

[Service Date August 2, 2002]

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,)	DOCKET NO. TC-001846
)	
Complainant,)	FIFTH SUPPLEMENTAL ORDER
)	
v.)	FINAL ORDER GRANTING, IN PART,
)	AND DENYING, IN PART, PETITION
BREMERTON-KITSAP AIRPORTER, INC., C-903,)	FOR REVIEW; REJECTING TARIFF
)	FILING AND REQUIRING COMPLIANCE
Respondent.)	FILING
.....)	

Synopsis: Reviewing three challenges to an administrative law judge’s Initial Order, the Commission modifies the Initial Order with respect to executive compensation, and affirms the Initial Order with respect to normalized regulatory costs and imposing costs for this proceeding. This results in an overall revenue requirement reduction of 8.83 percent for Bremerton-Kitsap Airporter, Inc., instead of the 9.15 percent reduction recommended by the Initial Order. As allocated, the approved revenue requirement results in a reduction of Kitsap County rates of \$2.00, and an increase to Pierce County rates of \$2.75 per fare.

1 **Nature of the Proceeding:** This matter, filed November 27, 2000, began as an application by Bremerton-Kitsap Airporter, Inc. (“BKA”) for an increase in general rates. The Commission granted the Company’s request to withdraw the filing, but, with the Company’s consent, converted the matter into a complaint proceeding with Staff bearing the burden of proof in seeking to lower BKA’s rates.

2 **Procedural history:** The matter was heard upon due and proper notice to all interested parties before Administrative Law Judge Marjorie Schaer on December 12 and 13, 2001, in Olympia, Washington.

3 **Initial Order:** On April 15, 2002, the presiding Administrative Law Judge entered the Third Supplemental Order in this proceeding, which proposes to grant the

complaint and to require the Company to file new tariffs. On May 20, 2002, the presiding Administrative Law Judge entered the Fourth Supplemental Order, which reopened and supplemented the record. The Fourth Supplemental Order also added language to the Third Supplemental Order but does not change any results proposed via the Third Supplemental Order. In this Order, we collectively refer to the Third and Fourth Supplemental Orders as the “Initial Order.”

4 **Petition for Administrative Review and Response:** On June 11, 2002, Bremerton-Kitsap Airporter, Inc., filed its Petition for Administrative Review of Third and Fourth Supplemental Orders complaining of error and seeking relief with respect to three contested issues addressed by the Initial Order. The three issues concerned executive compensation, legal and accounting expense, and the assessment of costs of investigation under RCW 81.20.020. On June 20, 2002, Commission Staff filed its Response opposing the Petition. The matter is now ready for Commission decision.¹

5 **Appearances:** James K. Sells, Attorney at Law, Silverdale, Washington, and David W. Wiley, Attorney at Law, Seattle, Washington, represent Bremerton-Kitsap Airporter, Inc. Jonathan C. Thompson, Assistant Attorney General, Olympia, Washington, represents the Commission’s regulatory staff.²

I. PROCEDURAL HISTORY

6 Bremerton-Kitsap Airporter, Inc. (“BKA” or “Company”) is an auto transportation company, and operates under a certificate of public convenience and necessity issued by the Washington Utilities and Transportation Commission (“Commission”). BKA’s certificate is C-903. The Company provides airporter service between points in Kitsap and Pierce Counties and the Seattle-Tacoma International Airport.

7 On November 27, 2000, BKA filed with the Commission a request for a general rate increase. The filing sought an increase of \$2 per fare, an annual revenue increase of

¹ We will generally follow the format of the Initial Order, adding text where needed to reflect our determination of the matters raised by Bremerton-Kitsap Airporter, Inc.’s Petition and adopting as our own the text of the Initial Order where appropriate.

² In formal proceedings, such as this case, the Commission’s regulatory staff functions as an independent party with the same rights, privileges, and responsibilities as any other party to the proceeding. There is an “*ex parte* wall” separating all parties, including the Commission’s regulatory staff, from the Commissioners, the presiding ALJ, and the Commissioners’ policy and accounting advisors. *RCW 34.05.455*.

\$230,000 (14.2%). The Commission suspended the filing on December 27, 2000. On May 14, 2001, following an initial prehearing conference on April 3, 2001, the Company asked for permission to withdraw its rate increase request. On June 8, 2001, the regulatory staff of the Commission (“Commission Staff” or “Staff”) filed an answer asking the Commission to deny BKA’s request to withdraw its tariff filing. Staff argued that BKA’s tariff rates should be lowered, and that the most efficient way to resolve this dispute was to continue to examine the rates in this proceeding, so that work already performed would not have to be duplicated. On June 11, 2001, the Company asked for permission to reply to the answer, and the Company was authorized to file its reply by July 2, 2001. The procedural schedule was suspended on June 28, 2001.

8 On July 25, 2001, the request to withdraw the tariff filing was denied, and a second prehearing conference was scheduled for August 9, 2001. At the conference, the parties agreed that BKA should be granted leave to withdraw its proposed tariffs, and the proceeding should be converted into a complaint proceeding in which Staff would bear the burden of proof in seeking to lower BKA’s present rates.³ Hearing on the complaint was held in Olympia on December 12 and 13, 2001. Post-hearing briefs, and proposed findings of fact and conclusions of law were filed on February 5 and 12, 2002, respectively.

