[Service Date March 25, 2011]

March 25, 2011

NOTICE OF STAFF RECOMMENDATION FOR FUEL SURCHARGES, OPPORTUNITY TO FILE WRITTEN COMMENTS, AND OPEN MEETING (Set for 9:30 a.m., Thursday, April 14, 2011)

RE: Fuel Surcharge Inquiry
Docket T-101661

TO: REGULATED COMMERCIAL FERRY COMPANIES

This Notice is provided to advise companies of the Staff's recommendation to the commission, that companies can file additional written comments, which are due April 8, 2011, and that the commission will consider this matter at the April 14, 2011, open meeting.

SUMMARY

The commission opened an inquiry in Docket T-101661 to consider whether to adopt, by rule, methods for determining the circumstances under which it will permit commercial ferry companies to impose a surcharge for fuel costs, and the methods of calculating any such fuel surcharge. The commission held two workshops, but no representatives of commercial ferry companies attended and the commission received no written comments from commercial ferry companies.

Order 04 in Docket A-042090 clarifies that Order 02 remains in effect and is now scheduled to expire May 2, 2011.

After considering written comments and the discussions at the two stakeholder meetings, staff recommends the commission:

1. Eliminate the current fuel surcharge methodology for commercial ferry companies effective May 2, 2011, as scheduled.

2. Allow all commercial ferry companies, except Lake Chelan, to use a revised fuel surcharge methodology as discussed below. Staff's analysis of Lake Chelan's operations and past fuel surcharge activity concluded that a fuel surcharge methodology without a tracker, or true-up, is not appropriate.

3. Allow, but do not require, commercial ferry companies to implement deferred accounting for fuel expense. For each company choosing to implement deferred accounting, establish the deferred accounting by separate order.

4. Any company can file a proposed rate change using any other methodology. Those filings must comply with the commission's rules and regulations.

BACKGROUND

There are three types of commercial ferry operations:

Year- Round Scheduled Ferry Service:

a. Hat Island Community, Inc. (BC-96): Everett and Hat (Gedney) Island.

   This company serves only the Hat Island Community.

b. Lake Chelan Boat Co. (BC-34): Chelan and Stehekin. Intermediate points.

2. **Seasonal Ferry Service**:

   a. Island Commuter, LLC dba Island Commuter Service. (BC-95, lease of BC-10): Bellingham and Friday Harbor. Flag stops.

      Third Saturday in May through Labor Day.

   b. Pacific Cruises (BC-10): Leased to Island Commuter.

   c. Puget Sound Express (BC-118): Port Townsend and Friday Harbor.

      April 1 to October 10.

   d. San Juan Express (BC-117): Seattle, Friday Harbor, and San Juan Islands.

      May 21 through September 26.

3. **Launch Service Ferry Operators – Between ports and boats at anchor**:

   a. Argosy Cruises (BC-101): Between Pier 56 (Seattle, WA) and East, West, and North anchorage points located in Elliott Bay and Alki Points.

b. Arrow Launch Service, Inc (BC-97): Between various anchorage zones in Puget Sound and the Strait of Juan de Fuca.

Lake Chelan and Arrow Launch are the only ferry companies that have filed a fuel surcharges under the current methodology. Lake Chelan filed 40 surcharges between June 2004 and November 2008. Arrow Launch filed six fuel surcharges that were in effective from July 2008 through December 2008.

The following shows each company's revenue from its last rate case and its 2009 Annual Report. Annual report data is not audited and may not accurately reflect a company's financial position from a regulatory perspective.

