instead of his inaccurately derived amount, had Mr. Ramirez actually used even the staff's recommended (T)DNI figure of just over \$400,000 per year for pilotage labor, his own return on investment calculation would decline from roughly 62% to "to near zero."¹²

⁹ Exh. DPK-1T. 7, where RR=Revenue Requirement; Exp.=General and Operating Expenses (inc. taxes other than income); Dep.=Depreciation Expense; Int.=Interest; TDNI=Total Distributable Net Income.

¹⁰ Exh. GQ-5T, 3:22-23.

¹¹ Exh. DPK-3T. 8; JCR-1Tr2. 5: 24. fn. 2.

¹² Exh. SK-3T, 14:2.

17 As to the concept of a “fair return on pilotage labor,” Staff correctly admonished against comparing pilot labor to wage laborers under an employer-employee relationship:

Regulation must recognize the reality of the business form used by pilots to conduct business and not attempt to impose an imaginary business structure for the convenience of moving pilot earnings from net income to a labor expense. Therefore, the Commission should not rely on Mr. Ramirez’s analysis regarding a fair return on labor because it fails to properly acknowledge PSP’s structure as an association of independent contractors and does not explain why a comparison to the 90th percentile of BLS wage data is reasonable.¹³

Further, as noted by Mr. Kermode, “[t]he distributions received by the pilots are not payment for employee labor, but instead, earnings from self-employment.”¹⁴

18 Ironically, even PMSA’s own primary witness, Captain Moore, contradicted Ramirez’s equation of pilotage service to employment in his Cross Answering testimony, where he observes:

“[p]ilots are not employees, they are all partners and co-owners...”¹⁵

19 On cross examination, Mr. Ramirez steadfastly doubled-down on that imaginary business structure, by disputing that partnership owners receive distributions in lieu of “salary,” and that therefore imputing pilotage income as “salary expense” was fully appropriate because they are “providing labor.”¹⁶ Such testimony of course completely ignores reality, the form of the pilot business entity and even challenges the propriety of federal income tax reporting for partnerships, sole proprietorships and K-1 income schedules where business owners duly reflect income distribution from the business entity despite receiving no “salary.”¹⁷

20 Mr. Kermode was even more pointed in his critique of Mr. Ramirez’s return on equity calculation:

...Mr. Ramirez’s approach violates the ratemaking principle that requires an investor only receive a return on actual invested capital that has been dedicated to the provision of the regulated public services and not its fair market value.

Mr. Ramirez computes his equity amount based on the three-year average earnings of a pilot multiplied by the number of pilots. His calculation doesn’t

¹³ Exh. DPK-3T, 18:10-16.

¹⁴ Exh. DPK-3T, 17.

¹⁵ Exh. MM-42T, 6:3,4.

¹⁶ Ramirez TR. 438:9.

¹⁷ Ramirez TR. 438:1-10.

recognize the value of the original contribution when a pilot bought in to PSP nor does it reflect the impact of PSP's off-balance sheet liabilities.

Additionally, by not using PSP's reported financial equity balance and ignoring its unrecorded liability for call backs, Mr. Ramirez's equity valuation exceeds the pilot's actual equity investment by over \$20 million."¹⁸

21 PSP joins the Staff in not recommending reliance on any of Mr. Ramirez's ratemaking analysis, indeed, in advocating its rejection in toto. Due to the numerous patent errors in his fundamental assumptions,¹⁹ any such misplaced reliance would undoubtedly lead, both quantitatively and conceptually, to wholly misguided outcomes and results in this proceeding.

IV. TOTAL DISTRIBUTABLE NET INCOME

A. Policy considerations should drive a methodology for determining pilot earnings

22 As discussed above, because pilots earn income based upon a share of the distributable net income earned by PSP rather than a salary, in order to establish fair, just, reasonable and sufficient pilotage rates, the Commission should determine the value of the services to be contributed by PSP's members in the rate year and include in the revenue requirement an amount sufficient to permit pilots an opportunity to earn fair compensation. This portion of the revenue requirement, labeled the "Total Distributable Net Income" ("TDNI") could theoretically be calculated any number of ways. In establishing a methodology that is fair, and which will result in sufficient income without achieving unintentional unjust results, the Commission should consider the history and nature of pilotage and the policies that should be applied so that the value of the pilots' contribution of labor included in the revenue requirement is soundly derived.

23 First, it is important that the Commission acknowledge that pilotage associations are "a unique institution and must be judged as such."²⁰ As noted by the U.S. Supreme Court, pilot associations were created to replace the disadvantages of a competitive system, which created sharp rivalries, led to precarious earnings, and frequently left ships without an available pilot. With a

¹⁸ Exh. DPK-3T, 15: 5-14.

¹⁹ E.g., his statement that operating ratio methodologies are more reflective of and appropriate to capital-intensive industries and rate base returns should include returns on debt and all equity whether used for regulated service.

²⁰ *Kotch v. Bd. of River Port Pilot Comm'rs for Port of New Orleans*, 330 U.S. 552, 557, 67 S. Ct. 910, 913, 91 L. Ed. 1093 (1947).

coordinated system that increased pilot availability for the benefit of the ships, the ports, and the pilots themselves, and ensured consistent and predictable earnings for pilots.²¹

24 While pilot associations promote efficiency and reliability through better organization, the form of organization as a voluntary association is unique as well. Pilot associations have long relied upon a work schedule by which pilots receive assignments on a rotation system and thereby share in the net revenue of the association based upon the number of days the pilot was active, which the Supreme Court held protects pilots and pilot associations from liability for the acts of pilot association members.²²

25 Indeed, as owner/operators of PSP, pilots are not compelled to perform an indefinite amount of work for the Association or for ship owners, nor should they be. Instead, each member is expected to be available for assignments during each scheduled work day according to PSP's watch schedule, which averages 181 days on-watch per year.²³ During those 181 days, and based upon a strict rotation system, pilots perform as many assignments as they are called upon to work.²⁴ The number of assignments each pilot performs while on-watch will vary based upon the number of assignments that occur during a watch period, the pilot's license level, the timing of those assignments within the watch period, the number of harbor shifts that can be performed, and the other responsibilities each pilot performs in carrying out the duties of PSP's pilotage service. But pilots should not be expected to work on-call 365 days a year, and are not obligated to accept ship assignments during their off-watch respite period.

²¹ *Id.* at 561 (internal citation omitted).

²² *Guy v. Donald*, 203 U.S. 399, 404, 27 S. Ct. 63, 63, 51 L. Ed. 245 (1906) (“By their agreement they take turns in boarding vessels required by law to take a pilot, and the fees, which otherwise would be paid to the pilot that boarded the vessel, are paid, except in cases of national vessels and disputed bills, to the association upon bills made out by it, and go into a common fund, from which the association pays the expenses of the business, including office rent. At the time of the accident the net profits were divided according to the number of days the several pilots were upon the active list.”); *See also Krause Marine Towing Corp. v. Ass'n of Maryland Pilots*, 205 Md. App. 194, 219, 44 A.3d 1043, 1059 (Md. 2012) (noting that use of a rotation system ensures that pilots receive consistent work and assists with avoiding fatigue).

²³ Exh. EVB-1T. 8: 1 – 4 (discussing the “day for day” watch schedule); Exh. IC-4Tr. 19: 2 - 5 (addressing the number of duty days per year).

²⁴ Exh. IC-4Tr. 18: 15 - 19: 5.

26 In recognizing these core features of pilotage associations, the Commission should thus establish a revenue requirement in the public interest of maintaining a competent, efficient and reliable pilotage service compensation that respects pilots’ work schedules and rotation system. In doing so, the Commission should ensure that every licensed pilot has an opportunity to earn fair compensation for the services they perform on scheduled work days²⁵ and that additional pilotage service performed above that baseline is also compensated. If the revenue requirement is set too low, and pilots cannot earn at the prevailing income level, this can lead to attrition and loss of pilot candidates to other districts with more appropriate compensation levels, such as has already occurred with multiple candidates who declined positions in the BPC training program in order to train to become pilots in San Francisco.²⁶ Further, if the result of performing additional off-watch assignments is reduced compensation in the future, pilots would be disincentivized to work, which can also attribute to attrition.²⁷

B. Only PSP’s proposal determines the fair value of pilotage service to be performed in the rate year

27 Unlike the proposals by Staff and PMSA, PSP’s revenue requirement accomplishes each of these goals. PSP first determined the value of a full-time pilot’s labor through a comparison to earnings of pilots in other districts, which is consistent with analogous Commission precedent and the pilotage ratesetting principles followed by other jurisdictions. Then, PSP determined the number of pilots needed in system that would recognize the pilot work schedule by treating on-watch work as the full-time equivalent (“FTE”) workload, and off-watch work as additional work. Taking these two steps together, the Commission can fairly establish the value of the labor being performed in the rate year. And whether the income from that labor is distributed to fewer pilots who each worked more than full-time to earn it, or the number of pilots actually needed under the model, each will still be fairly compensated for the work performed.

²⁵ To be clear, PSP means that the average net income per PSP member should achieve this level.

²⁶ Exh. EVB-1T. 22 – 23:2; Exh. SM-1T. 5: 19 – 6: 16.

²⁷ See Great Lakes Pilotage Rates—2016 Annual Review and Changes to Methodology, 81 FR 11908-01 (Great Lakes pilots were suffering considerable attrition due to high work hours without adequate compensation).

C. Distributable Net Income per pilot

28 As noted, pilotage is a professional service-oriented industry in which the primary investment from its owners and investors is a contribution of labor rather than the significant operational expenses required of transportation companies or the capital investment required of utilities. Thus, unique among industries for which the Commission establishes rates, there is no pilot labor-associated operating expense from which the Commission may assess the results of operations in a historic test year. Consequently, rather than a focus on the appropriate rate of return on their capital contributions or expenses, the primary determinant in establishing that pilotage rates are fair, just, reasonable and sufficient is the net income the pilot association should collect and distribute to its members for their overall contribution to the pilotage service.

29 While PSP and Staff offer conflicting proposals as to how DNI should be determined, PSP concurs with Staff that DNI represent a return on pilots' labor. Mr. Kermode may have described that concept best when he stated:

DNI is the projected amount of net income each pilot would earn if the total number of implied pilots was active and providing pilotage services. The Commission should not consider DNI as a salary or wage because each pilot is an independent business entity and not an employee of PSP. Additionally, DNI is not a guaranteed payment. As with all Commission-regulated, investor-owned companies, the pilots bear the risk of the enterprise, reaping the benefit when there are excess earnings and bearing the cost when there are insufficient earnings.²⁸

Mr. Kermode expanded on this concept further, describing it in cross-answering testimony as a "fair return on pilot labor."²⁹

30 There also appears to be agreement between PSP and Staff that DNI represents the amount that should be distributed to pilots in the present year for their work performed while on-watch. Here, Mr. Kermode explained his thinking at the hearing, testifying:

Q. Mr. Kermode, do you agree that precipitous transitions on issues like pensions and callbacks are something that we should avoid in this first rate case with [the] UTC?

A. Well, pensions I would look at. I testified on callbacks. Callbacks are what they are. What I see was that the -- I just -- was it \$5 million liability? That's \$5

²⁸ Exh. DPK 1T. 11: 12 – 19.

²⁹ Exh. DPK-3T. 18: 18 – 19: 6.

million that has flowed through to the pilots over those decades. The pilots got that money. Now, the -- now it is time to pay the piper. Now, the -- I recognize because they are on a cash basis that they didn't recognize that they were building up this liability. But -- but they did. And so -- I -- I guess I'm still -- as staff I would have to say no. I believe that -- go ahead, allow the callbacks to reverse as they should. The new callbacks coming in will help mitigate part of it, and slowly start paying that back. And -- and by doing that, by -- by doing the approach that I suggest with the liability and reduction of -- of the revenue, it actually adjusts the DNI. That's why -- that's one of the reasons we decided to call it the distributable net income. Because it might have had a greater income, but the question is how much should be distributed? Well, the -- using the liability method for callbacks, it actually reduces the distributable income to the correct amount and does not over distribute those amounts related to comp time.³⁰

Because Staff has recommended that all liability associated with Callback Days be accounted for on an accrual basis and the net income associated with Callback assignments be reserved to fund the liability when it is incurred, the remaining net income to be distributed would all be earned from assignments performed while on-watch.³¹ This is actually very much akin to the “full-time equivalent” standard by which PSP believes pilots’ work should be measured and their DNI earned.³²

i. Appropriate pilot income levels are established by comparison to the income earned by other pilots

31 Where PSP and Staff significantly differ however, is the method by which the Commission should determine the value for DNI. PSP proposes that the reasonableness and sufficiency of the DNI amount be objectively determined through consideration of the income earned by other state-regulated pilots who perform similar services and carry similar risk. PSP’s position is well supported by the broad ratesetting standards that the Commission “must in each rate case endeavor to not only assure fair prices and service to customers, but also to assure that regulated utilities earn enough to remain in business.”³³ As addressed below, when pilot income is insufficient, it jeopardizes the ability to attract and retain pilots, and ultimately diminishes safety.

³⁰ Kermode, TR. 576: 12 – 577: 14 (emphasis added).

³¹ Sevall, TR. 623: 2 – 15 (affirming that Staff’s goal was to fund through a callback premium sufficient income that pilots would earn DNI after distribution or reserving income for Callbacks under an accrual accounting basis).

³² Yet, as discussed below, Staff’s proposed number of pilots and assignment level do not actually accomplish the policies described by Mr. Kermode with respect to the distributable net income.

