Exhibit T-___ (RC-1T)
Docket No. TC-001846
Witness: Robert Colbo

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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	)	
In the Matter of the Complaint	)	
Against Bremerton-Kitsap	)	**DOCKET NO. TC-001846**
Airporter, Inc., C-903	)	
	)	
	)	
. . . .	)	

TESTIMONY OF

ROBERT COLBO

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

October 3, 2001

Q. Please state your name and business address.

A. My name is Robert Colbo. My business address is 1300 So. Evergreen Park Drive S.W., Olympia, Washington 98504-7250.

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission (WUTC or Commission) as a Transportation Program Consultant.

Q. Have you reduced a summary of your qualifications and experience into exhibit format?

A. Yes I have. Please see Exhibit ___, (RC-2) – Statement of Qualifications and Experience.

Q. What are the duties of a Transportation Program Consultant?

A. The bulk of my work involves examining, inspecting, verifying, and auditing the financial books and records of transportation companies in connection with rate increase applications filed with the Commission. I analyze revenues, expenses, fixed assets, payroll, depreciation expense, accounts payable and receivable, customer statistics, invoices, taxes, allocations between regulated and non-regulated operations (if any), and whatever else may be necessary to form an opinion as to the merits of the rate proposals.

Q. What will be the subject of your testimony?

A. I will present the procedural history of the filing and the summary results of Staff's review of Bremerton-Kitsap Airporter, Inc.'s (B-K Airporter or Company) pro-forma financial operations for the 12 months ended September 30, 2000. I will propose an appropriate level of compensation of Mr. Richard E. Asche, company president, to be included in rates; and I will also make recommendations to the Commission concerning the final determination of an appropriate revenue requirement and rate structure for B-K Airporter.

Q. Please describe the background of this proceeding.

A. B-K Airporter filed a general rate increase with the Commission on November 27, 2000, which the Commission assigned Docket TC-001846. The proposed effective date was January 1, 2001. The filing was a new Tariff 6 that cancelled and replaced the current Tariff 5. I provided a copy of Tariff 6 as Exhibit ___, (RC-3) to my testimony.

Q. Please explain what fares and charges B-K Airporter proposed to increase.

A. The Company proposed to increase all one-way adult fares by $2.00 each, and all one-way children's fares by $1.00. The increases apply to all classes of customers above the age of two, between Sea-Tac Airport and points in the city of Bremerton/Kitsap County and Ft. Lewis/McCord Air Force Base in Pierce County. Round trip fares increased twice as much. The proposed fares are shown in the table in Tariff 6, Section I on pages four and five. Additionally, a new "service charge” of $3.00 was proposed for all refunds as per Item 10 on page two. The Company also proposed to increase the additional and overweight baggage charges from $2.00 to $3.00 as per Item 12 on page two and Item 16 on page three. Also, the Company proposed to increase the ten ride commute fare book price from 80 percent to 90 percent of the equivalent regular fare as shown on page five.

Q. **What happened after the filing was received?**

A. I was assigned to review the filing. My first action on November 29, 2001, was to send a letter to the Company asking for the additional information needed to begin my investigation. Attached to the letter was the standard instruction handout to auto transportation companies asking for rate increases. The handout lists the types of information and gives examples of the justification material that the Staff needs to evaluate rate applications. I provided a copy of my letter of November 29, 2000 as Exhibit ___, (RC-4), to my testimony.

Q. Why did Staff need additional information?

A. The justification material that accompanied the filing was incomplete. There was no pro-forma income statement accompanying the filing (either total company or separated between the Kitsap and Pierce County portions of the business) showing a historical 12 month test period restated and proformed to current conditions. Additionally, there was no showing as to the revenue impact of the filing.

Q. When did you receive the Company's response to your request for more information?

A. I received the Company's response to my letter on December, 22, 2001. This was too late to be considered before the December 27, 2000, Commission Open Meeting, the last Open Meeting before the January 1, 2001, proposed effective date of the new tariff.