Table 1
Growth Since The Company's Last Rate Case

	Last Rate Case		2009 Annual Report		Change in Regulated
Company	Effective	Pro Forma Revenue	Regulated Revenue	Total Company Operating Ratio	Revenue Since Last Rate Case
Hat Island	August 30, 2008	$ 297,709	$ 201,860	85.6%	-32%
Lake Chelan	June 1, 2009	$ 1,473,087	$ 1,348,497	86.8%	-8%
Argosy	April 10, 2009	$ 928,577	$ 9,063	102.1%	-99%
Arrow Launch	January 1, 2011	$ 2,768,819	NA	NA	NA
Island Commuter	July 31, 2009	$ 177,655	$ 147,775	107.0%	-17%
Pacific Cruises	March 15, 1996	NA	$ 9,193	85.0%	NA
Puget Sound Express	February 15, 2011	$ 325,025	NA	NA	NA
San Juan Express	April 21, 2008	$ 1,162,980	$ -	NA	NA

Commercial ferry companies do not serve a constant customer base. This is different from the solid waste industry where haulers generally serve the same customers, or at least the same addresses, daily, weekly, or every-other-week.

Although launch services operate year-round, most passenger ferries provide seasonal service. Four companies operated four to six months between April and September. Lake Chelan, the only year-round ferry operator serving the general public, transported 80 percent of its 2008 annual passengers during May through September.

Fuel expense, as a percent of total revenue, varies by company. The following table shows each company's fuel expense as a percent of total revenue (regulated and nonregulated) for the company's last rate case and as reported in the 2009 annual report.

Table 2
Fuel Data

	Rate Case		2009 Annual Report
		Regulated	Total Company
Company	Effective Date	Fuel to Total Revenue	Fuel to Total Revenue
Hat Island	August 30, 2008	7.5%	3.7%
Lake Chelan	June 1, 2009	17.5%	15.6%
Argosy	April 10, 2009	8.3%	17.7%
Arrow Launch	January 1, 2011	3.0%	4.0%
Island Commuter	July 31, 2009	16.5%	13.7%
Pacific Cruises	March 15, 1996	NA	11.4%
Puget Sound Express	February 15, 2011	25.7%	20.9%
San Juan Express	April 21, 2008	33.3%	0.0%

The commission currently uses an operating ratio methodology (operating expense ÷ total revenue), with a 93 percent target, to calculate a company's revenue requirement.

CURRENT METHODOLOGY

The current fuel surcharge method is flawed in the following respects.

- It isn't a surcharge. A surcharge is intended to address a significant change in a significant cost element, not otherwise offset by other factors, over a short period of time. Base fuel cost, the relationship of fuel expense to revenue, customer counts, etc. are "frozen" at the levels in the company's last rate case. Lake Chelan filed 40 surcharges in 53 months between June 2004 and November 2008.

- Company's file voluntarily. Companies are not required to file when fuel costs fall below the level that would require the company to provide customers a credit.

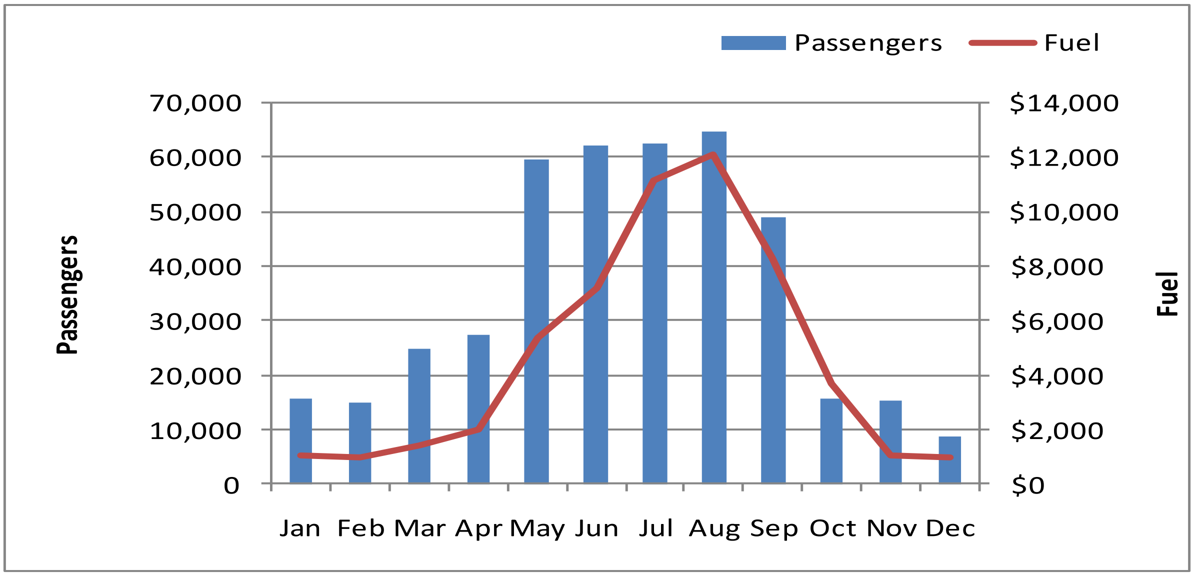
- There is no updating mechanism, so that a company could rely on fuel surcharges to provide additional revenue instead of filing a rate case.