II. DISCUSSION AND DECISION

A. Principles of Utility Rate Setting

9 The Commission must determine in this proceeding whether the rates and charges currently charged by BKA are just, reasonable, and sufficient. *RCW 81.04.250, RCW 81.28.230*. If not, the Commission must prescribe and authorize rates that are just, reasonable, and sufficient for prospective application. *Id.* As previously discussed, the Company withdrew its proposed tariffs that proposed increased rates, and this matter was converted to a Commission complaint in accordance with WAC 480-09-600 and RCW 34.05.070. Hence, increased rates are not at issue in this proceeding. The issue remaining is whether the Company’s rates should continue at present levels or be reduced. *RCW 81.04.150, RCW 81.04.250, RCW 81.28.230*. This question is

³ *WUTC v. Bremerton-Kitsap Airporter, Inc., C-903*, Docket No. TC-001846, Order Allowing Withdrawal of Rate Filing; Converting Proceeding to Complaint by Commission; Establishing Schedule (September 19, 2001).

resolved by determining the adjusted results of operations during the test year, establishing the fair value of the Company's property-in-service, to which it will be authorized to claim depreciation expense, determining the proper operating ratio (margin to be earned) and then ascertaining the appropriate spread of rates charged to customers in Pierce and Kitsap counties to recover that margin.

10 The parties presented evidence and argument on the bases of which the Commission may determine the following issues:

1. The appropriate test period, which is defined here as the most recent 12-month period for which income statements and balance sheets were available at the time the proceeding began. The test period is used for investigation of the Company's operations for the purposes of this proceeding;
2. The Company's results of operations for the appropriate test period, adjusted for unusual events during the test period, and for known and measurable prospective changes;
3. The appropriate rate base, which is derived from the balance sheets of the test period. The rate base represents the net book value of assets provided by investors' funds, which are used and useful in providing utility service to the public for the test period. Under the pre-tax operating ratio approach, the appropriate amount of test period depreciation expense is derived from this appropriate rate base;
4. The appropriate operating margin the Company is authorized to earn;
5. Any existing revenue excess or deficiency; and
6. The allocation of the rate increase or decrease, if any, fairly and equitably among the Company's ratepayers.

B. Test year

11 All parties used the 12 months ended September 30, 2000, as the test period for investigation of the Company's operations for the purposes of this proceeding, and that test year is adopted in the Initial Order. This question is not contested on review

and we adopt the 12 months ended September 30, 2000, as the appropriate test year for purposes of this Order.

C. Allocation

12 After the appropriate level of pro forma operating expenses, operating income, and corresponding gross operating revenues are determined, they must be allocated between the two services BKA offers to the public. The Initial Order observes that the Commission Staff proposed an allocation between the Bremerton-Kitsap operations and Pierce County/Ft. Lewis/McChord operations that was not contested by the Company. BKA also did not oppose Staff's proposal to set separately the fares in the two sectors of the Company's operations based upon these allocations.

13 The Initial Order adopted the allocation methodology proposed by Staff. This question is not contested on review and we adopt the Initial Order's determination of the issue for purposes of this Order.

D. Conversion Factors

14 The Initial Order adopted a pre-Federal income tax operating ratio methodology to determine the Company's revenue requirement, as proposed by both parties. This is an appropriate methodology "to arrive at the objective of prescribing and authorizing just and reasonable rates," as required by RCW 81.04.250. We adopt the proposed methodology for purposes of this Order.

15 The Initial Order states that although there is no Federal income tax adjustment to consider under the pre-tax operating ratio methodology, both parties identified certain revenue sensitive expenses. The Initial Order takes these revenue sensitive expenses into account in the revenue requirement calculation by applying a pre-tax conversion factor of 0.976740. This conversion factor is composed of a Commission Regulatory Fee Factor of 0.4% and a Business and Occupation Tax Factor of 1.9260%. The amounts for these two factors were agreed upon and used by both parties in their results of operations statements. This matter is uncontested on review. We adopt the pre-tax conversion factor of 0.976740, as proposed by the Initial Order.

E. Results of Operations

16 BKA's results of operations for the test year is the starting point for the Commission's analysis to determine the Company's forward-looking revenue requirement, which is the amount that it will be allowed to recover prospectively through rates. Appropriate adjustments are made to the test period results of operations to determine the Company's prospective revenue requirement. These adjustments account for costs booked during the test period that are inappropriate to include for recovery in prospective rates for one reason or another (restating adjustments), and account for known and measurable changes in costs that will occur prospectively and not be offset by other factors (pro forma adjustments).⁴ Thus, the Company's results of operations are adjusted to reflect changes to the test year that will better match revenues to costs and establish prospective rates that are fair, just, reasonable, and sufficient to permit the Company to recover its costs and earn a fair return on its operations and investments. Both parties' results of operations statements portray restating and pro forma adjustments, which they propose be made to the Company's test period results of operations.