³³ *People's Org. for Washington Energy Res. v. Washington Utilities & Transp. Comm'n*, 104 Wn.2d 798, 808, 711 P.2d 319, 326 (1985)

Moreover, as a return on the investment of labor by PSP’s members, the Commission should consider DNI a return on investment like any other, and the reasonable range of such returns must be considered based upon an analysis of the rate of return for firms with corresponding risk (the income earned by members of other state pilot associations), whether the rate of return is sufficient to assure confidence in the firm’s capital structure, and to maintain creditworthiness and the ability to attract capital.³⁴

32 Conversely, Staff proposes a DNI figure based upon the normalized net income earned by pilots during a five-year period, marked up through a CPI inflation adjustment without any independent or objective consideration and evaluation of the sufficiency of the amount.³⁵ When considering the potential ramifications of insufficient pilot income, the legal standards for determining an appropriate rate of return, and the Commission’s consistent application of objective standards in determining the appropriate income level of owners and executives, Staff’s proposal should be rejected and PSP’s proposal approved.

c. Staff’s proposed methodology treats pilot labor as an expense and ignores benchmark standards that prevent attrition

33 As noted, Staff proposes that the value of DNI determined by use historic average pilot net income, normalized over a five-year period after adjusted to present value for inflation.³⁶ Mr. Sevall justifies this “historical average approach with known and measurable adjustments” approach as “a solid method that this Commission has employed.”³⁷ Despite Mr. Sevall’s conclusory justifications for his approach, his recommendation inappropriately treats DNI as an expense to be normalized and projected based upon the amount incurred in a historic test period.³⁸ This approach is inconsistent with Mr. Kermode’s recognition that DNI represents a “return” on labor that he affirmed it to be.

³⁴ See *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603, 64 S. Ct. 281, 288, 88 L. Ed. 333 (1944); Exh. SK-3T. 12: 1 – 20.

³⁵ Exh. SS-1T. 15: 13 – 16: 3; Exh. SS-2r2, Schedule 2.3.

³⁶ *Id.*

³⁷ Sevall, TR. 646: 8 – 9.

³⁸ *WUTC v. Avista*, Dkts. UE-090134, UG-090135, & UG-060518, Order 10, ¶¶ 41-43 (Sep. 4, 2009).

34 Moreover, Staff’s recommended methodology for establishing DNI relies upon circular logic, erroneously presupposing the sufficiency of the normalized test year income without use of any external or objective benchmark. Relying on such an approach, pilot income could either well exceed a reasonable value, or in this case, be permitted to fall substantially below the prevailing earnings of other pilotage districts. In PSP’s case, as demonstrated, not only has pilot income fallen well behind the level that most state pilots earn for their labor, but Staff inadvertently recommends that the statutory inability to recover increased expenses during the legislative rate freeze for 2017 and 2018 be codified into the future. As noted by Linda Styrk, PSP experienced increased operating expenses during that period which it was unable to recoup through rate adjustments.³⁹ Thus, by failing to develop any benchmark for sufficiency, Staff also insures that these multiple adverse impacts of the rate freeze on net income be perpetuated in a new tariff.

35 As noted, when pilot income is insufficient, it can lead to attrition through early retirement and/or an inability to attract new pilots, perpetuating understaffing, which can reduce safety by encouraging pilots to work excessive amounts. Indeed, the Great Lakes pilots recently observed significant attrition as a result of insufficient income, including a tariff-funded pension, much like the Alaska Marine Pilots experienced in the mid-2000s when Capt. Moreno left that district to start over in the Puget Sound.⁴⁰ In fact, the U.S. Coast Guard specifically found, and the D.C. Circuit affirmed, that insufficient pilotage income leads to pilot attrition and, in turn, shipping delays and reductions in safety.⁴¹ Thus, Staff’s recommended approach inherently fails to meet legal standards for ratesetting by considering whether the proposed DNI amount is sufficient to ensure PSP will objectively be able to attract and retain pilots based upon the prevailing earnings of other pilots.

d. Staff’s recommended approach is also inconsistent with broadly adopted pilotage ratesetting principles

³⁹ Exh. LS-1T. 3: 19 – 23.

⁴⁰ Exh. SM-1T. 4: 8 – 5: 3.

⁴¹ Great Lakes Pilotage Rates—2016 Annual Review and Changes to Methodology, 81 FR 11908-01; *Am. Great Lakes Ports Ass’n v. Schultz*, 962 F.3d 510, 516 (D.C. Cir. 2020).

36 Staff's approach would also result in a ratesetting methodology that is unique among pilotage ratesetting authorities, as Mr. Sevall acknowledged,⁴² and is inconsistent with Commission precedent regarding the appropriate treatment of owner/executive compensation.

37 As has been emphasized in this proceeding, pilot income is a return on pilot labor contributed by PSP's members. Thus, DNI represents both a return on the investment of services provided by its owners that should acknowledge the risk pilots operating in an association assume, and which can be valued based upon the prevailing income levels earned by pilots in other pilotage districts. In fact, as Capt. George Quick testified, determining the income pilots should earn by use of comparable pilot income information is an essential criterion relied upon in setting marine pilot income by ratesetting authorities across the country.⁴³ While reliance upon comparable pilot income is sometimes statutorily required, it has also been considered an important factor in ratesetting in states where pilotage rates are established by public utility commissions whose statutory authority does not expressly require such consideration.

38 For example, the Oregon Board of Maritime Pilots, which operates as part of the Oregon Public Utilities Commission, established by rule that pilotage income earned in the Puget Sound and San Francisco districts should be considered when establishing rates in Oregon.⁴⁴ It further required by order that parity exist among the various Oregon pilot associations.⁴⁵

39 Additionally, when the Maryland Public Service Commission first established pilotage rates under newly established authority in 1985, it was confronted with a similar question about whether the income pilots earn in other jurisdictions should be considered in setting pilotage rates.⁴⁶ It noted that pilot income was not a statutory rate setting criteria that it was required to consider, but determined that it must be considered as a component of just and reasonable rates, stating:

⁴² Sevall, TR. 645: 25 – 646: 11.

⁴³ Exh. GQ-1T. 11: 11 – 14; 14: 24 – 15: 9. Exh. GQ-5T. 6: 8 – 11; 7: 8 – 9: 18.

⁴⁴ OAR 856-030-0000(2).

⁴⁵ Exh. SS-10X (Oregon Board of Marine Pilots Order 10-01).

⁴⁶ *Re Ass'n of Maryland Pilots*, 76 Md. P.S.C. 498 (Md. P.S.C. Sept. 16, 1985).

Pilot income is not one of the factors mentioned in Section 72B. Nevertheless, it is an important matter which must be considered in the setting of just and reasonable rates, since pilot distributions represent two-thirds of the Association's total expenses. Pilotage rates cannot be just and reasonable if pilot income is out of line.⁴⁷

40 Once it determined that the sufficiency of pilot income must be considered, the PSC was left with answering the question of how pilot income should be determined. The Maryland Pilots presented a survey of pilot incomes in other districts as evidence that pilots earned insufficient income under the existing tariff, while the Staff argued that the current net income level was already adequate because of a lack of pilot attrition and that pilot earnings in other districts should not be considered. Although the PSC saw the logic in both arguments, it ultimately determined that the lack of actual pilot attrition was an unfair standard for determining sufficiency of income because entry into pilot associations is restricted and that the “the absence of defections from the Association is as much a function of a lack of alternatives as it is a function of adequate wages.” The PSC then sided with the pilots’ position because agency determinations of pilotage income in other jurisdictions “are legally prima facie correct and entitled to great weight,” adding “[m]oreover, pilots earnings in other jurisdictions, however arrived at, are the best indication available to the Commission concerning the value of pilotage service.”⁴⁸

41 In setting rates for numerous Great Lakes pilot associations, the Coast Guard also considers the sufficiency of pilot income via a similar comparability standard. In its order establishing pilotage rates in 2016, the Coast Guard considered one pilot’s argument that “[market] forces dictate the success of each association’s effort to attract and retain talent, and because the Coast Guard is required to set rates with consideration to the cost of pilotage service, which itself is subject to market forces.” The Coast Guard agreed, adding:

Response: We agree with the pilot association president in comment 56 that pilotage associations are not “decoupled” from market forces, for the reasons the president gave. This rule is intended to promote safe, efficient, and reliable Great Lakes pilotage. Pilot associations have made it clear that they cannot ensure safe

⁴⁷ *Id.*

⁴⁸ *Id.*

pilotage if continued low rates make it impossible to attract and retain high quality pilots, maintain adequate infrastructure, and provide decent working conditions. Shipping interests have made it clear that they will not tolerate delays to vessel schedules, or backups on certain vessel routes, that are attributable to pilot shortages. This rule lays out the vision of a system in which highly capable pilots want to work on the Great Lakes, do so safely, and move traffic efficiently and reliably. We think every stakeholder wants to see that vision realized. However, achieving that level of efficiency and reliability requires a comparable level of compensation to attract and support those pilots.⁴⁹

42 As noted by Capt. Quick, a significant number of other jurisdictions require the consideration of comparability in establishing pilotage rates as well, including without limitation, California, Florida, Virginia, Hawaii, California, and Louisiana.⁵⁰

e. The Commission's standards for considering owner and executive compensation are consistent with PSP's proposal

43 Just as other jurisdictions consider income comparators for establishing pilot income, the Commission follows similar standards when establishing the appropriate level of owner or executive compensation in a public service company's revenue requirement, which Mr. Sevall acknowledged for the first time at the hearing.⁵¹

44 Contrary to Mr. Sevall's insistence that historic averages have been used by the Commission to establish the appropriate compensation level for an owner/executive, this objective comparability standard has been applied by the Commission since at least 1988.⁵² In fact, the Commission has repeatedly rejected alternative approaches to establishing appropriate owner/executive compensation, including ones similar to that proposed by Staff here. For example, when Staff proposed to establish the appropriate compensation level of a company owner/executive through CPI adjustments to a previously approved compensation level, the Commission rejected that approach, instead accepting the company's evidence, including surveys comparing to salaries

⁴⁹ Great Lakes Pilotage Rates—2016 Annual Review and Changes to Methodology, 81 FR 11908-01. The Coast Guard's decision to increase rates in order to ensure that pilot association could attract and retain high quality pilots in order to maintain a safe, efficient and reliable service was also affirmed by the Court of Appeals for the D.C. Circuit in *Am. Great Lakes Ports Ass'n v. Schultz*, 962 F.3d 510, 516 (D.C. Cir. 2020).

⁵⁰ Exh. GQ-1T. 11: 11 – 14; 14: 24 – 15: 9. Exh. GQ-5T. 6: 8 – 11; 7: 8 - 9: 18.

⁵¹ Sevall, TR. 646: 16 – 647: 2.

⁵² *In Re: Consol. Garbage Cases*, Dkts. TG-2016 et al, Order 05, p. 20 (Jan. 28, 1988).

paid to similar executives, ruling that appropriate compensation should be established through the same objective standards used to determine the appropriate rate of return:

The Commission's prior ratemaking treatment in establishing an appropriate compensation level has been to authorize an owner/executive a salary that is comparable to a competitive or prevailing compensation for the type or types of services the owner-operator performs. Ratepayers should not have to pay a higher level of salary simply because Mr. Richardson is also the owner, nor should the owner be required to accept a lower salary because she or he is an owner. The owner is compensated for his investment and risk in the business through the authorized fair rate of return, and the services actually performed for the company should similarly be fairly determined and objectively set.⁵³

45 Indeed, even when the regulated company, rather than the staff, attempted to justify an owner's compensation level through a CPI increase over previously approved compensation levels, the Commission remained consistent with its precedent, ruling that "the standard ratemaking treatment in establishing an owner/operator salary is to authorize an amount that is comparable to a competitive or prevailing salary level for the type or types of services the owner-operator performs."⁵⁴ The Commission went on to rule that the best evidence of the salary level required to "attract and retain" executives is a survey of the income and benefits of comparable executives at comparable companies.⁵⁵

46 Consequently, the Commission should firmly reject Staff's proposed methodology for establishing a DNI, which relies entirely upon a CPI adjusted five-year average, as inconsistent with its long-standing objective criteria for establishing the value of services provided by an owner to a company.

ii. PSP's specific comparators are appropriate, well documented, and demonstrate that its proposed DNI of \$500,000 is reasonable

47 In support of its proposed DNI of \$500,000, PSP supplied the Commission with publicly available information regarding the net income earned by state-regulated pilots in other jurisdictions set forth in Exh. IC-3.⁵⁶ Capt. Carlson's exhibit was thoroughly documented

⁵³ *WUTC v. Rainier View Water Co., Inc.*, Dkt. UW-010877, 6th Supp. Order, ¶¶ 49 – 53 (Jul. 12, 2002).

⁵⁴ *WUTC v. Bremerton-Kitsap Airporter, Inc.*, Dkt. TC-001846, Fifth Supplemental Order, ¶ 34 (Aug. 2, 2002).

⁵⁵ *Id.* at ¶ 35.

⁵⁶ As described by Capt. Carlson in Exh. IC-1T, the amounts shown in Exh. IC-3 were adjusted to ensure that when benefits were included in the distributable net income they had been removed, and that benefits included as expenses

through public-record documents filed by pilot associations with pilotage rate regulators, including audited and/or reviewed financial statements, rate setting orders, as well as the order of a federal district court judge,⁵⁷ and supported by workpapers showing the adjustments made.⁵⁸

48 That exhibit also demonstrates that the net income earned by pilots who work in state-regulated pilotage districts earn an income range of \$356,560, at the low end, to \$727,287 at the high end. With the average of the range being \$541,204,⁵⁹ and the median of \$549,998.00, Capt. Carlson was therefore accurate when he described PSP's proposal as a reasonable figure, which was neither at the top nor at the bottom of the range.⁶⁰

49 Captain Quick's income-to-workload comparison also demonstrates the reasonableness of PSP's proposal. When viewed in light of the dollar per hour of total time on task per pilot, Puget Sound Pilots earned on average just \$305 per hour on task in 2018 and just \$281 in 2019, which currently fell below the hourly income level earned in every other pilot district for which information is available.⁶¹ Again, even at PSP's proposed \$500,000 per FTE (which would not be achieved for three years during its proposed rate plan), PSP pilots would earn just \$450 per hour worked, which is well below the average of \$669 and median of \$552 per hour of the other pilot groups.