Q. What happened next?

A. A. The Commission suspended the filing at its December 27, 2000, Open Meeting. Exhibit _____, (RC-5) is the Staff memorandum that I presented to the Commission at that meeting recommending that the filing be suspended. The memorandum incorrectly states that the filing was received on December 6, 2000. The correct received date was November 27, 2000, as I stated earlier in my testimony.

Q. What happened next?

A. A Prehearing Conference was held April 3, 2001, at which the original schedule for the docket was established. An Amended Notice of Hearing was issued on April 26, 2001, stating in Paragraph 4 that the issues involved would include the verification of existing rates as well as the proposed rates contained in Tariff No. 6, Exhibit ___, (RC-3).

Q. Did the Company later request that they be allowed to withdraw their filing?

A. Yes, on May 14, 2001, the Company submitted a petition for leave to withdraw the rate filing. On July 25, 2001, an order was issued denying the petition to withdraw the filing, and scheduling a second prehearing conference to be held on August 9, 2001. At the Second Prehearing Conference the Company was allowed to withdraw the original filing, a new hearing schedule was adopted, and the proceeding was converted from a suspended tariff filing to a complaint proceeding.

Q. **Is Exhibit ___ (RC-6) a pro-forma summary of your investigation in connection with this docket?**

A. Yes, it is. Exhibit ___, (RC-6) is a multi-page document summarizing the Staff's review of B-K Airporter's financial results of operations for the 12 months ended September 30, 2000. It forms the basis of the Staff's recommendations in this case.

Q. Please explain page one of Exhibit ___, (RC-6).

A. Page one is a summary pro-forma income statement for B-K Airporter for the 12 months ended September 30, 2000. Column (a) is a listing of the actual accounts appearing in the General Ledger of B-K Airporter. Column (b) contains the actual revenues and expenses of the Company as reflected in its books of account. Column (c) lists adjustments that restate the actual operating results of the Company to properly reflect a more representative "test year" for rate-making purposes. Restating adjustments correct for accounting errors and mispostings and also give recognition to those areas where the company's normal accounting procedures differ from accepted regulatory practice. The individual restating adjustments supporting the totals in Column (c) come from page two of the exhibit.

Q. Why do you use a 12 month test period?

A. A 12 month test year recognizes that for many businesses, particularly auto transportation companies, activity levels vary by season. For example, more people travel in the summertime or during the holiday season towards the end of the calendar year. By including the entire 12 month cycle in the base, we get a more accurate portrayal of "normal" operations. Column (d), then, is the sum of Columns (b) and (c).

Q. Please explain page two.

A. Each individual Restating Adjustment is shown in a separate column across the top of the page. The totals in Column (l) – on the far right - are carried forward to Column (c) on page one. The last few empty columns are reserved for any additional adjustments that may be required.

Q. Explain Restating Adjustment 1 in Column (b).

A. The revenue portion of the adjustment appearing on Lines 1 – 9 consolidates all revenues into two categories: that portion relating to Kitsap County operations at Line 4, and that portion relating to Pierce County operations at Line 9. This will facilitate the separation of the Company's operations between Kitsap and Pierce Counties later on. (Note: Some of what I refer to as "Kitsap County" revenues are actually derived from passengers boarding or being delivered in Tacoma, in Pierce County. However, the beginning or end point of the route is Bremerton, in Kitsap County.) These adjustments are offsetting in nature and don't affect the resulting total revenue figure appearing on Line 14.

The last three items at Lines 11 – 13 transfers $15,923 from Lines 64 – 66 "above the line" – that is, to be included within regulated transportation revenue. The reason I do so is that the costs incurred to produce each of these types of revenue are interspersed within the regulated transportation expenses shown on Lines 17 –52, but are impossible to identify separately. I have therefore elected to move the revenues from these activities to Lines 11 – 13 to more properly match up both revenues and expenses above the line.

Q. Please explain the $22,385 fuel tax credit amount on Lines 21 and 56.

A. This amount is a refund of Federal Fuel Taxes on gasoline that B-K Airporter claimed as a credit on its Federal Income Tax return. The Federal Government grants these credits to mass transit providers. This adjustment moves the net credit "above the line" so that rate payers receive the benefit of the fuel tax expense reduction.