1. Uncontested Adjustments

17 The parties agreed to certain actual results of operations and proposed adjustments to the test year, and these were accepted in the Initial Order. Table 1 shows the actual results and uncontested adjustments that were accepted by the Initial Order and that remain uncontested on review. These uncontested adjustments are accepted as reasonable for purposes of setting rates in this proceeding.

⁴ "Restating actual adjustment" is a regulatory accounting methodology used to revise the booked operating results for any defects or infirmities that may exist in actual recorded results, which can distort test period earnings. Restating actual adjustments are also used to adjust from an as-recorded basis to a basis that is acceptable for ratemaking purposes. Examples for restating actual adjustments are adjustments to remove amounts more appropriately attributable to a prior period, to eliminate below-the-line items that were recorded as operating revenues or expenses in error, to adjust from book estimates to actual amounts, and to eliminate or to normalize extraordinary items which have been recorded during the test period. "Pro forma adjustment" is a regulatory accounting methodology used to adjust the test period for all known and measurable changes that will occur prospectively that are not offset by other factors. Pro forma adjustments are used to adjust to prospective conditions. WAC 480-09-330(b).

TABLE 1: ACTUAL RESULTS OF OPERATIONS & UNCONTESTED ADJUSTMENTS FOR THE 12 MONTHS ENDED SEPTEMBER 30, 2000				
Ln #	Description	Total Operating Revenues	Total Operating Expenses	Net Operating Income
	(A)	(B)	(C)	(D)
1	Actual Results of Operations	\$1,653,071	\$1,783,832	(\$130,761)
	Uncontested Adjustments			
2	RA-01 Reclassify Income/Correct Mispostings	15,923	0	15,923
3	RA-02 Remove Non-Operating Income	0	0	0
4	RA-03 Adj Depr Sch & Gain on Sale of Assets	0	(38,665)	38,665
5	RA-07 Capitalized Items	0	(4,484)	4,484
6	RA-08 Adjust Fuel Tax Credit (RA-8/RA-10)	0	(22,984)	22,984
7	RA-1B Reclassify Investment Loss(RA-1/RA-9)	0	0	0
8	RA-09 Federal Income Tax (RA-9/RA-8)	0	0	0
9	PA-01 Remove Fuel S/C Revenue	(15,033)	(350)	(14,683)
10	PA-02 BKA Pay Increases	0	17,934	(17,934)
11	PA-03 Current Average Fuel	0	11,168	(11,168)
12	PA-04 Federal Income Tax (PA-4/None)	0	0	0
13	Total Uncontested Adjustments	<u>\$890</u>	<u>\$37,381</u>	<u>\$38,271</u>

2. *Contested Adjustments*

18

The Initial Order discusses and proposes resolution of four contested ratemaking adjustments, as portrayed in Table 2.

TABLE 2: CONTESTED RATEMAKING ADJUSTMENTS				
	Contested Adjustment	Company	Staff	Initial Order
1	Company Rate Case Costs	\$100,000	\$0	\$12,561
2	Executive Salary	(\$282,119)	(\$355,000)	(\$72,881)
	Related Payroll Taxes	(\$4,091)	(\$6,884)	(\$2,793)
	Total Amount of Adjustment	(\$286,210)	(\$361,884)	(\$75,674)
3	Affiliated Interest Facility Lease	\$0	(\$22,930)	(\$17,885)
4	Industrial Insurance Premium Refund	\$10,767	\$7,178	\$3,589

The parties do not seek review of the Initial Decision's proposed resolutions of the previously contested issues concerning the Affiliated Interest Facility Lease item, or the Industrial Insurance Premium Refund item. BKA's Petition does challenge the Initial Decision's proposed resolutions of Company Rate Case Costs, and Executive Salary plus Related Payroll Taxes.

a. Company Rate Case Costs

19 BKA, like many rate-regulated companies, books legal and accounting expenses. These costs are typically allowed at reasonable levels for recovery through rates. The Company's per books legal and accounting expenses during the test period were \$8,555. *Exhibit No. 34, line 21, column B*. When Staff filed its case-in-chief in this proceeding, after its conversion to a complaint, Staff proposed no restating or pro forma adjustment to legal and accounting expenses. *Exhibit No. 6, line 29*. The Company's response case, however, proposed to include for recovery in permanent rates, on an annual basis, its estimate of the full costs it would incur defending against the complaint in this proceeding. The Company estimated the amount to be \$100,000 and included that as a pro forma adjustment.⁵ *Exhibit No. 34, line 21, column E*.

20 Staff opposed BKA's recovering any of its legal and expert witness costs related to this proceeding. Staff argued in its initial Brief that:

There are important policy reasons to disallow rate recovery of legal expenses in the context of a complaint by the Commission to reduce excessive rates. It would be a dangerous precedent to allow case costs for defending a Commission-initiated rate complaint, particularly if it were done without regard to the ultimate reasonableness or successfulness of the Company's litigation position or without some reasonable limitation on the amount at issue.

Staff Brief at 7. Staff argued that if some portion of BKA's costs incurred in this proceeding is allowed as the basis for a pro forma adjustment to the Company's legal and accounting expense, it should be amortized over a reasonable period, suggesting that five years would be appropriate.