50 Yet another factor demonstrating the reasonableness of PSP's DNI proposal is that the incomes earned in other pilotage districts, save for San Francisco, are all worth more as a function of the considerably higher cost of living in the Seattle area. In response to Mr. Sevall's unilateral rejection of any comparable income information, PSP obtained cost of living adjustments to demonstrate the relative value of earnings in each of the areas for which pilot compensation was publicly available. As these adjustments demonstrate, even if the proposed rate increase were

not provided to PSP were included in income in order to equalize their income calculations and present a true apples-to-apples presentation of distributable net income. Exh. IC-1T. 17: 20 – 18: 9.

⁵⁷ Exh. IC-25 (a) – (p).

⁵⁸ Exh. IC-26 (a) – (h).

⁵⁹ Exh. IC-1T. 18: 12 – 19.

⁶⁰ Carlson, TR. 386: 18 – 23.

⁶¹ Exh. GQ-5T. 13: 1 – 10. Capt. Quick did not include the dollar-per-hour figure for the test year (July 1 2018 – June 30, 2019), but an average of the two years is \$293 per hour.

authorized, the cost-of-living adjusted compensation earned by PSP pilots would remain well below the earnings level of pilots working elsewhere.⁶²

f. Staff's position on PSP's proposal is not reasonable

51 In abruptly rejecting these comparators, in defending this omission, Mr. Sevall attempts to set the bar too high to clear. He variously claims he was unable to audit information he had either already been provided or failed to request, that each district is too unique to compare, or that other information not supplied must be considered to know if the included pilotage groups supply a fair comparison.⁶³ By these unreasonable and arbitrary standards, no comparator could ever comply.

52 The fallacies in Staff's position are highlighted by Mr. Sevall's initial assertion in response testimony that he was unable to verify whether the districts have "similar conditions, features or variables" as the basis for his rejection and subsequent admission in discovery that he had not concluded what conditions, features or variables should be considered.⁶⁴ If Staff had not identified any specific conditions, features or variable that it considered to be relevant to the comparison, on what basis could they have deemed the information supplied inadequate and how was PSP ever to meet his fluctuating and undefined criteria for consideration?

53 Mr. Sevall nonetheless rejected any comparison as a result of the unique characteristics of the local waters in each jurisdiction. Ironically, the unique nature of each pilotage district serves as one of the unifying similarities of pilotage service, nationally, while it is other factors that may serve to create distinctions. Indeed, the considerable experience, training and expertise of the pilot in navigating the invisible hazards of local waterways while protecting life, property and the environment from the hazards of massive ships is precisely the primary source of a pilot's value. As noted by a number of witnesses, including Columbia river Pilots Capt. Jeremy Nielsen,

⁶² Exh. SS-12X.

⁶³ Exh. SS-1T. 4: 4 – 6; 14: 14 – 15: 11.

⁶⁴ Exh. IC-24.

pilots are professionals whose roles and methods are similar, even if the hazards they receive extensive training to avoid are unique.⁶⁵

54 Mr. Sevall further rejects the comparators supplied by PSP based upon the premise that a fair comparison must “consider information from pilotage districts excluded from the list of comparable districts.”⁶⁶ Yet, he failed to identify any other publicly available pilotage districts that should be considered in this equation. As noted by PSP and acknowledged by Staff, there are few pilotage districts whose compensation information is even publicly available, and the limited public information that is available corroborates the testimony of Capt. Quick that pilot income ranges nationally in the area of \$550,000 to \$600,000 per year.⁶⁷

55 Finally, Mr. Sevall failed to recognize or otherwise acknowledge that the pilots of each of the state-regulated pilot associations for which PSP submitted earning information share similar financial risks to PSP, and therefore serve as appropriate comparators. Unlike pilots who serve as port employees and earn guaranteed wages by negotiated contracts, each of the pilotage districts offered as comparators by PSP receive service via pilot associations whose members wholly bear the risks and rewards associated with their investment.⁶⁸

D. Number of implied pilots

i. Funding only licensed pilots creates an unintentional over-earning problem

56 As noted, PSP also proposes that the Commission determine the number of pilots to fund in rates based upon determining the optimal level of pilots needed, so that the contributions by pilots to the pilotage service are fairly valued regardless of the number of actual licensed pilots performing the work. Understanding why this is necessary starts with grasping the downsides of alternative models. For example, one possible way to establish the TDNI would be to multiply an income goal per pilot (the “Distributable Net Income”) by the existing number of licensed pilots. However, this method would present a number of problems due to fluctuations in the number of

⁶⁵ Exh. JJN-1T. 2: 8 – 16.

⁶⁶ Exh. SS-15: 1 – 3.

⁶⁷ Exh. GQ-1T. 16: 1 – 6.

⁶⁸ *Id.* 2: 17 – 3: 2.

licensed pilots, changes in shipping traffic, and variances in the size of vessels calling on the Puget Sound. For example, if TDNI were established by this method and some pilots were to retire during the rate year without an available newly licensed pilot to replace the retiring pilot, as has been a noticeable pattern in recent years, each of the remaining pilots would be expected to work more, and would each earn additional income as a result. This would cause each pilot to earn more than the DNI included in the revenue requirement, and, in a subsequent rate proceeding, the tariff might be reduced to ensure each pilot earned only the targeted amount. The same problem would exist if the number of assignments increased in the rate year, or if larger vessels presenting greater risk and requiring greater skill were to call on the pilotage district. Income per pilot would justifiably increase, but this methodology could unfairly require a reduction in rates in future rate proceedings.

57 Another drawback with funding only the number of existing licensed pilots is that such a determination would disregard the unique and stressful nature of pilotage by ignoring the pilots' works schedule and rotation system and the workload that each pilot can perform under these systems. For example, if fewer pilots are licensed than are needed to move ships on time without reliance upon off-duty pilots, as has been the case in Washington for many decades,⁶⁹ pilots would have to work more to earn the projected DNI than pilots in other districts that staff sufficient pilots to avoid Callbacks. Such a decision would unfairly dilute the value of pilot labor and suppress pilot earnings based upon the staffing decisions made by the licensing authority, the Board of Pilotage Commissioners ("BPC"), rather than determining the value of pilot service and establishing rates to compensate for it.

58 A related concern exists as the result of the Legislature's decision to place with the Commission the economic pilotage ratesetting authority but leave with the BPC the authority to determine the number of licensed pilots. If the Commission were to merely fund the number of BPC licensed pilots, its decision would necessarily delegate a key ratesetting function back to the BPC, from

⁶⁹ See Exh. IC-27 (Callback Jobs per year from 1995 – 2019).

whom the ratesetting authority was just transferred. Yet all parties to this proceeding appear to agree that the roles and responsibilities of the BPC and UTC should be mutually respected as distinct and separate. Thus, the Commission should establish a ratesetting methodology with an outcome that cannot be directly altered by decisions that rest solely within the ambit of the BPC's authority.

- g. The solution to the over-earning problem is to fund a number of implied pilots using a pilot staffing model

59 The most logical solution to the problems discussed above is to treat the number of licensed pilots as a floor, and then rely upon a staffing model to determine the number of full time equivalent pilots needed in the rate year when utilizing the watch schedule and rotation system under optimal staffing conditions that minimize or eliminate Callbacks. Such a model would recognize that if the existing number of licensed pilots falls below the optimal number of pilots needed, the excess revenue earned by the existing pilots represents the value of their additional work. This concept similarly recognizes that if additional work is performed because shipping traffic increases, the additional distributable income created is authorized additional compensation rather than the result of over-earning. Funding based upon a staffing model also eliminates any concern that the Commission's decision could be altered by licensing decisions of the BPC. Finally, such a model would value Callbacks in the present period and ensure that any deferral of revenue to match future costs under the advocated accrual accounting would still provide compensation for full-time workloads at prevailing state pilotage earning levels.

- h. PSP's proposed staffing model solves multiple problems while achieving a fair, just, reasonable and sufficient result

60 As noted above, in order to fairly compensate pilots for their labor, the average workload each full-time pilot is expected to perform must be determined in any staffing model. This determination cannot focus solely on the total workload each pilot historically performed, because that workload is influenced by uncontrollable factors like attrition of pilots to retirement (which directly increases the workload of other pilots) and fluctuations in shipping traffic from year-to-year which can increase or decrease the average number of assignments each pilot

performs. Reliance upon a historic average of total workload also completely disregards whether PSP was understaffed, forcing PSP to take on additional Callback liability in order to induce pilots to perform assignments while off-duty, and would inequitably then treat off-duty work as an expected component of each pilot's full-time workload. Historic average workload also ignores any factors that influence pilot work availability, like changes to mandatory rest rules that influence the number of assignments that pilots can perform during their scheduled work days.⁷⁰

61 Instead, a staffing model should ideally determine the workload each pilot performs while working on a full-time basis so that on average each actual pilot will earn the prevailing compensation level if they perform a full-time workload, and additional off-watch assignments will generate additional revenue that can be used to pay a pilot for that additional work or be reserved to fund the corresponding Callback liability. As addressed in the unchallenged testimony of Capt. Eric von Brandenfels, a pilot's full time workload is defined by the traditional "day for day" work schedule that requires pilots to stand watch and be available for assignments during their watch period, and thereby earn an equivalent number of days off.⁷¹ Thus, a pilot's full time workload should be determined by the average number of assignments a pilot would perform on watch if PSP were staffed in a manner that permitted pilots to work only while on-watch.

62 PSP's revenue requirement recommendation was based precisely on such a proposal. As Dr. Khawaja discussed, the DNI is the amount each full time pilot should earn, where "full time" is defined by a pilot who stands watch 181 days pursuant to PSP's watch schedule.⁷² Thus, in order to establish the appropriate number of pilots to fund, Dr. Khawaja constructed a model that would eliminate off-watch work in order to determine the number of pilots needed to perform

⁷⁰ Exh. MM-73X (Q&A with Dr. Flynn Evans, p. 4, regarding the impacts of the change in fatigue rules); Exh. IC-15 (Puget Sound Pilot Fatigue Study), p. 14 – 15, 33 – 34.

⁷¹ Exh. EVB-1T. 7: 22 – 8: 9.

⁷² Exh. SK-3T. 2: 1-14.

work while working only on-watch.⁷³ By this analysis, Dr. Khawaja determined that the optimal number of working pilots in 2018 would have been 62. Extrapolating from the result, Dr. Khawaja then determined the assignment level (118 assignments per pilot) that would have been performed under optimal staffing in order to extrapolate and calculate the number of pilots that would be needed based upon his vessel traffic projection for 2020.⁷⁴ And while Dr. Khawaja did rely upon NASA's pilot fatigue study to project the number of additional pilots that would have been needed in 2018 as a direct result of new pilot fatigue rules, he certainly did not, as Mr. Sevall casually contends,⁷⁵ base his recommendation regarding the assignment level or number of pilots needed to fund on a fatigue study.

i. Staff's proposal creates more issues than it resolves

63 Like PSP, Staff also proposed that the Commission rely upon a staffing model to determine the number of pilots to fund in the revenue requirement. Unlike PSP, however, Staff in doing so set forth no specific policies it attempted to follow⁷⁶ in so advocating and ignored the unique characteristics of pilotage associations and the policies that should be followed in determining an optimal number of pilots needed.⁷⁷ Instead, Staff elected to determine the number of pilots needed based solely on the average number of assignments pilots actually performed in a five-year period once again.⁷⁸

64 In justifying its approach, Staff asserts that using a five-year historic average is appropriate to determining the current and future staffing levels because it will be updated in each successive rate filing.⁷⁹ As noted above however, one of the problems with using a historic average is that it merely ratifies what actually occurred during the historic period, without any evaluation of the result. If there were an inadequate number of pilots during the historic time period due to pilot

⁷³ Exh. SK-1T. 5: 19 – 9: 17.

⁷⁴ *Id.*

⁷⁵ Exh. SS-1T. 10: 6 – 8.

⁷⁶ Sevall, TR. 615: 12 – 616: 10.

⁷⁷ *Id.* 616: 11 – 17 (Staff treated all assignments as equal).

⁷⁸ Exh. SS-1T. 10: 10 – 15.

⁷⁹ *Id.*

retirements or any other form of attrition, Staff's proposal will assume that the inadequate number was in fact adequate. In other words, if fewer pilots were licensed than were needed, the average workload of pilots will increase during the historic year analyzed and Staff's approach would normalize that increased average rather than treat it as "additional work." In fact, in 2018 when PSP had just 50.3 pilots rather than the authorized 52 pilots, Mr. Sevall relied upon the lower number of pilots and resulting higher average workload and nevertheless included it in his model.⁸⁰ Thus, Staff has already intrinsically imbedded pilot shortages into its implied pilot count, thereby reducing its number of implied pilots projected for the rate year.

65 Additionally, by relying upon a five-year average for pilot assignments, Staff's proposal simultaneously adopts the BPC's past licensing decisions while introducing significant regulatory lag in response to evolving licensing outcomes. For example, the BPC decided in 2019 to increase the number of authorized licenses to 56,⁸¹ but the actual number of pilots has since dropped to 48 as the result of retirements.⁸² Using a five-year average, when the licensed pilots actually do increase to the higher authorized level, it would take five more years from that point before the new level could ever be recognized in Staff's model. Thus Staff's circuitous proposal introduces significant regulatory lag between the time the workload changes to the time such changes would be recognized in rates, which will have the highly negative effect of reducing pilot compensation during times of increasing pilot licenses.

66 Yet another concern with Staff's proposal is that during the specific five-year average used, the mandatory rest periods were revised twice, first by PSP policy in 2015, and then by BPC policy in October 2018, which was followed by legislation in 2019. Because each change appropriately lowered the on-watch workload pilots could handle in order to reduce pilot fatigue and increase safety, the actual number of pilots needed has increased. Yet Staff's average ignores this reality resulting in a skewed expected assignment level.