Q. Please explain the $15,917 gain on Lines 52 & 62.

A. B-K Airporter operates a fleet of 15 vehicles, all with high annual mileage. For auto transportation companies such as this, regularly replacing vehicles is a normal part of operations. During the current test year, B-K Airporter sold or traded-in four vans at about four years into their service life. In the process, they realized a $15,917 gain. This adjustment recognizes the gain as an operating expense reduction, moving it “above the line” to benefit ratepayers.

Q. What is meant by the term “above the line”?

A. The Commission sets rates for auto transportation companies using a 93.00 percent operating ratio. Operating ratio is the ratio of operating expenses (at Line 53 of the Pro-Forma Income Statement) divided by operating revenues (at Line 14). For this company, the per books operating ratio reflected on B-K Airporter’s Pro-Forma Income Statement in Column (b) is 107.91 percent as shown at Line 72. Similar ratios are shown going across page one in Columns (d) through (f) as restating and pro-forma adjustments are made. The 93.00 percent operating ratio means that for every 93 cents of operating expenses incurred, the Commission allows $1.00 of operating revenues to cover those expenses and also to pay any interest, Federal Income Taxes, and to provide a profit. The differences in operating ratios between Column (b) and Column (d) on page one of Exhibit ___ (RC-6) represents the difference in how the company has portrayed its revenues and expenses versus what I have found to be more accurate for ratemaking purposes. The revenue and expense accounts included in the operating ratio calculation are defined in the Uniform System of Accounts for Auto Transportation Companies prescribed by the Commission. Regulated bus companies are required by WAC 480-30-120 to use this system to record their financial transactions. Exhibit ___, (RC-7). Revenues and expenses included in the operating ratio calculation are said to be "above the line."

Q. What types of expenses are recorded "below the line"?

A. Non-regulated items, interest income and expense, Federal Income Taxes, charitable contributions, and fines and penalties etc.

Q. Please explain Restating Adjustment 2 in Column (c) of Exhibit ___, (RC-6).

A. Restating Adjustment 2 removes $72,303 in test year net non-regulated investment income. B-K Airporter has extensive non-regulated investments in its Balance Sheet totaling over $700,000 during the test year in money market funds, mutual funds, stocks, and bonds as revealed in the Company's Response to Staff Data Request No. 17. I prepared an exhibit summarizing a five year history of such information for B-K Airporter. Exhibit ___, (RC-8). The direct revenues and expenses associated with those investments during the test period are recorded on Lines 57 – 63 of Exhibit ___, (RC-6), and they should be removed for ratemaking purposes.

In Exhibit ___, (RC-8), I have scheduled a one-page recap from the pertinent information contained in the Company's thirty-page response to Staff Data Request No. 17 to facilitate the Commission's understanding of that information.

Q. Please explain Restating Adjustment 3 in Column (d) on page two of Exhibit ___, (RC-6).

A. Restating Adjustment 3 adjusts depreciation expense to the Staff calculated amount for the regulated fixed assets used in the Company's operations. For this purpose, I used the same five-year service life that the Company has used for all the vans and busses. However, I applied straight-line depreciation as prescribed in the Uniform System of Accounts, see pages three and fifty-nine of Exhibit ___, (RC-7), rather than the accelerated depreciation method used by the Company. I have also imputed a 33 percent salvage value to the vans/buses. This percentage is in accordance with B-K Airporter's trade-in value received for equipment traded-in, sold, or otherwise disposed of in the last two years. These two changes from Company depreciation methods have three (3) impacts: 1) A resulting net reduction of $48,823 in depreciation expense as recorded by the Company during the test period; 2) An $8,015 reduction in the Gain on Sale of Assets on Line 52 (This amount represents a "true up" of prior estimated depreciation expense as recorded by the Company, and the final determinations that become certain at the time the assets involved are traded-in, sold, or otherwise disposed of); and 3) Inclusion of the resulting $381,875 total company rate base amount on Line 72 of Restating Adjustment 3, Column (d).