⁵ The Fourth Supplemental Order reopened the record in this proceeding, in part, to permit the Company to submit revised Exhibit No. 42, which shows BKA's actual costs incurred in this proceeding from May 15, 2001 through February 14, 2002, equaled \$101,756.

21 The Initial Order rejects the Company's proposal to include \$100,000 of rate case costs in this proceeding as a measure of its prospective revenue requirement, but also rejects Staff's proposal to allow no adjustment to legal and accounting expense. The Initial Order (Third Supplemental) states at ¶ 24 that:

[I]t is very unlikely that these costs will recur in the near-term future, and certainly not on an annual basis. Including the entire amount in rates in the rate year would embed \$100,000 of operating revenues in rates with no comparable prospective expense. BKA will be allowed to include \$62,805 in rate case costs, to be amortized over five years.

The ALJ's recommendation results in a pro forma adjustment to legal and accounting expense in the amount of \$12,561 to be recovered in rates annually. The Initial Order (Fourth Supplemental), adds at ¶ 16 that:

Implicit in this proposed adjustment is the assumption that the Company needs \$100,000 per year to cover rate case costs. The Third Supplemental Order rejected this implicit assertion, and normalized the rate case costs to reflect an on-going level. This is standard ratemaking procedure, since rates are set to cover prospective costs.

22 The Company's position on review is that the Commission should reject the Initial Order's proposed allowance of a \$12,561 pro forma adjustment to legal and accounting expense in favor of a \$33,919 pro forma adjustment. BKA's proposal is conceptually similar to the analysis employed in the Initial Order in that it is based on recovery of a portion of the total costs the Company incurred during the course of this proceeding. BKA, however, argues that the reasonable portion of its total costs that should be the basis for adjustment is \$101,756, amortized over three years. *Petition at 5*. This is the amount the Company states it incurred after this matter was converted to a complaint proceeding.

23 Commission Staff, in its Response to BKA's Petition, focuses on the amortization period rather than the amount at issue. Staff argues that the end results are the appropriate focus for our attention on review. According to Staff, if the Initial Order's determination of a five-year amortization is adopted "[a]ccepting the Company's larger figure would not change the resulting fares." *Response at 3*.

- 24 On the question of the appropriate amortization period, BKA argues that it regularly incurs rate case expense, including five general rate filings since June 1991. *Petition at 10*. The Company, however, withdrew every one of these filings, including its filing in this proceeding. The explanation offered by BKA is “that in earlier proceedings, BKA likely determined that maintaining its position through an adversarial rate process was not worth the time and money involved . . .” *Petition at 9*. Thus, in these various filings BKA incurred expenses that did not even arguably benefit ratepayers, or the Company.
- 25 While acknowledging the Initial Order’s point that the Company voluntarily withdrew its tariff filing in each of those five cases prior to hearing and, indeed, has had only “one [fully litigated] rate case in the last 10 years,”⁶ BKA nevertheless argues that its pattern of filing and withdrawing rate cases supports its argument for a three-year amortization period. *Id.*
- 26 Unnecessary filings made by a regulated company, and the expenses it incurs in connection with such filings, do not provide a sound basis for proposing a pro forma adjustment. Even considering, however, BKA’s pattern of filing and withdrawing a rate case on the average of once every two to three years, the evidence from this, its latest filed and withdrawn case, shows a total expense up to the date of withdrawal of \$26,481. Applying a two-year amortization, this would result in a pro forma adjustment of \$13,241; applying a three-year amortization would reduce the adjustment to \$8,827.
- 27 The Company also argues, citing several Commission utility cases (*i.e.*, cases concerning rates for a natural gas company, two telecommunications companies, and a water company) decided since 1977, that it is “well established that when rate case expenses are amortized, the amortization period used is typically not more than three years.” *Id. at 9*. Amortization periods used to normalize legal and accounting costs, however, vary depending on the time between rates cases, consideration of the magnitude of the cost claimed, and the effect of including it in rates. Two of the utility cases cited by BKA in its Petition amortized rate case expenses over two years, and three of those cases established three-year amortization periods for these costs.

⁶ We note that BKA actually appears to have had only two litigated proceedings involving rate issues in its 23-year existence, one in 1985 and another in 1988. *Staff Response at 4 (citing Exhibit Nos. 9-11)*.

At times, certain solid waste companies who were appearing annually before the Commission had no amortization of rate case costs. A certain electricity company that was required to file a rate case every three years had a three-year amortization. Companies whose costs were excessive received no rate case costs, or only a portion of rate case costs.⁷

28 Commission Staff argues that the objective in setting an appropriate amortization period in each individual case is “to choose a period that will normalize the level of legal and accounting expenses that are to be embedded in permanent rates.” Staff argues the related principle that rate case expenses should be amortized “over the period between expected occurrences or over a reasonable period.” We agree that these are sound principles to follow when determining the appropriate amortization period to use in pro forming BKA’s legal and accounting costs. The Company’s last litigated rate case was more than a decade ago, and the present case before the Commission is the first time, to our knowledge, that the Commission has ever filed a complaint against BKA. In light of these facts, a five-year amortization period is reasonable.