⁸⁰ Exh. SS-2r2, Schedule 2.2.

⁸¹ Exh. IC-13.

⁸² <https://bit.ly/3jWDt4y> (Board of Pilotage Commissioners' Licensed Pilot Directory, of which PSP requests the Commission take official notice pursuant to WAC 480-07-495(2)(iv))

67 Staff also contends that its implied pilot count proposal is consistent with the historic test year approach.⁸³ However, this additional conclusory premise is asserted without any analysis of or reference to the justification of the use of historic test year. In utility ratemaking, the Commission relies upon a historic test year because it can fairly assume it captures the complex ratio between costs, revenue, load and other factors over a uniform period of time that will continue in the future when new customers are added.⁸⁴ Here, however, PSP cannot control the number of licensed pilots. If more pilots are needed, they cannot simply be hired off the street by PSP. The number of pilots is subject to the decision making of the BPC as well as the capacity of the training program to license new pilots. Additionally, the number of licensed pilots fluctuates based on the rate of retirements relative to the ability to license new pilots. Thus, when the total number of assignments increases, the number of pilots cannot immediately and organically expand along with it. Consequently, the number of assignments per pilot historically performed, in isolation, does not determine or foreshadow the number of pilots needed in the future. Instead, it merely demonstrates the number of assignments each pilot actually worked.

ii. Funding the Callbacks prospectively in a staffing model

68 Another critical issue in this rate proceeding that can and should be resolved through the staffing model is the treatment of Callbacks. The Callback system traditionally permitted PSP to operate with fewer pilots than are needed and therefore at a lower revenue overall revenue requirement than if PSP were fully staffed at the level necessary.⁸⁵ This system did not work by increasing efficiency alone. It worked because PSP agreed to take on a liability that would be funded only when pilots burned Callbacks in order to move a ship on the ship's schedule rather than when the next rested on-watch pilot was available. If PSP had not created the Callback system and taken on that liability, the alternatives would have been to permit the ships moved to be delayed or to license additional pilots.⁸⁶

⁸³ Exh. SS-1T. 10: 1 – 4.

⁸⁴ *WUTC v. Avista Corp.*, Dkts. UE-090134 and UG-090135, Order 10, ¶¶ 41 - 42 (Dec. 22, 2009).

⁸⁵ Exh. WT-1T. 18: 21 – 19: 9; 20: 1 – 13.

⁸⁶ Exh. IC-1T.7: 3 - 12.

69 As acknowledged by Mr. Kermode, the Coast Guard also faced an issue of how to staff for peak shipping levels, which on the Great Lakes, like the Puget Sound, can occur at any time.⁸⁷ Rather than relying upon a Callback system, the Coast Guard adopted a peak staffing model that ensures there are sufficient rested pilots available to move ships without delays even when surges in vessel traffic occur.⁸⁸ This staffing model required additional pilots, however which thereby increased the revenue requirement. Unlike the Coast Guard, however, the BPC never adopted a peak staffing model and has instead continued to rely upon PSP's Callback system to meet peak demand and funded the Callback Days when burned prior to retirement as another pay-as-you-go expense.⁸⁹

70 Because the Callback system historically mitigated the overall revenue requirement by relying on additional work put in by fewer pilots, the only fair way to value the work being performed by off-watch pilots is to consider the number of pilots that would be required if the Callback system were not used. Thus, under a shift to an accrual accounting basis, the value of Callbacks that should be included in the revenue requirement can be measured as the difference between the appropriate DNI multiplied by the number of licensed pilots, and the same DNI multiplied by the number of pilots required to move ships without delay during times of peak demand without use of Callbacks.

71 By determining the number of pilots that would be needed if there were no Callback system,⁹⁰ Dr. Khawaja's model serves to illuminate that net income differential. As he discussed, Dr. Khawaja ran a simulation to determine the workload of a full-time (i.e., on-watch) pilot under the traditional pilot's day-for-day work schedule with minimal Callbacks.⁹¹ This workload then

⁸⁷ Kermode, TR. 581: 20 - 25; Great Lakes Pilotage Rates—2016 Annual Review and Changes to Methodology, 81 FR 11908-01.

⁸⁸ *Id.*

⁸⁹ Exh. MM-59X (BPC Minutes May 2000); Exh. WT-2 (2001 MOU); Exh. DP13X (BPC Minutes May 2001); Exh. DP-14X (BPC Minutes May 2005).

⁹⁰ In this case, Dr. Khawaja stopped just short of peak demand due to the diminishing return of additional pilots. Exh. SK-1T.

⁹¹ Exh. SK-1T. 5: 19 – 9: 17.

represents what would be performed if near-peak staffing were used. Using that workload, Dr. Khawaja then projected the number of FTE pilots that would be required in the rate year.⁹²

72 By funding each FTE pilot at prevailing income levels in the revenue requirement, Dr. Khawaja’s model ensures that on-watch work is appropriately valued and funded, and that each licensed pilot has an opportunity to earn fair compensation for their “regular” labor. And by including in the revenue requirement the additional income that is needed to fund pilots were they staffed to near peak demand, the income earned above each pilot’s “regular” work provides funding for the Callback liability accrued during the rate year.

73 The liability for Callbacks worked will then finally be appropriately funded via the revenue collected from the Callbacks actually worked. That additional revenue would permit PSP to consider Staff’s recommendations to either distribute the income immediately without a Callback liability or to accrue and record the liability and implement a reserve/trust account for distribution at the time the Callback Day is used. Either treatment would comport with GAAP accrual accounting principles and ensure that Callbacks create additional revenue when worked.

j. Staff is incorrect that Callbacks were already funded

74 Yet Staff opposes funding Callbacks at all, insisting that they were already funded when worked, or could have been had PSP only distributed additional revenue to the pilot who worked a Callback assignment. But, as described by Capt. Ivan Carlson, historically there was no additional revenue earned when an off-watch pilot was called back.⁹³ PSP’s outside auditor Ms. Norris also commented on this subject, noting that with a finite number of assignments required, the same revenue is earned regardless of whether PSP pilots work additional days to move ships on their own schedule or make them wait for an available pilot.⁹⁴ Thus, with no additional revenue, had PSP actually distributed additional income to pilots who worked Callbacks, it would have unfairly reduced the income earned by other pilots,⁹⁵ which Mr. Kermodé also

⁹² *Id.*

⁹³ Exh IC-4Tr.

⁹⁴ Exh. JN-6T. 3: 13 – 6: 4.

⁹⁵ Carlson, TR. 376: 10 – 21.

acknowledged.⁹⁶ In fact, if PSP funded Callbacks internally and every pilot worked the same number of Callbacks, the result would be that each would earn the same as if none had worked Callbacks at all.⁹⁷ Thus, because PSP could not historically distribute additional income for Callback assignments in a just and equitable way, the only incentive PSP could offer for Callbacks was an additional day off (worth two distribution duty days) in the future.⁹⁸ As described by PSP's former Executive Director, Walt Tabler, it was the intent that Callbacks be funded only when taken or burned and the Callback system has always thus deferred the cost of a Callback Day to a later period of time when the Callback Day is actually used.⁹⁹

75 The BPC certainly did not fund additional pilots in the revenue requirement whose work those Callbacks represented, nor did it consider the accrued liability in expenses at the time the Callback was performed. To the contrary, the BPC only ever funded Callbacks when burned prior to retirement.¹⁰⁰ Additionally, as Capt. Carlson testified, if the same ship is delayed and moved by an on-duty pilot the same revenue is earned and no Callback liability exists.¹⁰¹ No party argues that in that circumstance it would be inappropriate to immediately distribute the revenue to pilots. Thus, similar to the earnings of pilots if vessels are delayed, there is no additional revenue associated with a Callback under the existing tariff and the liability was never funded when it accrued.

76 Staff's assumption and assertion that Callbacks were funded at the time the pilot moved the vessel is likely the result of the fact that the liability can be linked to service provided to a specific customer. But in reality, the entire pilotage service PSP's pilots provide, including the Callback system, is funded by the revenue requirement, which is then spread in rates to all of

⁹⁶ Kermode, TR. 571: 9 – 572: 6.

⁹⁷ Carlson, TR. 376: 22 – 377: 11.

⁹⁸ Exh. IC-4T. 3: 11 – 13; Exh. EVB-5X (PSP Bylaws), Bylaw 16.4.4.2; as Capt. von Brandenfels discussed, a Callback Day entitles a pilot to two days off, one is a day on-watch, and the other is the corresponding day off-watch each day on-watch earns. Carlson, TR. 388: 8 – 14; Exh. EVB-5X (PSP Bylaws), Bylaw 16.4.4.2.

⁹⁹ Exh. WT-1T. 23: 19 - 23.

¹⁰⁰ WT-1T. 20: 14 – 23; 23: 19 - 23; Exh. MM-59X (BPC Minutes May 2000); Exh. WT-2 (2001 MOU); Exh. DP-13X (BPC Minutes May 2001); Exh. DP-14X (BPC Minutes May 2005).

¹⁰¹ Exh. IC-4T. 3: 1 – 10.

PSP's customers. If the revenue requirement never included the value of labor provided by Callbacks and the liability was only funded when paid (in this case, when pilots burn Callback Days prior to retirement), there is no foundation for Staff's assertion that funding actually existed when the ship paid for pilotage service. Moreover, this concept is far from unique in the annals of regulated utility ratemaking; it's just that similar issues for other industries the Commission regulates were resolved decades ago by the implementation of accrual basis accounting.

77 A good example of this circumstance can be found in the treatment of pay-as-you-go employee benefits in the early 1990s. Prior to that time, a number of utilities offered post-retirement benefits to employees, including post-retirement healthcare benefits. Because these benefits were paid only after the employee retired, the expense associated with those benefits was historically included in the revenue requirement only when paid and accounted for on a cash basis. Then, in 1990 the FASB issued Statement of Financial Accounting Standards ("SFAS") 106, a statement regarding the GAAP treatment of benefits other than pension (other post-employment benefits or "OPEB"). SFAS 106 required companies, including utilities, to begin accounting for OPEB on an accrual basis during the working lives of employees in order to match costs to the period in which the benefit was earned.¹⁰² Importantly, when utilities made the transition from cash-basis to accrual in their treatment of OPEB, public utility commissions, including the UTC, did not treat the accrued liability as fully and historically funded by the ratepayers as Staff treats and advocates for the Callback liability here. Although ratepayers had already paid for the service at the time the employee earned deferred compensation benefits, funding the liability that had already accrued was not treated as retroactive ratemaking because it was previously intended that the liability be funded only when paid and therefore had never been included in rates.¹⁰³

¹⁰² Goodman, S.L. The Process of Ratemaking, 331-37; <https://www.fasb.org/summary/stsum106.shtml>. Regulatory Commissions, including the UTC also permitted the creation of a regulatory asset with a five-year phase in period to accrue the future liability in rates.

¹⁰³ *Id.*, citing *Town of Norwood v. F.E.R.C.*, 53 F.3d 377 (D.C.Cir. 1995) ("...the transition obligation does not run afoul of the retroactive ratemaking proscription, because [the utility] has not shifted any costs that it tried but failed to collect in the past: it *always* planned to collect these costs from future ratepayers, the only shift is timing within the future.")

78 Moreover, when the transition to accrual accounting of deferred compensation occurred under SFAS 106, the revenue requirement was increased to cover the accrual of deferred compensation. PSP proposes to do the same here and ensure that the cost of Callbacks is included in the revenue requirement at the time the benefit is earned. Doing so, however, necessarily requires that the value of labor consumed by a Callback first be fairly valued and funded in the revenue requirement.

iii. Staff now, too, surprisingly claims that its staffing model creates funding for Callbacks

79 At the hearing, Mr. Kermode and Mr. Sevall testified that Staff's staffing model and resulting Target Assignment Level provide a "premium" that will help fund the liability created by Callbacks. Yet the concept they posited does not work as they proposed because the highlighted "premium" identified is not determined by the number of Callbacks, but instead exists only when there are fewer licensed pilots than implied pilots under Staff's proposal.

80 Mr. Kermode first identified this "premium" during cross-examination by counsel for PMSA, stating:

So theoretically, the implied amount of pilots, you would -- using Dr. Khawaja's approach, you could eliminate a lot of callbacks, because you have a high number of pilots. Well, in reality, those pilots don't exist. We know that. So we -- we impute, let's say, the -- 52 pilots, 53 pilots. But only 48 exist. That means there's approximately \$2 million of earnings that is being put into rates to account for that extra work that we expect the pilots to do. And so we're not asking 48 pilots to work overtime and work their hardest without pay. We're actually putting that into rates. What Dr. Khawaja does is he says, yeah, we -- we have the basic distributable net income. We add in what I call the premium for the imputed -- or the implied number of pilots. And then above that, we also add some overtime. Well, no, you already have the overtime. You already have that additional amount of money, and the -- in our example, about \$2 million worth of extra money that will be evenly distributed to all of the pilots.¹⁰⁴

When questioned, Mr. Sevall then expanded upon the explanation of this premium, explaining that the \$2,000,000 premium results from the inclusion in the revenue requirement of

¹⁰⁴ Kermode, TR. 591:19 to 592:14.

approximately \$400,000 per pilot for 5 pilots more than were licensed at the time of filing (52 pilots funded, less 47 licensed pilots).¹⁰⁵

81 While it is true that Staff’s assignment level proposal would result in additional compensation when there are fewer licensed pilots than Staff’s “implied pilot” count, this “premium” is not the result of work performed by pilots while off-watch, but merely constitutes the difference between one level of understaffing and another. As addressed in the testimony of Dr. Khawaja, even if PSP had added 1 pilots on watch (or just over 2 total pilots) to get to approximately 52 pilots in 2018,¹⁰⁶ (the number of implied pilots Staff recommends be funded in rates), PSP would still expect over 800 Callback Days to be earned that year.¹⁰⁷ Thus, even when no premium exists in the difference between the implied pilot count and the actual number of licensed pilots, Callbacks will continue and without additional funding under Staff’s premise.

k. Illustration of insufficient Callback funding in Staff’s revenue requirement proposal comparing Staff’s proposed Assignment Level vs. PSP’s proposal

82 Another way to understand the shortfall in Staff’s “overtime premium” is to apply the concepts discussed by Staff to the proposed rates to determine if their intended outcome results. As discussed above, Staff described the DNI as the amount to be distributed after PSP applies accrual basis accounting to reserve the net income earned by Callbacks in order to fund that liability. Thus, under Staff’s proposed TDNI, after determining the average net income earned by Callbacks, the actual net income per pilot should equal at least the \$400,000 DNI Staff recommends. Yet it does not, as illustrated by a simple example using Staff’s proposed TDNI and the results of operations for 2019.