Q. Please explain Restating Adjustment 4 in Column (e) on page two of Exhibit ___, (RC-6).

A. Restating Adjustment 4 amortizes over three years a refund given the Company by the Washington Department of Labor and Industries for Workmen's Compensation Insurance received and recorded by the Company as a credit during the test period. The full amount of the refund/credit was $10,767. This adjustment increases (debits) expenses by $7,178, thereby leaving one-third of the originally booked credit in the test period. The remaining two-thirds will be amortized (debited) by $3,589 each year for the next two years.

Q. Please explain Restating Adjustment 5 in Column (f) of Exhibit ___, RC-6).

A. Restating Adjustment 5 reduces the test year recorded compensation for the Company's President & Chief Executive Officer, Mr. Richard E. Ashe, to a more reasonable level for ratemaking purposes. As can be noted on page one in Column (b) of Exhibit ___, (RC-6), B-K Airporter booked $421,000 of officer compensation for Mr. Ashe during the test year. As shown on pages one and two of Exhibit ___, (RC-9), provided by the Company in response to Staff Data Request No. 2, this amount was the combined total of a regular monthly salary of $5,500 ($5,500 x 12 = $66,000), plus a December 29, 1999, bonus of $265,000 plus another bonus of $90,000 in May of 2000. The $421,000 amount represents 25.47% of all revenues as recorded by the Company during the test year, and averages $3.61 for each ticket sold. (The current one-way adult fare from Bremerton to Sea-Tac Airport is

$17.00.) This adjustment removes all bonus amounts recorded during the test year, and restates Mr. Ashe's compensation to the base $66,000 level. Mr. Asche's salary and bonus activity for the years 1995 through 2000 are included as pages three and four of Exhibit ___, (RC-9) and is the Company's Response to Staff Data Request No. 16. Also, as indicated in the first paragraph at the bottom of page two of Exhibit ___, (RC-9) (Company Response to Staff Data Request No. 2), the Company is allowed a Federal Income Tax deduction for Mr. Asche's salary and bonuses, but not for dividends paid to shareholders. By including bonuses in salary, therefore, the Company is significantly reducing its Federal Income Tax burden. This is a perfectly legitimate IRS-allowed approach to reduce Income Taxes. However, these large bonuses more properly represent distributions of profits, not operating expenses for ratemaking determinations. This same conclusion was expressed by the Administrative Law Judge in Paragraph 26 on page seven of the Initial Order in Cause TC-1880, *see* Exhibit ___, (RC-10), and later confirmed by the Commission. These "bonuses" are paid at year end and vary in proportion to the annual earnings of the Company.

Q. What analyses have you undertaken to ascertain what a proper compensation level for Mr. Asche should be for ratemaking purposes?

A. The first thing I did was compare Mr. Asche's compensation to the other key employees of B-K Airporter. This was accomplished by reviewing the Company's payroll summary for the test year, as supplied by the Company in response to Staff Data Request No. 1. Pages five through eight of Exhibit ___, (RC-9) are copies of that response. The Operations Coordinator for the Company was Mark Munderloch for the period October 1, 1999, to December 31, 1999, when Jerry Danskin took over. Mr. Munderloch's salary for the three months was $7,000 and Mr. Danskin's from January 1, 2000, to September 30, 2000, was $13,194. The total for the 12 months for both was about $20,000. Alan Foster is a driver and the Company safety/training officer. His total salary for the test year was $18,268. Company controller/chief financial officer Richard Spivey and his wife together earned $20,413. Company dispatchers earned about $20,000 each. Experienced, full-time drivers, whose wages top-out at $10.25/hr., can earn as much as $22,000. These amounts are all substantially below Mr. Asche's "regular" salary of $66,000, let alone his $355,000 bonuses.