29 As to the level of expected future expense, considering the expenses actually incurred in this proceeding, both parties acknowledge by their arguments that this has been, in some ways, an extraordinary case that placed unusual demands on the parties. The time and effort expended in this case do not reflect what ordinarily would be expected in a rate proceeding. As Staff argues in its Response, “by all indications, in the history of this Company, this \$101,756 expense represents a particularly large ‘spike’ in the Company’s cost of determining rates before the Commission.” *Response at 4*. Thus, the full, actual costs incurred by BKA during the complaint phase of this proceeding would be a poor basis upon which to determine an appropriate pro forma adjustment to BKA’s legal and accounting expense. The Initial Order makes an informed judgment, taking into account the evidence and argument presented at hearing and on brief, that \$62,805 is a reasonable and appropriate level of expense

⁷ See, e.g., *WUTC v. Sno-King Garbage Company, Inc.*, Docket Nos. TG-900657, TG-900658, Fourth and Fifth Supp. Orders, (Dec. 1991) (Commission found no benefit to ratepayers from the amounts spent on expert and attorney fees in the case and denied their recovery in rates as exorbitant and imprudent); *Petition of PSE*, Docket No. UE-920433, Fifteenth Supp. Order (Dec. 15, 1993) (Commission affirmed rejection of portion of PSE’s rate case expenses, partly in response to Public Counsel argument that the Company simply spent too much); see also, *WUTC v. Rosario Utilities, LLC*, Docket No. UW-951483, Fourth Supp. Order, pp. 7, 8 (November 25, 1996) (\$6,000 allowed, \$18,000 sought).

upon which to base a pro forma adjustment to BKA's legal and accounting expense. We adopt the Initial Order's determination of this issue for purposes of this Order.

30 Pro forma adjustments are used to adjust costs to prospective conditions. Considering the Initial Order's informed judgment, and on the basis of our independent review of the record and the further argument presented on review, we find that the Commission should adopt the Initial Order's determination that \$12,561 (*i.e.*, \$62,805 amortized over five years) is a reasonable pro forma adjustment to BKA's test period legal and accounting expense.

b. Executive Compensation

31 The president of BKA is Mr. Richard Asche. He and his wife own 99 percent of the stock in the corporation. Albeit in different amounts, both Commission Staff and the Company included a restating adjustment RA-5 for the owner/operator compensation for the work performed by Mr. Asche as an employee of BKA.⁸ Another portion of the ratemaking formula, the margin, is designed to provide payment of the return on the equity that the Asches have invested in BKA. Thus, the owners are compensated for their investment and risk in the business through the authorized revenue margin allowed above the authorized operating ratio.⁹

32 The issue is what salary level should be allowed for Mr. Asche as President of BKA. The Company proposed at hearing that his salary should be set at \$138,881, based on a figure taken from a staff workpaper in a prior rate filing that BKA withdrew prior to hearing in Docket No. TC-980036, adjusted for inflation and the addition of a benefits package equal to 22.5 percent of base salary. Staff proposed at hearing that Mr. Asche's salary be set at \$66,000, based on the Company's per books base salary level and a survey of salaries paid in 1999 by other regulated airporter companies with revenues similar in magnitude to BKA's and salaries paid to public transit

⁸ See Table 2, *supra*.

⁹ As stated above, the Company and Staff agreed to the principle that an adjustment to BKA's per books executive compensation during the test period should be made to remove bonuses from the results of operations for ratemaking purposes. The record indicates that including bonuses as an operating expense may be part of a federal income tax reduction strategy. As long as it is understood by the Company that for ratemaking purposes, the Commission will treat these bonuses as a distribution of earnings to the owners or stockholders rather than as an operating expense, then the Company should be allowed to pursue whatever tax strategy it wishes on a per books basis. In the pursuit of a lower income tax liability, the interests of the stockholders and ratepayers are essentially identical.

executives operating companies with annual revenues up to \$10 million. Staff proposed that there be no adjustment for benefits because BKA does not provide benefits to any employee, including Mr. Asche.

33 The Initial Order proposed that Mr. Asche's annual salary level should be set at \$66,000 for regulatory purposes in this case, with an appropriate adjustment to payroll taxes. BKA challenges this issue on review and continues to advocate the figure it argued at hearing, \$138,881. Staff opposes the Company's Petition on this issue and argues that the Initial Order's determination of this issue should be adopted.

34 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. Whether this executive is also the company's largest shareholder has no bearing on the question of what is appropriate compensation for the job(s) the executive actually performs. The goal is to determine what the owner would have to pay someone with the requisite skills, in an arms-length transaction, to do the job.