- The increased monthly fuel expense is calculated by dividing the annual fuel expense increase by twelve. Although staff does not have monthly data, we expect that works well for seasonal companies and launch companies. However, Lake Chelan operates different schedules on a seasonal basis. In 2008 and 2009, Lake Chelan operated up to 93 round trips per month in the summer and only 16 round trips per month in the winter. Therefore, its fuel expense is higher during the summer and lower during the winter. Dividing annual fuel expense by twelve shifts expense from high-consumption, high-passenger summer months to low-consumption, low-passenger winter months.

- For passenger fares, the calculated fuel surcharge is the monthly fuel surcharge revenue requirement divided by the one-way equivalent passenger count for the same month in the base period as the month in which the fuel surcharge will apply. Staff does not have monthly passenger data for seasonal operations.

  In 2008, Lake Chelan passenger counts varied from 12,092 in August to 940 in December, and calculated fuel expense varied from $64,676 in August to $8,632 in December. The following shows the relationship of calculated fuel expense, based upon the number of trips operated per month, and the passenger counts.

Table 3
Lake Chelan – 2008 Passenger Count and Calculated Fuel Expense



  Calculating surcharges using monthly passenger counts results in large variations in the monthly surcharge.

- For 2008, Lake Chelan filed surcharges for January through November that were designed to collect $108,141. The company collected $164,013, $55,872 more than projected.

There has been little controversy regarding the elements of the current methodology.

INDUSTRY PROPOSALS

The commission received one written comment from Arrow Launch urging the commission to maintain the fuel surcharge methodology because it is a straightforward and efficient mechanism to reflect fluctuating fuel prices.

THRESHOLD REQUIREMENT

If the commission adopts a threshold time period since a company's last rate case, staff recommends that it be used only as a guideline and that it be three years. A rate case typically uses data that is about a year old, which means that a three-year old rate case is based on four-year old operations of the test period.

Immediately after a rate case, staff has a high degree of confidence that the rates are fair, just, reasonable and sufficient. That confidence decreases as time passes.

Fuel surcharges are a simplified method to change rates with no consideration of need, no consideration of other factors that might offset the need for additional revenue, and no burden to demonstrate that the resulting rates are fair, just, reasonable, and sufficient.

The length of time since the last rate case is not the issue. The issue is whether or not there have been changes in the company's operations. Some companies may operate in a very stable market, with very constant operating characteristics. However, as the length of time since the last rate case increases, changes are more likely, and the rate case data and operations are less representative of current operations: newer vehicles may have greater capacity and get better fuel mileage, number of customers change, etc.

STAFF RECOMMENDATION – ALL COMPANIES OTHER THAN LAKE CHELAN REVISED FUEL SURCHARGE METHODOLOGY

Allow commercial ferry companies, except for Lake Chelan, to continue using a revised fuel surcharge methodology. Seasonal operations make it impractical to implement deferred accounting for fuel. Arrow Launch, which has a relatively low fuel expense as a percentage of revenue used the fuel surcharge only during the highest fuel prices in 2008. Fuel expense as a percentage of total revenue is relatively low for the launch companies.

Staff recommends that the commission revise the current fuel methodology by defining the Base Fuel Cost as (1) the average monthly fuel cost from the company's last rate case or (2) the average monthly fuel cost for the previous calendar year, whichever is greater. The proposed change will incorporate changes in recent fuel prices into the methodology.