Q. What else did you do to determine the appropriate executive officer compensation?

A. The next thing I did was go back and review what prior Commission Orders and Staff audits have allowed for Mr. Asche's compensation in prior WUTC rate cases. Page 9 of Exhibit ___, (RC-9), is a recap of those amounts and also shows the disposition of each docket. The column headings are fairly self explanatory. Columns (e) – (g) are a recap of Mr. Asche's booked compensation for the relevant test periods, split between regular salary and bonus amounts. Columns (h) – (j) are the Staff allowed amounts, both total company and the net regulated after allocations to non-regulated activity – primarily charter and baggage operations. Column (k) shows the disposition of each case. Other than the dockets approved in

1991 (including the establishment of present rates in Docket TC-911279), all prior filings were either denied by the Commission or withdrawn by the Company. An annual total compensation of $64,808 was allowed for Mr. Asche, for ratemaking purposes, in the Company's last general rate case.

Q. What other studies have you done?

A. I compared Mr. Asche's compensation in this case with the salary of chief executives of other regulated airporters in the state that have recently filed for rate increases. That summary is presented on page 10 of Exhibit ___, (RC-9).

Q. Please explain that page of your exhibit.

A. The most recent dockets of the other regulated airporters are presented across the page in Columns (a) – (e). B-K Airporter's current case is presented in bold type in final Column (f). The amount of executive pay included in rates for each is indicated on Line 7. In most cases, this amount is paid to one individual, but FTE equivalents are also provided. Mr. Asche's total compensation and Staff recommended amounts are shown in the final column. Revenues, passengers, number of busses/vans operated, and the number of drivers employed indicate overall company size. Certain derived statistics for each company are shown on Lines 11 through 18. Driver pay rates show the difference between driver pay and executive/management pay. The breakdown between executive and management indicates the span of control of the chief executive. As can be observed, Mr. Asche's $421,000 compensation amount is more than 1.7 times the next highest amount for the chief executive of Shuttle Express, which is itself much higher than any of the other carriers shown. Further, Shuttle Express had more than 7.4 times as much revenue and carries more than 5.1 times as many passengers. It operates and employs about 8.0 times as many busses/vans and drivers, respectively, as does B-K Airporter. Shuttle Express also operates a substantial door-to-door service, and a limousine/town car service, in addition to scheduled runs to the airport. When compared to the others in this group, Mr. Asche's compensation is clearly excessive.

Q. Please explain the next three pages of Exhibit ___, (RC-9).

A. Under my direction, Ms. Kim Dobyns conducted a survey of county operated transit systems throughout the state of Washington and the compensation amounts paid to their chief executive(s). These are the key individuals within each organization with overall responsibility for the entire transit operation. They are available 24 hours a day, 7 days a week. The results of Ms. Dobyns' survey are summarized at page eleven of Exhibit ___, (RC-9), and the detail supporting the summaries are included on pages twelve and thirteen. Page eleven shows executive pay levels for the eight transit systems surveyed, split between those with annual gross revenue less than $10,000,000 and those with revenues higher than $10,000,000. Fringe benefits amounts are similarly shown on the lower portion of the page, and are expressed as a percentage of the salary amounts displayed above. This study shows the $66,952 average executive salary amount for chief executives of municipal transit systems with revenues less than $10,000,000 is very close to the $66,000 base salary amount paid to Mr. Asche by B-K Transportation in our test period. The information in the next two pages forms the detail for the summary information. Also disclosed is the contact person who provided the information, along with other indicators as to the size of the overall operation: FTE positions, number of passengers/boardings etc., gross revenue, and number of executives and managers. The transit operations of these county systems are significantly larger, and more complex and diverse than is the operation of B-K Airporter. They offer scheduled as well as door-to-door operations, handicapped/senior services, car & vanpool coordination, park-and-ride lots, ridesharing, commute trip reduction plans, and special runs to holiday events, baseball games, and fairs, etc. The comparisons at page 14 of Exhibit ___, (RC-9) give a numerical representation to the extent of that difference. The smaller operations at Lines 1 – 4 average 2.0 times as much revenue, carry 5.1 times as many passengers, and employee 36 percent more people. For the average larger operation at Lines 5 – 8, the differences are even more striking. Revenues average 25.6 times more, and the number of passengers carried is 71.1 times higher. The larger operators employ 13.5 times as many workers. The $66,000 total compensation included in operating expenses for Mr. Asche is generous in this context.