35 We find on review that the best evidence of what the Company would have to offer a third party to serve in this role is Commission Staff's survey of public transit authority executives. These salaries presumably are established in an arms-length fashion, unlike the salaries of other owner-operated airporter services that also are part of the evidence on this issue. The evidence shows that smaller public transit authorities are able to attract and retain executives with a base salary of \$66,952, an amount very close to BKA's per books base salary for Mr. Asche. The public transit authorities, however, also provide their executives with a benefits package equal to approximately 25 percent of the base salary amount. It is most likely the case that BKA would be required to include a benefits package were it to seek a third party to run the Company. Accordingly, we will grant BKA's petition on this issue to the extent of adjusting the \$66,000 salary amount proposed in the Initial Order by 25 percent to reflect total compensation of \$82,500, including salary and benefits. Thus, the restating adjustment to "Officer Salary" will be <\$338,500> instead of the <\$355,000> amount proposed by the Initial Order.¹⁰ Payroll taxes should be adjusted

¹⁰ Compare, Initial Order Appendix A, page 1, line 43, to the corresponding entry in Appendix A to this Order.

to be consistent with the adjustment to Mr. Asche's salary. The restating amount for this item will be \$5,859, instead of \$5,620 as proposed by the Initial Order.¹¹

3. Affiliated Interest – Facilities Lease

- 36 BKA pays \$60,000 annually in rent for the facility out of which it operates in Port Orchard. BKA pays this rent to Mr. Asche and his wife, who own the real property and the buildings and improvements on this property. This transaction is a transaction with an affiliated interest within the meaning of RCW 81.16.010. The standard for a reasonable allowance is the lower of the competitive market price or the affiliate's cost plus a fair return.
- 37 Commission Staff proposed restating adjustment RA-6, Affiliated Rent, to adjust the per-books lease payments paid by BKA to Mr. and Mrs. Asche to a cost-plus-return figure for regulatory purposes. The approach taken by Staff has been a standard ratemaking approach used by the Commission for many years. It protects the ratepayers by ensuring that they pay for the full historical cost of service, no more and no less. The owners of the property also are fairly treated because they are allowed the equivalent of full capital recovery plus a fair return on the investment at issue, analogous to what occurs under rate-base/rate-of-return ratemaking commonly used in the utility sector. Reliance on principles derived from original cost ratemaking methodology is especially useful in situations where there is less than arm's length transaction conditions involving lease payments paid by the regulated utility.
- 38 The Initial Order recommended that the Commission authorize an adjustment to facilities lease expense for a post-test period addition. Specifically, the Initial Order proposed that the Commission take notice of the fact that the owner invested \$30,500 in a building addition in November 2000. These improvements were put in service two months after the close of the test period. There is no indication on the record that the post-test period addition is not used and useful and in service at the present time.
- 39 It is not the Commission's usual practice to allow post-test-period additions in rate base or to otherwise consider them for ratemaking. This proceeding, however, is not a rate case in the usual sense, since no proposed tariff is at issue in this case. The

¹¹ Compare, Initial Order Appendix A, page 1, line 17, to the corresponding entry in Appendix A to this Order.

Company's proposed rates, as detailed in Exhibit No. 3, were withdrawn. Realistically, given the nature of this case, it is most likely that the Company's rates will remain the same or be reduced. The Commission should, therefore, allow a return on the new addition and allow a half-year of depreciation expense. The recalculation of the affiliated rent adjustment is attached as Appendix C to the Initial Order and to this Order.

40 The Initial Order would reduce the Company's test period operating expenses from \$60,000 in lease expense proposed by the Company to \$42,115, taking into account the post-test period addition, as discussed above. This matter is uncontested on review. We adopt the Initial Order's recommendation on this issue.

4. Industrial Insurance Premium Refund

41 During the test year, BKA received two refunds related to Labor & Industries Workers' Compensation premiums totaling \$10,767. The Company removed the entire refund amount from the test year revenues, claiming that the amount consists of premiums paid outside the test period and that there is no evidence that this refund is, or will be, recurring. Staff proposed to amortize these refunds over three years on the grounds that these refunds are on-going, "truing-up" premiums paid as opposed to actual claim experience.

42 The purpose of our test year approach is to develop a normal level of expenses that is expected to match the company's expenses in the rate year. The Commission follows a general rule against including out-of-period, non-recurring expenses in rates. The Initial Order states that the evidence shows this is a prior period item that is non-recurring and that there is no expectation that this refund amount will recur prospectively. This issue is uncontested on review. We adopt the Initial Order's recommendation that the Commission accept the Company's proposed adjustment.

F. Operating Ratio

43 The Commission has used the operating ratio approach for many years to set rates for auto transportation companies. The operating ratio is defined as the ratio of expenses to revenue. Thus, an operating ratio of 93 percent means that 93 percent of revenue is used to pay expenses, depreciation, and certain taxes, leaving seven percent of revenue to pay Federal income taxes, interest expense, plus a fair return to the

investors. This residual seven percent is the complement of the operating ratio, that is, one minus the operating ratio. Both parties agree that auto transportation companies' rates have traditionally been set by the Commission at a 93 percent operating ratio.

44 The Initial Order recommends that we use the standard 93% operating ratio in this case to measure the Company's prospective revenue requirement. This issue is not contested on review. We adopt the Initial Order's recommendation.

45 Table 4 below, summarizes the Company's results of operations for the 12 months ended September 30, 2000, and incorporates our decisions regarding issues contested on review having a revenue requirement impact, and the decisions recommended by the Initial Order and adopted here.