83 The following chart demonstrates the result of operations that would occur using the results of operations from 2019¹⁰⁸ (the first year under the new fatigue management rules), using Staff’s historic average assignment level (143.4) versus PSP’s optimized assignment level (118). In

¹⁰⁵ Sevall, TR. 621: 11 – 622: 14.

¹⁰⁶ There were 49 working pilots on average in 2018. Exh. SK-1T. 8: 9- 23.

¹⁰⁷ *Id.* 7: 6 – 8.

¹⁰⁸ See PSP’s 2019 Financial Statement, produced in response to Bench Request No. 5.

both situations, the income earned by Callback assignments would be reserved rather than distributed, as Staff proposes.

Staff Proposal		PSP Proposal	
2019 Assignments	7000	2019 Assignments	7000
DNI Proposal	\$400,000.00	DNI Proposal	\$500,000.00
Assignment Level	143.4	Assignment Level	118
Number of Implied Pilots	50	Number of Implied Pilots	61
Number of Licensed Pilots	49.9	Number of Licensed Pilots	49.9
2019 Callback Assignments	1377	2019 Callback Assignments	1377
TDNI Required	\$19,925,801.95	TDNI Required	\$30,661,016.95
Net Income Per Assignment	\$2,846.54	Net Income Per Assignment	\$4,380.15
Income Reserved for Callbacks	\$3,919,689.90	Income Reserved for Callbacks	\$6,031,460.05
Net Income for Distribution	\$16,006,112.05	Net Income for Distribution	\$24,629,556.90
Net Income Per Pilot	\$320,763.77	Net Income Per Pilot	\$493,578.29

Because Staff’s proposed Assignment Level results in pilots earning well below the target, it clearly does not function as Staff asserts it should.

iv. Staff’s Callback adjustment demonstrates that Staff has misapprehended and failed to fully confront how to treat Callback liability

84 Understandably, Staff’s flawed position on a method for funding Callback Days misses the mark, likely because the Callback concept is as unique as pilotage, and not a concept Staff has ever had to confront before in a revenue requirement recommendation. Staff’s struggle to truly master the concepts involved with Callback is highlighted by the missteps made by Mr. Sevall in calculating a recommended DNI. The most significant mistake he made involved his “Callback Adjustment.” In his initial testimony, Mr. Sevall testified that in calculating a recommended DNI he removed a portion of the historic revenue earned by pilots that he associated with Callbacks and recommended a DNI per pilot “without any call back liability associated.”¹⁰⁹ As he testified later in supplemental testimony, he had believed the amount he adjusted represented a double recovery.¹¹⁰

85 What Mr. Sevall actually did in that adjustment was to calculate the value of net income earned from assignments worked by off-watch pilots and remove that from the total net income earned

¹⁰⁹ Exh. SS-1T. 16: 5 – 15.

¹¹⁰ Exh. SS-5T. 4: 4 – 10.

by pilots when calculating his DNI recommendation. This faulty adjustment thus had the effect of decreasing the revenue requirement by millions of dollars. After learning of his mistake, Mr. Sevall reversed his Callback Adjustment without explanation of why that amount would ever have represented a double recovery.¹¹¹

86 In performing his subsequently reversed Callback Adjustment, Mr. Sevall also appears to have conflated the difference between Callback jobs and Callback Days. A Callback Day is a day earned when a pilot works on his or her day off. However, a pilot can and frequently does work multiple assignments in a single day when performing multiple harbor shifts (each being a Callback job) and only earns one Callback Day.¹¹² Capt. Carlson supplied the number of assignments that were performed as Callbacks in 2018 in Exhibit IC-27, which are markedly higher than the Callback Days Mr. Sevall used in Exh. SS-2 for his Callback Adjustment.

87 Having misunderstood the difference, Mr. Sevall relied upon an incorrect figure when performing his Callback Adjustment in Exhibit SS-2. There, on p. 3, Mr. Sevall attempted to calculate the value of Callback assignments, using the total Callback Days earned. This had the effect of materially undervaluing the resulting liability and amount that Staff insists PSP should reserve under an accrual basis. Mr. Sevall's thus undervalued the average net income associated with Callbacks by \$842,750 (\$3,825,376 - \$2,982,626).¹¹³

E. Funding a second operations/administrative pilot

88 The Commission should also resolve whether to fund the Vice President as a second operations and administrative pilot. As described by both Capt. von Brandenfels and Capt. Carlson, the Vice President serves an important role in the operations of PSP, including fulfilling the operational roles of the President when the President is unavailable due to conflicting obligations, and fulfills

¹¹¹ Exh. SS-5T, 4: 4 – 10.

¹¹² See Exh. EVB-5X (PSP Bylaws), Section 16.4.4.1 (a pilot earns a Callback Day for taking an assignment while off duty); Exh. 9X (PSP Op-Rules), Rule 2 – Assignments (“Multiple harbor shifts assigned to a pilot shall not exceed thirteen (13) hours from the call time of the first assignment to the planned check-in time of the final assignment.”);

¹¹³ Exh. SS-2, Schedule 2.3, row 16.

administrative responsibilities that only a pilot can perform.¹¹⁴ The President cannot select just any pilot to provide that support and expect the same high degree of institutional knowledge regarding the operational and administrative functions of the Chief Executive. Thus, it is vital that the Vice President be fully engaged in the Association's operations to ensure the Association's continuity of expertise and professional operations at all times.

89 Additionally, due to the day-to-day operational and administrative functions to which the President and Vice President must attend, he or she cannot be replaced with a salaried employee. Both elected executives must have real-time understanding and experience with what is going on with membership, pilot navigation safety, equipment, and environmental conditions. Only another pilot member can calculate tide windows, address technical piloting questions and navigational safety concerns raised by pilots and dispatchers, or resolve terminal, berth, and shiphandling concerns. Neither the Executive Director nor any other salaried employee holds the authority or credentials necessary to fulfill these functions.

90 As a result of this critical work, the Vice President has not been able to carry the full assignment workload of other pilots for many years.¹¹⁵ This impacts the overall workload of pilots because the V.P. is not available to move ships, but because the non-revenue activities of the Vice President are necessary for the functioning of pilotage service and should be recognized in the revenue requirement.

91 PMSA attempts to paper over this by arguing the Vice President has traditionally worked a high assignment level and has only recently begun serving a greater role as an operations and administrative pilot due to this rate proceeding,¹¹⁶ but the evidence on which it relies is superficial at best and focuses only on what work the V.P. has been engaged in recently. Yet, as depicted in Exh. MM-70X, the Vice President has carried only a portion of the regular assignment workload of a pilot since 2011 because the Vice President's responsibilities exist

¹¹⁴ Exh. EVB-1T. 17: 3 -14; Exh. IC-1T. 1: 12 – 2: 4; von Brandenfels, TR. 123: 5 – 124: 12; 125: 3 – 18; 147: 1 – 12; Carlson, TR. 390: 17 – 403: 9.

¹¹⁵ Exh. MM-70X. p. 2.

¹¹⁶ Exh. MM-42T. 25: 23 – 26: 16.

even when a rate proceeding does not. Consequently, the Commission should recognize this vital contribution to PSP's overall pilotage service and include an additional administrative pilot in the implied pilot calculation.

V. TREATMENT OF THE ACCRUED CALLBACK LIABILITY

92 PSP's proposal for funding pilots burning Callback Days prior to retirement is consistent with the historic treatment of Callback Days by the BPC and ensures that the ratepayers, who received the benefit of the Callback system and the reduced number of pilots it permitted, will fund PSP's accrued Callback liability in the most precise method available.

A. **As a transition issue, PSP's proposed funding mechanism is the most equitable solution for all parties**

93 The current unrecorded Callback Day liability addressed in Note 10 of PSP's financial statements resulted from years of understaffing by the Board of Pilotage Commissioners and the expectation that the resulting liability would be funded at the time pilots burned Callback Days prior to retirement. Although admittedly PSP's proposal does not comport with the accrual basis under which its liabilities would have been ideally accounted and which Staff now insists be applied, doing so will ensure accuracy by including only the actual cost to PSP is included in rates, and will ensure that the transition from BPC ratemaking to utility ratemaking does not unfairly leave PSP with a liability that was created for the benefit of industry. Thus, the Commission should approve 2.9 pilots burning callback days in the revenue requirement as PSP proposed.

94 One alternative to continuing to fund the accrued Callback Day liability as PSP proposed is for the Commission to authorize PSP to accrue the entire liability at once and create a regulatory asset to be deferred and amortized as the Commission once did with post-retirement benefits other than pension in the 1990s. Yet, this treatment would likely have a far more dramatic impact on increasing rates than PSP's proposal. Thus, PSP's proposal provides benefits to industry as well.

B. PMSA’s position against funding Callback Days is inconsistent with its position regarding the need for pilots to work Callbacks

95 While PMSA disputes that any deferred liabilities should be included in rates, it has also opposed any action that could result in rate increase for pilots since 2006. PMSA’s words and conduct demonstrate that rather than addressing these issues candidly, it merely wants the best of both worlds.

96 PMSA and its predecessor first agreed to fund Callback Days at the time they were burned prior to retirement, thereby promoting the simultaneous creation of the liability and the immediate savings it provided to PMSA’s members.¹¹⁷ Then, when PSP sought to reduce pilot workload and increase the number of pilots, PMSA consistently argued that pilots should be required to work Callbacks.¹¹⁸ Now PMSA argues that pilots should be limited in their ability to use earned Callback Days,¹¹⁹ while at the same time arguing that Callback Days should not be funded at all.¹²⁰ These positions are contradictory, and PMSA should obviously not be entitled to have it both ways to PSP’s detriment.

VI. EFFICIENCY STANDARDS FOR PILOTAGE

97 PSMA further contests that Callbacks are even the result of lack of available rested pilots, and declares without supporting evidence that Callbacks are merely the result of systematic inefficiency. This premise reveals that PMSA lacks an inherent understanding of pilotage and the demands on pilots in the existing dynamic environment of unpredictable vessel surges and never-ending change orders and vessels delays. In reality, many pilotage ratesetting authorities have expressly recognized that to ensure reliability in pilotage service, staffing must be sufficient to meet peak demand because the ability to respond promptly to vessels in need of service is of paramount importance to maritime commerce.¹²¹

¹¹⁷ Exh. WT-2.

¹¹⁸ Exh. IC-13; Exh. MM-96X, p. 2 (“The two-watch system is not a good fit for assignments that are seasonal and that fluctuate from day to day without some level of mandatory call backs per pilot.”); Exh. MM-85X.

¹¹⁹ Carlson, TR. 342: 6 – 9; 343: 4 - 8 (PMSA’s attorney repeatedly questions Capt. Carlson as to whether PSP has the right to limit the use of Callbacks)

¹²⁰ Exh. MM-42T. 43: 11 – 44: 12.

¹²¹ For example, the Coast Guard uses a peak staffing model because, despite the additional cost, it helps ensure that pilots may provide a safe, efficient and reliable service, which is in the public interest. Great Lakes Pilotage Rates—

98 In order to meet these demands, nearly every other pilotage district simply licenses additional pilots to meet the unpredictability of shipping schedules. Because PMSA has long been successful in arguing against it, the BPC has not licensed or funded a sufficient number of pilots, and PSP has been forced to create internal efficiencies (along with corresponding liabilities) and meet shipping demands with the Callback system instead.

99 In fact, PMSA refuses to acknowledge that PSP is severely understaffed, or that the operation of a safe pilotage service which meets the goals of the Pilotage Act requires that pilots contribute to operational and administrative functions of PSP rather than delay vessels indefinitely due to the severe pilot shortage. Instead, nearly every argument PMSA has raised regarding efficiencies is nothing more than an attempt to move the goalposts for PSP to avoid paying the full cost of a comprehensive and safe pilotage service.

100 First, PMSA argues that pilots have uneven workloads, with some working a significant number of assignments than others.¹²² PSP responded by demonstrating that pilot workloads are fairly even, with the chief difference being that some pilot contribute to the overall pilotage service through non-revenue activities, a concept directly acknowledged by the BPC.¹²³ Moving the goalposts anew, PSMA now argues that non-revenue activities are not technically “assignments” through lengthy witness examinations regarding whether meetings, training and other activities are precisely the same as an “assignment” for dispatch purposes. Yet PSP could not serve its vital role in “preventing the loss of human lives, loss of property and vessels, and [protecting] the marine environment of the state of Washington”¹²⁴ if its members could not contribute to its operations and administrative functions in ways other than simply performing vessel

2016 Annual Review and Changes to Methodology, 81 FR 11908-01. *Portland S. S. Operators' Ass'n v. Coos Bay Pilots' Ass'n*, 39 Or. App. 513, 516, 592 P.2d 1060, 1061 (1979)(“Maintaining a sufficient force of pilots to insure immediate competent pilotage service during peak traffic bestows a desired economic benefit on the ship operators. The cost of delay for want of a pilot can run as high as \$30,000 per day.”); *S. Florida Cargo Carriers Ass'n, Inc. v. State, Dep't of Bus. & Prof'l Regulation*, 738 So. 2d 391, 400 (Fla. Dist. Ct. App. 1999)(The public interest in having qualified pilots available to respond promptly to vessels needing their service “is the most important of the statutory factors” considered in pilotage ratemaking).