Q. What else have you discovered?

A. I reviewed a recent Commission docket involving CEO compensation as an issue in a contested utility case. Pages 15-22 of Exhibit ___, (RC-9) are a one-page summary (prepared by me) and a copy of pages 65 – 71 of the Third Supplemental

Order issued by the Commission in Dockets UE-991606 and UG-991607 for Avista Utilities. My summary at page 15 recaps total company and Washington regulated revenue and CEO compensation. The seven pages that follow are the Commission's discussion and decision regarding CEO compensation levels at Avista Utilities in the captioned dockets. The Commission decided an appropriate level of overall compensation for Mr. Mathews, not just an appropriate salary level. Avista's 1998 Washington regulated revenue exceeded $351 million. The Commission allowed $410,900 of his total compensation to be included in Washington rates – $10,100 less than the test year compensation Mr. Asche paid himself from B-K Airporter during our test year.

Q. What other information do you have?

A. Pages 23 – 25 of the packet is an exhibit prepared by Joanna Huang, Staff Witness and Revenue Requirement Specialist who testified regarding CEO compensation during the Avista hearing I just mentioned. Page 23 is the cover sheet. Page 24 is a tabulation taken from the April, 1999, issue of Fortune magazine, containing a summary of the 40 gas and electric utility companies, ranked by their 1998 revenues and number of employees, who represent their industry group in the overall listing of the 1,000 largest US companies during 1998. The 1998 base executive salary information is taken from the EDGAR web site of the US Securities and Exchange Commission. Page 25 shows fewer listings, containing only those companies who are closer in size to Avista. They are also ranked by number of employees and revenue. We can observe from these pages that companies that pay their chief executives in the hundreds of thousands of dollars are significantly larger (with revenues in the billions) and more complex than is B-K Airporter, with its $1.6 millions of revenue and 22 drivers. Pages 26 – 27 are another study done by Ms. Dobyns. The study lists the 50 highest paid executives in Washington State in 2001. The basic data was compiled by Watson Wyatt Worldwide, supplemented with research by Ms. Dobyns in the third column reporting total company revenues. These pages report total compensation, not just payroll, and the listing is sorted by decreasing total compensation shown in the final column.

Q. What else should we be aware of before determining a reasonable compensation amount for Mr. Asche to be included in rates?

A. The Company has a significant investment portfolio as evidenced by the Balance Sheet and Income Statement information disclosed in the Company's Response to Staff Data Request No. 17. See Exhibit ___, (RC-8). Both the holdings and the annual investment revenues are extensive, as I testified earlier. Additionally, the Company's Response to Staff Data Request No. 3, page 28 of Exhibit ___, (RC-9), states that a portion of Mr. Asche's time is spent managing the Company's investment portfolio. These items are all non-regulated. Restating Adjustment No. 2 removes $72,303 of non-regulated investment income from ratemaking consideration. The value of these non-regulated investments themselves is not included in the $381,875 rate base at Line 74 on the Pro-Forma Income Statement.

But just as those amounts are properly excluded, so is the value of that portion of Mr. Asche's time spent managing those non-regulated investments.

Q. In consideration of all the CEO compensation information and analysis you have presented here today, what is your recommended compensation for Mr. Asche for regulated operations during the test year?

A. I think $66,000 would be appropriate. That is his base salary without any bonuses, and it comes remarkably close to the findings determined by Ms. Dobyns in her survey of the municipal/county transit systems whose revenues are less than $10,000,000 on page 11 of Exhibit ___, (RC-9).

Q. Please explain Restating Adjustment 6 in Column (g) on page two of Exhibit ___, (RC-6).

A. Mr. Richard E. Asche, Company president, owns the land and buildings from which the Company operates in Pt. Orchard. He and his wife also own 9,900 of the total 10,000 outstanding shares of B-K Airporter, Inc., as indicated by the Company in its response to Staff Data Request No. 23. Per the terms of the agreement between Mr. Asche and the Company, the monthly rent is $5,000, and the 12 month total paid during the test period is $60,000. Restating Adjustment 6 lowers the Company's booked rent to reflect actual costs incurred based on the investment (i.e., Mr. Asche's purchase of the building) and its associated capital structure, rather than the monthly rental payment amounts recorded by B-K Airporter. For purposes of this adjustment, I depreciated the life of the buildings over 30 years without any salvage value. I also imputed a debt cost of 5.0 percent on the outstanding debt balance, as indicated by the Company in its response to Staff Data Request No. 24.