Ln#	Description	Total Operating Revenues	Total Operating Expenses	Net Operating Income	Oper. Ratio - %
1	Actual Results of Operations	\$1,653,071	\$1,783,832	(\$130,761)	107.91%
2	Total Uncontested Adjustments	890	(44,499)	45,389	
3	Total Contested Adjustments	0	(330,847)	330,847	
4	Results Before Rate Changes	\$1,653,961	\$1,408,486	\$245,475	85.16%
5	Operating (Excess) / Deficiency	(\$144,847)	(\$3,369)	(\$141,478)	
6	Results of Commission Decision	\$1,509,114	\$1,405,117	\$103,997	93.11%

46 Although the operating ratio adopted in this Order is 93.0 percent, the 93.11 percent operating ratio indicated in Table 4 occurs because of the rounding of the

recommended rate changes to the nearest quarter of a dollar. This rounding was recommended by Staff, was not contested by the Company at hearing or on review, and is accepted in this Order for purposes of rate simplicity.

47

Table 5 below reflects the revenue requirement calculation for BKA's adjusted results of operations for the test period, based on the decisions in this Order.

TABLE 5: REVENUE REQUIREMENT CALCULATION - DECISION		
Ln#	Description	Amount \$
1	Total Pro Forma Operating Expenses	\$1,408,486
2	Authorized Operating Ratio - %	93.0%
3	Operating Revenue Requirement (Ln 1 x (Ln 2/100))	\$1,514,501
4	Pro Forma Operating Revenue	\$1,653,961
5	Revenue (Excess) or Deficiency Before Gross Up (Ln 3 – Ln 4)	(\$139,460)
6	Pre-Federal Income Tax Conversion Factor	0.976740
7	Revenue (Excess) or Deficiency After Gross Up (Ln 5 / Ln 6)	(\$142,781)
8	Revenue (Excess) or Deficiency After Gross Up and Rounding Rates to Nearest Quarter	(\$144,847)
9	Percentage Increase (Decrease) in Overall Operating Revenues	-8.83%

48

The recommended revenue requirement calculation reflects a revenue excess after gross-up of \$142,781, and a revenue excess, after rounding rates to the nearest quarter of a dollar, of \$144,847. Because BKA's current rates produce excessive revenue they are found to be unjust and unreasonable. The indicated overall recommended reduction in operating revenues is 8.83%. Taking all factors discussed in this Order into account, including allocation and rounding to the nearest quarter of a dollar to maintain rate simplicity, results in a \$2.00 per passenger rate decrease for the Company's Bremerton-Kitsap operations and a \$2.75 increase for the Company's Pierce County/Ft. Lewis/McChord operations.

G. Recovery of Staff Investigation Costs

49 The Initial Order recommends that the Commission assess BKA a portion of the Commission's costs in this proceeding, pursuant to RCW 81.20.020. Although BKA contests on review the Initial Order's recommendation that the Commission assess the maximum recoverable amount of \$16,634 pursuant to RCW 81.20.020, we conclude the Company should be required to pay this portion of the Commission's cost of investigation.¹²

H. Appendices to this Order

50 The following appendices are attached to this Order to provide more detail of the numeric calculations of the Commission's decisions:

Appendix A is a recast of the Company's pro forma results of operations for the 12 months ended September 30, 2000, and incorporates the above discussions and decisions in this Order.

Appendix B separates the company's expenses using the adopted allocation methodology, and demonstrates that the result of the adjustments approved in this Order would require a \$2.00 per passenger rate reduction in the Company's Bremerton-Kitsap operations, and require a \$2.75 per passenger rate increase in the Pierce County/Ft. Lewis/McChord operations. The increase in the latter operating area occurs because of the cost of service differences in the two operating areas and the Company's historical rate levels.

Appendix C is a summary of the recalculation of the Affiliated Interest Adjustment for Lease Expense.

These appendices are a part of this Order, and are incorporated into the memorandum portion of this Order by this reference.

¹² The Commission's full cost of investigation in this matter exceed \$45,000 according to Exhibit No. 47.

III. FINDINGS OF FACT

51 Having discussed above all matters material to our decision, and having stated
general findings, the Commission now makes the following summary findings of fact.
Those portions of the preceding discussion that include findings pertaining to the
Commission's ultimate decisions are incorporated by this reference.

52 (1) The Washington Utilities and Transportation Commission is an agency of the
State of Washington vested by statute with the authority to regulate rates,
rules, regulations, practices, accounts, securities, and transfers of public
service companies, including auto transportation companies as such
companies are defined in RCW chapter 81.68 and related statutes.

53 (2) Bremerton-Kitsap Airporter, Inc., is an auto transportation company that
operates in this state, under a certificate of public convenience and necessity
issued by the Commission. The Company is authorized to provide airporter
service between points in Kitsap and Pierce Counties and the Seattle-Tacoma
International Airport.

54 (3) The Company filed proposed revisions to its tariffs on November 27, 2000.