¹²² Exh. MM-1Tr. 44: 7 – 21.

¹²³ Exh. IC-12.

¹²⁴ RCW 88.16.005.

assignments. Thus, these arguments deflect and fail to demonstrate that Callbacks are the result of any inefficient system.

101 Yet another example of goalpost shifting came during the cross-examination of Capt. Carlson and the subsequent re-direct of Capt. Michael Moore regarding the mandatory rest periods. There, PMSA's counsel attempted to argue that pilots are subject to a 14-hour assignment limit that ensured pilots were permitted 10 hours of rest each calendar day:

Q. And in terms of our -- your workload analysis, Captain Carlson, it seems that with the ten-hour rest rule in place, the absolute maximum work that a pilot could legally do while on duty in a 24-hour is a 14-hour assignment; would you agree with that?

A. No.

Q. What is there to disagree with?

A. We have many assignments that are over 14 hours. The maximum that a pilot can do, if they are performing multiple harbor ships, is 13 hours. We have many assignments that are over 20 hours.¹²⁵

PMSA's counsel went on to assert that each pilot would obtain 10 hours' rest during every day of a 181 watch day period.¹²⁶ Yet, this line of questioning clearly obfuscates and/or ignores that rest rules do not require 10 hours' rest every day, nor do they impose a maximum limit on the number of hours a pilot may work in duration for a single assignment. Instead, they merely require a pilot obtain 10 hours' rest following the completion of an assignment.¹²⁷

102 PMSA followed this argument with testimony during the re-direct of Capt. Moore, in which he inaccurately claimed that if he excluded assignments in which a pilot was carried away to British Columbia he could find only one assignment by PSP in excess of 14 hours.¹²⁸ To start, Capt. Moore's qualification is quite telling, since there could obviously be a significant number of assignments in excess of 14 hours when a pilot is carried out of district. Moreover, his finding is wildly significantly inaccurate. A review of data set forth in Exhibit IC-40X reveals that there were in fact 446 assignments in 2018 and 308 assignments in 2019 which exceeded 14 hours,

¹²⁵ Carlson, TR. 317: 10 – 14.

¹²⁶ *Id.* 319: 6 – 8.

¹²⁷ RCW 88.16.103(a).

¹²⁸ Moore, TR. 534: 18 – 535: 18.

while there was only one assignment in which the *bridge hours* exceeded 14 hours, suggesting PMSA once again attempted to minimize the workload pilots actually carry.¹²⁹

103 PMSA and Staff also seem to argue that expanded mandatory rest should have no impact on the number of assignments a pilot can perform because doing so is somehow simply an attempt to use fatigue management to earn more. While it is true that ensuring pilots finally obtain adequate rest between assignments will reduce the number of assignments that can be performed during their scheduled work days, and thereby increases the number of pilots needed to move ships, this result is both logical and fair. Conversely, any attempt to assert that expanding rest requirements during scheduled work days means pilots should be required to accept more assignments on days off-watch simply ignores or otherwise minimizes pilots' work schedules and the requirement that they serve on standby for 24-hours a day while on watch.

VII. ASSIGNMENT PROJECTIONS

104 The primary decision the Commission should make with respect to assignment projections and their resulting impacts on the implied pilot count and rate spread is whether to accept Staff's five-year average or Dr. Khawaja's econometric projection. Here, the Commission should favor accuracy and adopt Dr. Khawaja's projection. A five-year average may serve as a sufficiently accurate projection at times, but it will not be as accurate as an econometric analysis.¹³⁰ Half of the time it will be too high, and half of the time it will too low.¹³¹

105 As an additional matter of vessel assignment calculations, the Commission should refrain from any attempt to adjust these projections based upon the ongoing pandemic for a number of reasons. Indeed, rather than known and measurable, any adjustment will be highly speculative in nature as Staff and PSP agree.¹³²

106 Moreover, valid reasons exist to authorize a rate increased based upon historic shipping trends that should continue in the future. First, the BPC has not revised the current number of pilots it

¹²⁹ See Appendix A, compiling assignments in Exh. IC-40X, tab "jhr 2016-2019" where the time between "call time" and "check in time" exceeded 14 hours.

¹³⁰ Exh. SK-3T. 6: 17 – 7: 9.

¹³¹ *Id.*

¹³² All parties appear to agree with at least with respect to 2022 and 2023.

has authorized to license in the face of the pandemic nor should it. The process of examining, training and licensing new pilots requires long-term planning, and rather than using short-term extraordinary events to guide that process, the BPC should continue to license additional pilots particularly in light of the looming retirements sought in Bench Request No. 1. Second, the Commission should signal to trainees and pilot candidates alike that that adequate funding will be provided and available to compensate additional pilots when shipping traffic returns to normal. Finally, in the event that shipping traffic continues at reduced levels, the pilots will naturally earn less than projected. Meanwhile, the shipping industry has apparently already found various ways to reduce costs by cancelling sailings as acknowledged by Capt. Moore.¹³³

VIII. RATE DESIGN

- 107 The Commission should also resolve issues of rate design in favor of PSP's proposal. Here, the issue is not the determinants to use within PSP's proposed tariff, which Staff supports. Instead, the issue for resolution is the appropriate policy to be applied in charging vessels based upon their size through the gross tonnage charge as the primary determinant. Staff proposes that approximately 60% of the revenue requirement be derived from the Service Time charge, which applies equally to all vessels.¹³⁴
- 108 When applied to Staff's revenue requirement Staff's rate design results in an inexplicably large rate decrease for the largest vessels,¹³⁵ and further results in a rate increase greater than 100% for many of the smaller vessels that call on the Puget Sound.¹³⁶ Moreover, as discussed by Capt. Moreno, Staff's rate design will not scale well when applied to a revenue requirement that would actually provide sufficient rates to PSP, and would result in rate increases for smaller vessels of up to 230%.¹³⁷
- 109 While Staff and PMSA agree that larger ships should be charged more, the fact that Staff proposes that majority of all revenue earned by Service Time Chares means that smaller ships

¹³³ Moore, TR. 483: 11 – 484: 6.

¹³⁴ Exh. SS-3r.

¹³⁵ See Exh. IC-4Tr. 48: 1 – 8; Exh. IC-23 (Rate Comparisons); Exh. SM-2T. 12: 7 – 17.

¹³⁶ Exh. MM-42T. 29: 4 – 11.

¹³⁷ Exh. SM-2T. 14: 17 - 22; Exh. SM-4.

will pay a disproportionately larger share of costs incurred by PSP. Staff's proposal gives insufficient consideration to the significant difference in risk and skill requirements that correspond to ship size. This results in rates that are neither fair to the owners of smaller vessels that pay a disproportionate share of costs, nor to the pilot whose license is put on the line when in every ship movement.

110 Indeed, the Virginia State Corporation Commission rejected that such a premise is fair, ruling:

The physical size of a ship represents a fair basis upon which to assess pilotage charges because the size of a ship, more than any other factor, best reflects the overall difficulty, responsibility, and value of service rendered when piloting a ship. Indeed, any method that does not charge larger ships more for pilotage services than smaller ships would not represent a "fair charge for the service rendered" because it would require smaller ships to pay a disproportionately larger share of the costs incurred by the Association to provide service.

Assessing pilotage charges based on the physical size of a ship is also not unique to Virginia. Most ports in the United States use the physical size of a ship as the primary determinant of pilotage charges because it represents the most fair and equitable basis upon which to allocate the costs of providing pilotage services. We will not depart from this fundamental rate design concept when setting pilotage rates in Virginia.¹³⁸

The Commission should recognize this principle and approve of PSP's rate design as well as the specific allocations between Service Time and Gross Tonnage that PSP proposes, which utilize Gross Tonnage as the primary determinant of the rates a vessel will be assessed.

IX. POLICY RECOMMENDATIONS ON ACCOUNTING

A. Considerations of accuracy in revenue requirement establishment, actual revenue collection, and impacts of the pandemic

111 As he himself describes, Danny Kermode's testimony on two of the largest economic issues, Callback Days and pension/deferred compensation are "policy focused."¹³⁹ PSP concurs that in transitioning from BPC oversight for well over half a century to the UTC, there are no more significant economic and accounting policy issues than Callback and pension. Much of the presentation by the parties are detailedly devoted to these important issues, presenting differing

¹³⁸ *In Re Application of J. William Confer*, Case No. PUE-2006-00046, Final Order, (Sep. 11, 2006).

¹³⁹ Exh. DPK-1T. 3.

perspectives on the background, history and most importantly, the recommended approach by the Commission to these topics.

112 On the subject of the “pay-as-you-go” unfunded defined benefit plans for pilot retirement, PSP witnesses Capt. George Quick and Walt Tabler testified extensively on the history of PSP’s retirement program, its treatment and approval in rates by the BPC over the years,¹⁴⁰ and the national predominance in pilotage associations of the pay-as-you-go model whose roots and creation predate the modern 401K-defined benefit plans and ERISA by many decades.¹⁴¹ Steven Diess, an actuary, testified on behalf of PSP to the long-term viability and sustainability of PSP’s retirement program into the foreseeable future.¹⁴² Despite Mr. Diess’s expert testimony, Mr. Kermode critiqued what he described as the “PayGo” system as constituting a pronounced exposure to business risks, particularly in times of economic downturns.¹⁴³ He further highlighted this unrecorded liability, (akin to PSP’s Callback liability), which he testified is exacerbated by the lack of accrual accounting and the escalating size of that liability to current pilots.¹⁴⁴

113 Mr. Tabler anticipated some of these concerns in his initial testimony in November, where he explained that failure to include the costs of the retirement obligation in the tariff would mean PSP would likely be destroyed, “in a flurry of acrimony and litigation.”¹⁴⁵ In anticipating a recommendation for potential future structural changes to the pilot pension, he advocated that any changes should “occur the same way it was created: three way negotiations involving the pilots, industry and the rate-setting body.”¹⁴⁶

¹⁴⁰ See WAC 363-116-300 (“LOA Rate Schedule: The following rate schedule is based upon distances furnished by National Oceanic and Atmospheric Administration, computed to the nearest half-mile and includes retirement fund contributions.”)

¹⁴¹ See Testimony of Walter Tabler Exh. WT-1T. 10-16; Testimony of Captain George Quick, Exh. GQ-1T. 20-24.

¹⁴² Exh. SD-1T. 6: 1-2.

¹⁴³ Exh. DPK-1T. 24: 16-17.

¹⁴⁴ Exh. DPK-1T. 23:6-14.

¹⁴⁵ Exh. WT-1T. 15:13.

¹⁴⁶ Id., 15,16.

114 It is important to note again that PMSA has opposed every general rate increase ever proposed by PSP since 2006.¹⁴⁷ Thus unsurprisingly in its response testimony, it contested any inclusion of deferred compensation funding in PSP’s tariff, despite RCW 88.16.055 and the documented history of BPC recognition of PSP’s pension program in rates for decades before the arrival of PMSA in Puget Sound.¹⁴⁸ However, on cross-answering, Captain Moore actually supported Danny Kermode’s ultimate policy recommendation on transitioning to a fully-funded retirement program as a premise of the final Order to be issued in this proceeding, saying:

We believe it is important for all stakeholders to have an honest dialogue brokered by [the] Commission about the nature, extent, and scope of the actual retirement issues and where the true costs and benefits of the current system lie and how to resolve the lack of funding issues equitably for everyone.¹⁴⁹

115 While PSP fundamentally disagrees with and disputes PMSA’s so-called “externalization” theory of deferred compensation, it also well recognizes that in transitioning to a new economic regulator, examination of the fundamentals associated with its largest line item of expense is imperative. As with most all regulated companies for whom it sets rates, deferred compensation programs are prominent components and expense items for consideration by the Commission in the overall costs of performing regulated service.

116 Mr. Kermode identified both the size and makeup of the PSP “PayGo” plan as a major, if not the major issue in this proceeding, both presently and prospectively. PSP similarly believes, along with callbacks, there is no more significant accounting issue in the ratesetting transition to the UTC. Thus only a comprehensive and broad-ranging universal stakeholder evaluation and participation study, informed as well by knowledgeable specialists in the pension and retirement field, is required before any alternative to PSP’s current plan before any change is considered. Indeed, PSP believes the continuing viability, stability and ultimately, safety, of our marine pilotage system depends on that vital collaborative process.

¹⁴⁷ Moore, TR. 501: 21.

¹⁴⁸ Not to mention the support for continued funding of retirement as articulated by the former chair of the House Transportation Committee as SB 6519 was deliberated. <https://www.tvw.org/watch/?eventID=2018021347>, 48:18 to 49: 58.

¹⁴⁹ Exh. MM-42Tr. 45.

B. Callback Days.

117 Converging in Mr. Kermode's policy recommendation on accrual accounting transition and better alignment with GAAP reporting, was his testimony and critique of Callback Days and the historic accounting for this overtime system. Clearly, the history of callback acknowledgment by the BPC over the decades and the universal characterization of callback accounting Mr. Kermode aptly identified as one of the relics of the "black box" ratemaking style of the BPC.

Unquestionably, this is a highly problematic element of the transition from the BPC to the UTC and poses the real risk of an equivalent form of "rate shock" for PSP and its members as some of the traditional treatment of operating and accounting practices acknowledged and/or recognized by the BPC collide with the far more systematic and transparent form of regulatory utility accounting and uniform system of accounts reporting at the Commission.

118 While the response to the staff's and PMSA's contentions on the design and operating assumptions of the Callback system utilized by PSP for decades was outlined earlier in this brief, we respond below to staff's accounting and policy recommendations regarding the recordation and calculation of Callback Days and their impact on PSP's underlying revenue requirement.