Q. Why did you make this adjustment?

A. Chapter 81.16 RCW (Affiliated Interests) mandates that the Commission disallow any payments between regulated entities and affiliated parties that are not reasonable. (RCW 81.16.030) In addition, RCW 81.16.020 requires that affiliated parties file advance copies of contracts or other arrangements prior to their effective date. I have found no such filing from B-K Airporter with respect to this building lease in Commission files. According to the statute, "affiliated" means any arrangement wherein the owner of the regulated company also owns or controls at least 5 percent or more of any other business entity providing goods or service to the regulated company. Staff made affiliated rent adjustments in all earlier rate case investigations involving B-K Airporter.

Q. Please explain Restating Adjustment 7 in Column (h).

A. Restating Adjustment 7 capitalizes assets that were expensed during the test period. The Company expensed a new desktop computer for the office at $1,842 in September, 2000. It also installed a new furnace for $1,642 in October, 1999, and Mr. Asche incurred $1,000 of travel expense associated with the purchase of Van No. 9 in November, 1999. The benefits of all of these items extend well beyond the annual 12 month operating cycle test period in this case. Therefore, I deleted them from the indicated operating expenses and included them on the Staff depreciation schedule.

Q. Please explain Restating Adjustment 8 in Column (h) on page two of Exhibit ___, (RC-6).

A. Restating Adjustment 8 calculates Federal Income Tax expense based on the foregoing restated B-K Airporter operating results portrayed in Column (d) of the Pro-Forma Income Statement. As indicated, this results in an increase in Federal Income Tax expense to $117,774.

Q. Please explain Restating Adjustments 9 and 10 in Columns (j) and (k).

A. These adjustments are space holders only, to be used as other restating adjustments come to light. All indicated restating adjustments are totaled in Column (l) "Total Restating Adjustments" and carried forward into Column (c) "Restating Adj." on page one of the exhibit.

Q. You mentioned earlier that the operating ratio at Line 72 used by the Commission to determine revenue requirement is taken <u>before</u> Federal Income Taxes and interest, yet in Restating Adjustment 8 you have included Federal Income Tax in your analysis. Why did you do that?

A. First, I want to make it very clear that whether or not rate of return on rate base operating results are disclosed, the operating ratio determinations earlier described remain unaffected. Rate of return on investment is simply another method of describing financial performance. Operating ratio is the most common method used to determine the revenue requirement for regulated transportation companies, but it is not the only one. In rate of return on investment, used extensively in utility regulation, the overall return is calculated <u>after</u> Federal Income Taxes and interest expense (if any). I have included an adjustment for Federal Income Tax here to give the Commission additional insight into the financial operating results of this company, now and into the future rate year.

Q. Under normal circumstances what operating ratio would you recommend that the Commission use to determine the revenue requirement for B-K Airporter?

A. As I stated earlier, the Commission has historically used a 93.00 percent operating ratio in the determination of revenue requirements for the auto transportation industry and B-K Airporter for many years. In those prior cases that have gone on to formal investigations and orders, the Commission has consistently applied the 93.00 percent operating ratio standard to this Company. See Exhibit ___, (RC-10), Exhibit ___, (RC-11), and Exhibit ___, (RC-12). It is also the standard that Staff has used in all prior rate filings by B-K Airporter. Exhibit ___, (RC-10) and Exhibit ___, (RC-11) are the past orders involving B-K Airporter in formal rate proceedings before this Commission. Although they are all initial orders, they were all later affirmed by the Commission. They all used a 93.00 percent operating ratio to determine revenue requirement. They also all contain references to affiliated rent and CEO compensation adjustments similar to those Staff proposes in this case.