55 (4) On December 27, 2000, the Commission entered an order suspending the
tariff revisions filed on November 27, 2000, by Bremerton-Kitsap Airporter,
Inc., pending investigation and decision on such filing.

56 (5) On September 18, 2001, the Commission entered an order granting the
Company's request to withdraw its tariff filing and converting this Docket No.
TC-001846 to a complaint proceeding by the Commission Staff against the
Company, with Staff bearing the burden of proof.

57 (6) The twelve-month period ending September 30, 2000, is an appropriate test
year to examine for purposes of this proceeding.

58 (7) The statistics set forth in Exhibit No. 6, columns (a) and (b), which set out the
accounts prescribed by the uniform system of accounts for auto transportation

companies and the Company's test year "per books" figures for those accounts, are correct.

- 59 (8) The evidence concerning Bremerton-Kitsap Airporter, Inc.'s legal and accounting expenses incurred in this proceeding support a pro forma adjustment of \$12,561, based on reasonable expenditures of \$62,609 amortized over five years.
- 60 (9) The evidence concerning executive compensation supports an officer's salary for the Company's President of \$82,500, based on a salary of \$66,000 adjusted by a factor of 25 percent for imputed benefits. This salary level is reflected by a restating adjustment of (\$338,500) to test year per books executive compensation. The effect of this adjustment on payroll taxes is a restating adjustment of (\$5,859).
- 61 (10) A 93 percent operating ratio is the appropriate ratemaking methodology to use for determining the Company's revenue requirement for the provision of regulated auto transportation services.
- 62 (11) It is necessary for the Company to increase its fares by \$2.75 on the Pierce County/Ft. Lewis/McChord route and reduce its fares by \$2.00 on the Bremerton/Tacoma route to achieve a 93 percent operating ratio on both routes. These rates are rounded to the nearest quarter of a dollar to achieve rate simplicity, yielding an actual operating ratio of 93.11 percent overall.
- 63 (12) This Order takes notice of the fact that \$16,634 is one percent of the Company's gross revenues of \$1,663,452 in the year 2000. The gross revenues were reported to the Commission in the Company's year 2000 Annual Report.
- 64 (13) The Commission incurred more than \$45,000 in agency-wide costs in this proceeding. This amount exceeds the \$6,633.90 that the Company paid in regulatory fees in 2000.

IV. CONCLUSIONS OF LAW

- 65 Having discussed above in detail all matters material to our decision, and having
stated general findings and conclusions, the Commission now makes the following
summary conclusions of law. Those portions of the preceding detailed discussion
that state conclusions pertaining to the Commission's ultimate decisions are
incorporated by this reference.
- 66 (1) The Washington Utilities and Transportation Commission has jurisdiction
over the parties and subject matter of this proceeding. *Chapters 80.01, 81.04,
81.20, 81.28, and 81.68 RCW.*
- 67 (2) The uncontested adjustments shown in Table 1 constitute an appropriate basis
for setting rates for BKA. *RCW 81.04.250.*
- 68 (3) The Commission should use the 93% operating ratio to calculate the
Company's revenue requirements for its regulated auto transportation
services. *RCW 81.04.250.*
- 69 (4) The appropriate test year period for this proceeding is the 12-month period
ended September, 2000. *RCW 81.04.250.*
- 70 (5) The Company's current rates are excessive and, therefore, are not just and
reasonable rates. *RCW 81.28.230.* The fares that result from the decisions in
this Order should be prescribed and authorized as the just, reasonable, and
sufficient rates and should be observed and put in force in accordance with the
terms of this Order. *RCW 81.04.250, RCW 81.28.230.*
- 71 (6) Bremerton-Kitsap Airporter, Inc., should be required to pay \$16,634 toward
the Commission's costs in this proceeding. *RCW 81.20.020.*
- 72 (7) The Commission Secretary should be authorized to accept by letter, with
copies to all parties to this proceeding, a filing that complies with the
requirements of this Order. *WAC 480-09-340.*

- 73 (8) The Commission should retain jurisdiction over the subject matters and the parties to this proceeding to effectuate the terms of this Order. *Chapters 80.01, 81.01, and 81.04 RCW.*

V. ORDER

THE COMMISSION ORDERS That:

- 74 (1) The Commission has jurisdiction over the subject matter and the Parties to these proceedings.
- 75 (2) Bremerton-Kitsap Airporter is authorized and required to make appropriate compliance filings and such other filings as are necessary to effectuate the terms of this Order no later than ten business days following the entry and service of this Order. Commission Staff shall examine the compliance filing, and shall provide its analysis of whether the compliance filing meets the requirements of this Order no later than five business days following the Company's filing. The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Order.
- 76 (3) The Commission retains jurisdiction over the subject matter and the parties to effectuate the provisions of this Order.

DATED at Olympia, Washington, and effective this ____ day of August, 2002

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MARILYN SHOWALTER, Chairwoman

RICHARD HEMSTAD, Commissioner

PATRICK J. OSHIE, Commissioner

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

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APPENDICES

APPENDIX A

DOCKET NO. TC-001846

APPENDICES

APPENDIX B

DOCKET NO. TC-001846

APPENDICES

APPENDIX C