119 As a preliminary matter, Mr. Kermode testified he was not contesting the underlying premise of Callback Days. There, he noted that the Callback system is a consequence of an average staffing level which is consequently insufficient at peak demand, observing that "[a]verage staffing is a commonly used method of staffing in service industries that experience variable service demands."¹⁵⁰ His subsequent analogy to surge staffing at a grocery store however, was critiqued by one of PSP's expert economists, Dr. Sami Khawaja, who pointed out that while grocery store clerks who are performing tasks like inventory assessment and are on site can easily be reassigned to cashier duties, calling back off-duty pilots to work has a significant personal [and logistical] cost that needs to be reflected in the revenue requirement for PSP.¹⁵¹

¹⁵⁰ Exh. DPK-1T. 13: 1-2.

¹⁵¹ Exh. SK-3T. 6: 1-5.

120 Mr. Kermode’s testimony also acknowledged the historical practice of BPC in setting “rates to include compensation for ‘unfunded’ callback days by imputing into rates ‘the cost of call back days’ associated with retiring pilots.”¹⁵² This is yet another “carryover vestige” from the black box ratemaking of the BPC.¹⁵³ Mr. Kermode’s cross-examination testimony and recommendations highlight the present dilemma faced by the Commission in confronting and possibly unwinding approximately a half century or more of BPC oversight of callback accumulation which Mr. Kermode described as a “lens” in his live testimony but which unfortunately is hardly transparent as Exhibits DPK-12-14X demonstrate. In past years, it is clear, as Mr. Kermode’s original testimony confirms, the BPC believed it was setting rates to include the cost of funding callback days associated with retiring pilots. Despite Mr. Kermode’s concern with double counting of callbacks,¹⁵⁴ also admitted on cross-examination that PSP was not contesting it had been previously paid for the movement of the ship by an off duty pilot in seeking to avert a ship delay and that no additional revenue as a callback is then generated.¹⁵⁵

121 Yet, the problem with the colliding paths here is Mr. Kermode’s fundamental accounting recommendation that the off-balance sheet accumulation of callback liabilities be resolved simply by creating a book entry to accrue a liability when a callback day is earned. Indeed, he suggests noting a debit to revenue and a credit to callback liability which formula he illustrates at Exh. DPK-1T, page 17 could easily reflect the change. While this accrual accounting recommendation is not difficult to grasp, the rub, which Mr. Kermode himself acknowledges, is that the practice has been building up for almost half a century. And, despite his rather facile fix for the problem on an accounting level, there are significant ramifications when an off-balance sheet liability estimated to be \$6,927,172 as of December 31, 2018¹⁵⁶ because of an accounting

¹⁵² Exh. DPK-1T. 14.

¹⁵³ Kermode, TR. 575: 16 – 17.

¹⁵⁴ Exh. DPK-1T. 14. *See also* for example, Exh. WT-02 at Appendix D where the 2001 MOU with PSP, PSSOA and Polar Tankers expressly provides for tariff funding for callback days accrued by pilots at the time of their retirement.

¹⁵⁵ *Id.*, Kermode, TR. 571.

¹⁵⁶ Exh. JN-1T. 2: 21.

recording switch is somehow expected to be resolved overnight. Unquestionably, this is not a recommendation to be implemented in a vacuum.

122 Any recommendation for immediate recognition of the approximate \$6.93 million callback liability would precipitously render PSP effectively insolvent from a balance-sheet accounting standpoint. This could threaten the organization's overall creditworthiness and greatly hinder its ability to attract lenders for projects such as the hopeful prospective plan to replace the two 20-year old pilot vessels featured in the depreciation section, below. Additionally, an immediate recognition of this long-developing obligation would appear to violate the principle of regulatory consistency and gradualism which is only magnified here by the migration in economic regulation from one state agency to another. While staff's direct and cross-answering testimony emphasized comity and cooperation with the Board of Pilotage Commissioners in this transition, even itself referring to the need for "consistency,"¹⁵⁷ the immediate fallout from such a dramatic change in callback accounting would ironically be anything but consistent or gradual.

123 When questioned more directly on the implications of his callback accrual accounting recommendation however, Mr. Kermodé hinted at some alternatives to the dilemma: for instance, the possibility of cordoning off the previous accumulative liability and implementing the prospective liability on an accrual accounting basis while addressing his additional concerns about valuing callback days on a formula tied to the most recent DNI calculation.¹⁵⁸ When pressed about the timing of resolving this massive financial obligation, Mr. Kermodé seemed, despite his reference to "paying the piper" and effectively avoiding kicking the proverbial can down the road, to consider a similar deliberative approach to globally resolving the callback accounting issue in the same fashion and forum all parties appear to agree upon for a possible alternative to the presently unfunded deferred compensation plan for the pilots:

¹⁵⁷ Exh. DPK-1T. 5: 8 - 9; *See also*, Exh. DPK-3Tr. 7:8 -16.

¹⁵⁸ Kermodé, TR. 575, 576.

I'd be happy to participate. But I don't think I would – I'm not going to pull – I'm not comfortable withdrawing my recommendation. But I would not be upset if the commission took that [broad stakeholder participation and review] tact.¹⁵⁹

124 Mr. Kermode's testimony posits in very sharp terms the impediments to a smooth regulatory transition from a prior economic regulator to a new one. Again, no one at PSP disputes the goals of the legislative study committee in moving to a more transparent, uniform, consistent and technical forum and format for pilotage ratemaking. But penetrating that black box of ratesetting practices and rationale and adapting to accrual accounting, uniform systems of accounts and most importantly, eliminating off-balance sheet liabilities allowed to grow over multiple decades, requires thoughtful precision and thorough consideration of the impact on the continuing viability of PSP in conforming to conventional ratemaking and accounting methods. The testimony of Danny Kermode generally offers measured paths and solutions including GAAP-based reporting to the UTC in the future without immediately jettisoning the modified GAAP accounting previously accepted for many years by the BPC. In PSP's view, an essential element in that transition is thoughtful, comprehensive and measured approaches to bridging that divide, accounting for callbacks which will remain a reality in some form as both Dr Khawaja opined and Staff acknowledged, as a product of on-demand service which does not involve the complete expense of peak staffing. As with its historic deferred compensation plan, PSP trusts that the Commission will ultimately see the wisdom in approaching the transition to accrual accounting for callbacks interval in a similarly deliberative, informed and thoroughly considered pivot to the transparent and methodical accounting treatment of pilot staffing in local maritime commerce.

X. OPERATING EXPENSES

A. Staff Adjustments to operating expenses

125 In order to establish rates that are fair, just, reasonable and sufficient rates, PSP must be permitted to recover its reasonable operating expenses. Staff took few issues with PSP's operating expenses and PSP did not contest the majority of staff's expense accounting

¹⁵⁹ Kermode, TR. 579: 13-17.

adjustments for its filing and focused instead on just two of its five major adjustments on rebuttal: removal of \$156,809 (R-17) in expense for ground transportation and the restating or “pro forma” adjustment R-10 for depreciation expense on the two pilot boats used at its Port Angeles station to transport pilots to and from vessels transiting Puget Sound. These adjustments were unsupported and should be rejected by the Commission.

i. Staff adjustments to Transportation Expense Charges

126 The chief problem with Staff’s removal of the transportation expense adjustment made by Mr. Burton¹⁶⁰ is that without a pro forma adjustment to test year transportation expense a significant portion of actual operating expense that will be incurred in the rate year will not be recovered. This is because under the current tariff pilots receive the revenue under BPC tariff’s Transportation Expense Charge (“TEC”) directly rather than a reimbursement from PSP for actual expense.¹⁶¹

127 As explained by PSP, the current BPC tariff recovers ground transportation costs based on taxi fare allowances relating to 18 originating points in the Puget Sound area (excluding Canadian ports) which involve charges of as high as \$277.50 per assignment to a low of \$15.¹⁶² In order to transition from the BPC’s estimated expense methodology to an actual cost of service basis supporting the TEC, PSP thus performed a transportation expense study to estimate the actual expense that will be incurred under the proposed tariff that is not currently included in PSP’s operating expenses.

128 PSP informed Staff prior to implementing the pilot assessment that it wanted to compile a cost-based study that would aggregate actual charges for use in a new single transportation expense charge that would reflected an average aggregate actual cost rather than varying charges for 18 different points. The concept of a single, average cost-based assessment was obviously easier to administer, bill and account for and more transparent to customers.¹⁶³

¹⁶⁰ Exh. AMCL-4.

¹⁶¹ Exh. LS-1T. 2: 18 – 21; Exh. WTB-14T. 9: 1 – 14.

¹⁶² Exh. WTB-1T. 9.

¹⁶³ Exh. WTB-1T. 9: 12, 13.

129 In response testimony, Staff took issue with both the duration and seasonal accuracy of the pilot project and, as noted above, sought to remove the pro forma adjustment in its R-17 adjustment of almost \$157,000, arguing it was abnormally high. But Jessica Norris established that Staff had failed to include or otherwise normalize the historic expense recovered by the BPC tariff and which expenses were outlined in PSP’s audited financial statement for 2018 (Exh. JN-04). Ms. Norris prepared an exhibit, JN-07, which restored those historic charges, normalized the overall calculation and demonstrated that even with their restoration, pilot ground transportation charges were comparable between 2015-2019 even under the proposed cost-based system PSP implemented as a trial just prior to the end of the test period in order to be responsive to the Commission’s preference for cost-based rates.

130 Additionally, as JN-07 reflects, transportation expense as a percentage of overall revenue has actually decreased, from 4.2% in 2015 to 3.6% in 2019 even when adding back the transportation expense charge (“TEC”), which Staff inexplicably omitted from its original AMCL-4. Moreover, removing the 2015-2018 charges does not accurately reflect total transportation revenue collected by the BPC tariff as reflected and reported in PSP’s audited financial statements during this interval.

131 Ironically, PSP believed that its “pilot” ground transportation cost study would be more acceptable, modern and transparent than the present multi-point transportation cab-fare based allowance system. If the Commission ultimately decides to reject this approach, PSP can continue to recoup ground transportation charges under the model long-established in the BPC tariff for ground transportation charges, provided the historic “TEC” costs as set forth in Exh. JN-07 are restored in PSP’s allowed expense base.

ii. Staff depreciation adjustments

132 The other disputed accounting adjustment for refocus here is the Staff depreciation adjustment to the two pilot vessels which are two of the most significant assets in the entire PSP rate base. These are addressed in Staff adjustment R-10.

133 PSP has concerns about a number of factors on the staff's adjustment for the *Puget Sound* and the *Juan de Fuca*, the two vessels in question. While Weldon Burton's rebuttal testimony details the basis of PSP's objections here, on the former, PSP disputes the removal of any depreciation for the vessel in the test period and the failure to give effect to the final six months of the 20-year vessel depreciation life set forth at 46 CFR § 382.3 on the basis of Ms. LaRue's conclusion that it has no depreciable value in the test year. Next, for the *Juan de Fuca*, she relies on rather vague anecdotal references attributed to "discuss[ions] with the pilots and their representatives"¹⁶⁴ for an extended longevity of the vessels and on that basis, simply doubles the remaining depreciation amortization period for the *Juan de Fuca* to four instead of two. She supports her premise here by reference to a "remaining life theory" of depreciation. PSP's regulatory accountant was not aware of any such theory and which was defended by Staff in a data request response as a "regulatory accounting technique" for which they cited PSP to a 40-year old FCC telecom decision in support.¹⁶⁵ Mr. Burton testified he had never heard of this policy nor to his knowledge was it recognized in any final general rate case order of the Commission under Title 81 in his 35-plus years of filing general rate cases at the UTC for regulated transportation companies.¹⁶⁶ It is notable that the Commission has previously signaled its disapproval of the application of subjective criteria by Staff in applying expense adjustments.¹⁶⁷

134 The unilateral extension of the amortization period for the *Juan de Fuca* and the failure to allow any remaining depreciation in the test year or for the remaining six months of calendar year 2019 for the *Puget Sound*, results in a reduction of \$252,889 in disallowed depreciation expense for PSP.

135 Should the Commission ultimately determine to somehow ratify the unilateral extension of the amortization period and the similarly abrupt elimination of depreciable life for the *Puget Sound*,

¹⁶⁴ Exh. AMCL-1T2r. 9.

¹⁶⁵ Exh. WTB-16.

¹⁶⁶ Exh. WTB-14. T:14. In fact, a thorough review of Commission orders found zero instances of the remaining life depreciation approved for Title 81 companies.

¹⁶⁷ *In re: Consol. Garbage Cases*, Dkts. TG-2016 et al, Order 05 at 20 (Jan. 28, 1988).

PSP believes the staff's original premise of lengthening amortization of "foundational" legal and accounting fees should be reconsidered. Commissioner Rendahl's question of Staff at the hearing¹⁶⁸ on the extraordinary length of that amortization period is certainly appropriate if vessel depreciation and subjective "remaining life" regulatory techniques are to be rather loosely applied by Staff to abruptly eliminate or extend recovery intervals for allowable expenses. While PSP did not originally contest the "foundational expense" theory of rate case cost amortization on rebuttal which extended the interval of half those costs to seven years, should the Commission affirm the staff's other adjustments here, further overall review of amortization intervals should then be indicated in the context of Commission accounting adjustment consistency and the more standard maximum five-year period of legal and consulting cost amortization would seem fully appropriate.

B. PMSA's position on various operating expenses has been inconsistent and is unclear

i. PMSA objects to inclusion of reasonable operating expenses and insists they be treated as income

136 Unlike Staff, PMSA has taken issue with a number of PSP's operating expenses, deeming only direct operating expenses to be "essential" and most others to be "non-essential" and requests that only those it considers "essential" to be permitted.¹⁶⁹ Among those expenses it objects to as "non-essential" include those that are "not a component of vessel service" including medical insurance, pilot pension payments, pension payments to retired employees, license insurance, and transportation expenses.¹⁷⁰ PMSA further objects to the characterization of certain benefits as expense in the revenue requirement and insists they be treated as income to pilots. Inconsistently, PMSA also erroneously asserted that PSP had overinflated benefits in its revenue requirement by seeking funding for additional benefits and insurance for pilots that do not exist.¹⁷¹ The Commission should reject PMSA's arguments as out of conformity with both Commission precedent and pilotage ratesetting methodologies.