Staff recommends that the commission establish the revised fuel surcharge methodology for each company by order to ensure that customers benefit from any decreased fuel costs.

STAFF RECOMMENDATION – LAKE CHELAN DEFERRED ACCOUNTING

Staff recommends that the commission allow Lake Chelan to implement deferred accounting for fuel expense with an annual true-up. An annual true-up fits the company's seasonal operations by tracking higher expenses and revenue in the summer and lower expenses and revenue in the winter.

Staff's analysis shows that that the current surcharge methodology, which does not have a tracker, does not work well. In 2008, Lake Chelan passenger counts varied from 12,092 in August to 940 in December, and calculated fuel expense varied from $64,676 in August to $8,632 in December. For 2008, Lake Chelan filed surcharges for January through November that were designed to collect $108,141. The company collected $164,013, $55,872 (4.1 percent of 2008 passenger revenue) more than projected.

Although the company over collected in 2008, changing passenger counts could result in the company under collecting.

The purpose of a surcharge or deferral is to address changes in fuel cost. The total cost to the customer – base fare plus any surcharge or deferral - must still be fair, just, reasonable and sufficient.

Deferred accounting ensures that a company recovers actual expenses and that customers pay what they should. Because deferral guarantees recovery, the company bears no risk. Because there is no risk, the company should not earn any profit on fuel expenses and the commission should remove fuel expense from the calculation of the company's revenue requirement as follows:

Net Operating Expense
\- Fuel Expense
Net Operating Expense – Fuel
÷ .93

Revenue Requirement without Fuel Expense
\+ Fuel Expense
Total Revenue Requirement

The commission should establish deferred accounting by order, including the timing and mechanics of a true-up.

WRITTEN COMMENTS

Written comments addressing fuel surcharges as listed above must be filed with the Commission no later than 5:00 pm, Friday, April 8, 2011. The Commission requests that comments be provided in electronic format to enhance public access, for ease of providing comments, to reduce the need for paper copies, and to facilitate quotations from the comments. Comments may be submitted via the Commission's Web portal (www.utc.wa.gov/e-filing) or by electronic mail to the Commission's Records Center at records@utc.wa.gov. Please include:

- The docket number of this proceeding (T-101661)
- The commenting party's name
- The title and date of the comment or comments

An alternative method for submitting comments is by mailing or delivering an electronic copy to the Commission's Records Center on a 3-1/2 inch, IBM formatted, high-density disk, in .pdf Adobe Acrobat format or in .doc Word 97 or later format. Include all of the information requested above. The Commission will post on its web site all comments that are provided in electronic format. The web site is http://www.utc.wa.gov/101661.

If you are unable to file your comments electronically or to submit them on a disk, the Commission will always accept a paper document. Questions may be addressed to David Gomez at (360) 664-1240 or e-mail at dgomez@utc.wa.gov.

Your participation is welcomed via written comments. Information about the schedule and other aspects of the proceeding, including comments, will be posted on the commission's web site as it becomes available. If you would like to receive further information on this proceeding you may 1) call the Commission's Records Center at 360-664-1234, 2) e-mail the Commission at records@utc.wa.gov, or 3) mail written comments to the address below. When contacting the Commission, please refer to Docket T-101661 to ensure that you are placed on the appropriate service list. The Commission's mailing address is:

Executive Director and Secretary
Washington Utilities and Transportation Commission
1300 South Evergreen Park Drive S.W.
P.O. Box 47250
Olympia, Washington 98504-7250

NOTICE

Persons filing comments will be included on the distribution list for future information about this proceeding. If you want to receive such information but do not want to comment now, you may notify the Executive Director and Secretary in one of the ways described above and ask to be included on the distribution list for Docket T-101661. If you do not file comments or request to be included on the distribution list, you might not receive further information about this proceeding.

OPEN MEETING CONSIDERATION

The commission will consider Staff's recommendation and the comments of interested parties at its regularly scheduled Open Meeting on April 14, 2011.

Sincerely,

DAVID W. DANNER
Executive Director and Secretary