¹⁶⁸ La Rue, TR. 608, 609.

¹⁶⁹ Exh. MM-1T. 28: 9 – 16; 102: 6 – 13.

¹⁷⁰ *Id.* Exh. MM-36r.

¹⁷¹ Exh. MM-1Tr. 113: 11 – 26.

137 First, as noted above, PSP’s operating expenses are reasonable and ordinary expenses for a regulated public service company.¹⁷² Second, if the Commission does treat these components of the revenue requirement as income rather than benefits they will indeed distort the revenue requirement when there are fewer licensed pilots than implied pilots. Thus, even if considered benefits to pilots, they are reasonable and properly treated as expenses in PSP’s revenue requirement.

ii. SILA taxes should be included in the revenue requirement

138 PMSA further challenges PSP’s inclusion of payments made to the BPC by PSP pursuant to WAC 363-116-301 in PSP’s operating expenses. The payment required under that rule can be appropriately characterized as a either tax upon PSP’s revenues or a regulatory fee.¹⁷³ Regardless of whether it is a tax or a regulatory fee, it should be deemed a prudent expense that can and should be passed through and recovered by PSP in its revenue requirement.¹⁷⁴ The fact that customers already pay a surcharge to fund the liability does not establish that PSP is otherwise required to pay these charges to the BPC without recovery in the revenue requirement, nor is there any other basis for the Commission to conclude that the Legislature intended otherwise.

XI. PORT COMPETITIVENESS

A. PMSA’s evolving argument seeking to implicate pilotage rates as a material factor in port competitiveness obfuscates the role of recent port system increases and B.C. Port cost advantages.

139 In his opening testimony at Exh. MM-1T2r, Captain Moore spends roughly ten pages of that testimony largely relying on hearsay attributions to the Northwest Seaport Alliance (“NWSA”) ports of Seattle and Tacoma, seeking to implicate any upward adjustment in pilotage rates as a

¹⁷² See *WUTC, v. Puget Sound Energy, Inc.*, Dkts. UE-090704 and UG-090705, Order 11, ¶ 79 (Apr. 2, 2010)(approving employee pension expense); *WUTC v. Harbor Water Co., Inc.*, Dkt. U-87-1054-T, Final Order (May 13, 1988)(authorizing owner compensation and benefits); *WUTC v. Washington Water Service Co.*, Dkt. UW-143116, Order 02 (Jan. 15, 2015)(authorizing rate increase to cover transportation expenses, among others).

¹⁷³ The difference between a regulatory fee and a tax imposed by a governmental agency is whether the primary purpose is to accomplish desired public benefits which cost money, or whether the primary purpose is to regulate. If the primary purpose of the charge is to raise revenue, the charges are a tax. *Covell v. Seattle*, 127 Wash.2d 234 (1995).

¹⁷⁴ See *WUTC vs. the Washington Water Power Co.*, Respondent., Dkt. U-88-2380-T, (Oct. 19, 1989)(authorizing recovery of excise taxes, and utility taxes/franchise fees); See also *Willman v. Washington Utilities & Transp. Comm’n*, 154 Wn.2d 801, 808, 117 P.3d 343, 346 (2005)(tribal utility taxes are considered prudent expenses).

cause of loss in competitive market share of container traffic at these regional ports.¹⁷⁵ While admitting that “the NWSA was very steadily productive in growing volumes from 2014 to 2018, that growth has slowed,”¹⁷⁶ he goes on to attribute the loss in trans-pacific trade as “primarily a reflection of the lower overall volumes at Puget Sound ports.”¹⁷⁷

140 While noting that the biggest competitors of NWSA are the British Columbia Ports of Vancouver and Prince Rupert, Captain Moore curiously fails to suggest, nor provide any evidence of how tying increased pilotage rates to his central theme of diminution in port competitiveness unfolds. Captain Moore also fails to acknowledge that the NWSA has had a direct hand in creating any disparity in west coast port costs. Captain Carlson testified for PSP the Ports of Seattle and Tacoma charge terminal tariff moorage rates that are significantly higher than other west coast ports, “and have raised their own terminal rates since 2015 while PSP has had no rate increases in that time.”¹⁷⁸ Captain Carlson sponsored Exh. IC-22, utilizing publicly available west coast port tariffs to demonstrate that Captain Moore’s references to NWSA’s opposition to pilotage rate increases suggest the adage of “charity begins at home” might be pertinent. In other words, port costs do not exist in a vacuum and as Exh. IC-22 reflects, the Ports of Seattle and Tacoma cannot point to any increases in pilotage costs in the 2015-2020 interval as a basis for their own escalation of port charges in that same period which as demonstrated, significantly contributes to a lack of “port competitiveness” in the realm of the comparators set forth in the illustration in Exh. IC-22.

B. PMSA’s attempts to link PSP’s rate filing with the decline in containerized tonnage in cargo volumes at northwest ports were thoroughly rebuffed by PSP’s expert, Dr Leachman.

141 Even more telling, however, in the premise advanced by PMSA that pilotage rates materially impact northwest port competitiveness was the testimony of Robert Leachman, PhD. for PSP in

¹⁷⁵ Exh. MM-1T2r. 125-136.

¹⁷⁶ *Id.*, 128. Captain Moore here curiously omits any consideration of the widely reported U.S./China trade disputes in 2019 that impacted international shipping volumes.

¹⁷⁷ *Id.*, 130.

¹⁷⁸ Exh. IC-4Tr. 45: 22-23.

rebuttal, provided in Exh. RL-1T. Since 2003, Dr. Leachman has directed the ongoing development and application of a large-scale economic model studying all waterborne containerized imports from the far east to the continental United States. Dr. Leachman and his group craft optimal supply chain strategies for various importers in order to provide the total lowest logistical costs including transportation, handling and inventory of affected goods. His elasticity model has historically been applied to assess the impact of proposed port fees, including the impact of harbor maintenance, Puget Sound pilot fees and various other elements of the supply chain.¹⁷⁹

142 Dr. Leachman’s uncontroverted testimony in this record as captured by his Table 6, Exh. RL-1T, 15, demonstrates that since 2013, and actually beginning in 2005, containerized traffic via inland point intermodal services has declined significantly or now, by more than 34.9% in the Puget Sound area.¹⁸⁰ But the reasons for that are not pilotage rates. Dr. Leachman, instead, cites two reasons for this decline. The first is the harbor maintenance fee assessed by all US ports that is based on a 0.125% of total declared value paid by the importer which Dr. Leachman estimated in 2019 to NWSA was about \$38,400 per declared value of TEU which, if routed through BC, would save an importer about \$48 per TEU which for average current container configurations would actually amount to \$96 per FEU or (40 foot equivalent units) through Canadian ports.¹⁸¹

143 The second factor contributing to the increasing routing of containers away from NWSA and other west coast ports Dr. Leachman attributed to cheaper rail rates assessed ocean carriers by Canadian versus US rail carriers to Midwest inland ports which he estimated to be from \$100 to \$200 less per 40 foot equivalent unit (“FEU”) in an inland shipment from the west coast to the Midwest.¹⁸²

144 In factoring in the proposed increases in Puget Sound Marine pilotage rate projected over the three years of 2020, 2021 and 2022, Dr. Leachman calculated the effect of the increased rates

¹⁷⁹ Exh. RL-1T. 5.

¹⁸⁰ Exh. RL-1T, 15:1.

¹⁸¹ Exh. RL-1T. 16.

¹⁸² Exh. RL-1T. 16.

would ultimately amount to approximately \$1.36 per TEU or \$2.74 for a 40 foot equivalent unit which he termed to be “too small to be measurable” on imports.¹⁸³ On exports, Dr. Leachman calculated the increased caused by the proposed pilotage tariff increases to be equivalent to adding 1.24 miles in additional travel cost equivalence¹⁸⁴ which he similarly described as “too small to be measurable.”¹⁸⁵

In summary, the proposed changes in PSP fees assessed on container vessels results in an equivalent cost of \$1.36 per loaded TEU laded for discharge at the NWSA ports. If such costs were passed through as surcharges to beneficial cargo owners, the impact on volumes handled by the Puget Sound Port, if any, would be too small to be measurable.¹⁸⁶

145 The evidence of record is indisputable. PSP’s PhD Berkeley economist studied the current and previous data in updating his ongoing elasticity study. PMSA’s broad and unsubstantiated charges based largely on second-hand Northwest Seaport Alliance advocacy pieces previously submitted to the BPC are at best, red herrings. They are designed to divert attention from the fact that much of the recent increase in port costs are “self-inflicted wounds.” Dr. Leachman’s testimony refutes the attribution of blame by PSP to pilotage fees for erosion in west coast port competitiveness and determines that the harbor maintenance fee on the declared value of goods imported into the United States as well as the more favorable tariff assessed by Canadian versus American railroads to inland centers are by far the largest contributors to the diversion of containerized traffic from the American west coast to British Columbia. While shipping companies typically are anticipated to pass increases in operating costs on to their customers, their current efforts at cost containment would be better directed to their ports of call, their interlining rail carriers and the level of duty/fee assessed on the declared value they transport across the Pacific. Puget Sound pilotage rates may seem an easy “low hanging fruit” to PMSA, the testimony of Dr. Robert Leachman conclusively establishes just how misguided and disproportionate their arguments on port competitiveness here are.

¹⁸³ Exh. RL-1T. 22: 20.

¹⁸⁴ Exh. RL-1T. 23, 24.

¹⁸⁵ *Id.*, 24: 21.

¹⁸⁶ Exh. RL-1., 25: 4-8.

XII. PMSA'S UNWARRANTED PERFORMANCE AUDIT REQUEST

146 PMSA's debut at the Commission also featured a unique and recurring critique of the staff's review of PSP's rate filing and advocacy for what it termed (without defining nor establishing its applicability), a "performance audit," rather than the financial audit customarily employed by Staff in a general rate case filing. This theme was advanced in both the responsive and cross-answering testimony of Captain Moore, in opening argument by counsel and in cross-examination testimony of Moore.

147 In order to assess this unusual qualitative critique by PMSA, resort to a threshold definition of performance audits is instructive, as "performance audits" are not a term heretofore referenced in audits of public service companies by Commission staff.

148 "Performance audit" refers to an independent examination of a program, function, operation or the management systems and procedures of a governmental or non-profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources. The examination is objective and systematic, generally using structured and professionally adopted methodologies.¹⁸⁷ Performance audits of state government agencies were first authorized in 2005 by Initiative 900 and are performed by the State Auditor's office on select state agencies. No party in this proceeding has established their applicability to non-governmental or for profit entities which likely explains why the Commission Staff has neither been authorized to nor conducted such an audit here nor is there any suggestion that under Washington law they could engage in such a practice.

149 To the contrary, public service companies whose rates are established by the Commission undergo rigorous financial audits by Commission Staff which unquestionably was the case here in PSP's first marine pilotage tariff submission. In contrast, performance audit analyses involve probes of "system" efficiencies and potential improvements thereto. Regulatory rate audits consistent with the Uniform System of Accounts feature a typically exhaustive review of an

¹⁸⁷ https://en.wikipedia.org/wiki/Performance_audit

entity's chart of accounts, financial data and workpapers supporting a rate filing and often, as here, involve a site visit to directly review the company's books and records which can involve support of expense items by individual archive invoices, original cost documentation and in the present circumstance, review of PSP's office and moorage leases, payroll and vessel survey records for the two pilot boats.

150 Nevertheless, Captain Moore on cross examination went so far as to assert that the staff's failure to conduct a performance audit rendered staff's review "inadequate."

151 PMSA's lack of familiarity with the WUTC staff's financial and audit procedures and approaches is hardly a basis for an informed critique of comprehensiveness nor a basis to "direct its staff" to conduct a performance audit even assuming such would be allowed of PSP's financials to support its overarching rendition of "essential expense allowance" for ratemaking. This ill-informed insistence is strikingly similar to its testimony that a so-called "market impact survey" needed to somehow be included with PSP's initial rate filing.

152 Such critiques and recommendations are neither germane to, required nor implicated by a marine pilotage rate filing under WAC 480-07-525. In short, they smack of attempts to utilize the Commission Staff to engineer micromanagement of PMSA's operational judgment, substituting PMSA's rendition of operating efficiencies and expenditures necessity for that of PSP.

153 The Commission has had previous invitation in the regulated maritime industry field to exercise supercessive regulatory control of operations and has rebuffed an attempt to exercise such supervisory oversight in the context of an operating certificate restriction: "...[a]lthough we require ferry companies to file and adhere to a time schedule, the Commission will not attempt to manage the day-to-day business decisions of a regulated company."¹⁸⁸

¹⁸⁸ *In re Sean McNamara d/b/a Bellingham Water Taxi and Pacific Cruises Northwest d/b/a San Juan Cruises*, Dkts. TS-121253 and TS-121395, Order 04, p. 7 (July 2013).

154 Whether in an application or general rate case, overtures to the Commission inviting micromanagement of qualitative operational decisions of a regulated entity by protestants or intervenors are wisely declined.

XIII. CONCLUSION

155 PSP has now suffered under years of a legislative rate freeze during which its operating expenses increased without opportunity for a rate increase from which to recover its expenses. Moreover, due to the inability to increase rates to a level that would compensate pilots sufficiently for their high workloads, pilot candidates have elected to train to become pilots elsewhere. These problems are now exacerbated by the COVID-19 pandemic, which will reduce the operating revenues of PSP, but which have had little adverse impact on shipping companies who have reduced expenses through decreased sailings. Thus, in order to establish pilotage rates that are fair, just, reasonable and sufficient and which enable the continued operation of a safe, efficient and reliable pilotage service, PSP respectfully requests that the Commission grant the relief requested in this proceeding.

DATED this 10th day of September, 2020.

RESPECTFULLY SUBMITTED,

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