For a discussion of the actual operating ratio that I think should be used for B-K Airporter in this docket, see pages 30 and beyond of my testimony.

Q. What are the pro-forma adjustments appearing in Column (e) of Exhibit ___, (RC-6) at page 1?

A. Pro-forma adjustments give effect to verifiable revenue and expense increases or decreases that are not offset by other factors, and that have or will soon occur as if they had been in effect for the entire test period.

Q. Something like a budget?

A. Close, but not quite. Budgets and forecasts make predictions about future levels of business activity as well as expected changes in revenue and expense levels. Pro-forma adjustments do not make any changes to base year service units or other predictions. All pro-forma adjustments must be known and measurable.

Q. Give an example.

A. If there has been a pay increase for drivers, a pro-forma adjustment would restate actual hours worked during the test period based on the higher pay rates. If there has been an increase in the price of gas, actual gallons of fuel consumed during the test period would be restated to the more recent price. In both instances, the base units consumed (hours worked or gallons consumed in the example) would not change, only the expense levels associated for each. Pro-forma adjustments would also be made whenever expense levels decrease. Revenue/expense increases occurring mid-way through the test period would be proformed only for those months prior to the date of the change, since the subsequent months data would already by included in the base test year. Revenue/expense changes occurring after the close of the test year would be given the full 12 month effect, since none of it is included in the base numbers. In this exhibit, the pro-forma adjustments in Column (e) are then added to the Per Books Restated results in Column (d) to arrive at the present results of operations in Column (f). Column (f) represents expected results of operations for B-K Airport for the 12 months ended September, 2000, as if present revenue and expense levels had been in effect for a full year, and after Staff restating adjustments have been made. The detail of the individual pro-forma adjustments appearing in Column (e) on page one are shown on page three of Exhibit ___, (RC-6).

Q. Please explain Pro-Forma Adjustment 1 in Column (b) on Page 3 of Exhibit ___, (RC-6).

A. Pro-Forma Adjustment 1 removes fuel surcharge revenue B-K Airporter collected from April 1, 2000, through September 30, 2000, the last day of the test period. There were no fuel surcharges collected by auto transportation companies before April 1, 2000. After fuel prices spiked beginning around January 2000, Commission Staff developed a formula auto transportation companies could use to help offset increased fuel expense. As long as certain criteria were met, the surcharge could be renewed monthly, thereby tracking the ongoing shifts in fuel price with the varying monthly fuel surcharge.

Q. Why did you remove this fuel surcharge revenue?

A. In a letter to the auto transportation industry dated September 12, 2001, Staff announced it would recommend the Commission no longer approve fuel surcharges effective January 1, 2002. Exhibit ___, (RC- 13). Pro-Forma Adjustment 3 in Column (d) provides a permanent, one-time adjustment to fuel expense based on the most recent 12 month average price through September 2001. By including this amount in the expense base used to set rates, the need to have monthly fuel updates in the future will be eliminated.

Q. Has B-K Airporter continued getting fuel surcharges during the time this case has been suspended?

A. Yes, they have in Dockets TC-010245, TC-010886, and TC-011272. Exhibit ___, (RC- 14) is a March 14, 2001, Staff Memo regarding B-K Airporter fuel surcharge in Docket TC-010245. The criteria for fuel surcharges compared the percentage of fuel expense to revenue, and the percentage change in fuel expense measured from January 2000, to the price at the time the company applied. There was no earnings test, and there were no restating or pro-forma adjustments to update actual results of operations. If the net increased fuel expense was greater than 1.00 % of revenues, the surcharge was approved for the current month. Depending on the level of changing fuel prices, the company could re-apply each month. On February 20, 2001, B-K Airporter applied for a new fuel surcharge proposed to become effective March 20, 2001. It was assigned Docket TC-010245.

Q. Did Staff oppose this filing?

A. Yes, the Staff position on this matter is contained in Exhibit ___, (RC-14). First I asked the Company to withdraw the fuel surcharge filings, but it refused. On March 14, 2001, I made a recommendation to the Commission to deny the increase "….. based on information gathered in the general rate increase from Bremerton-Kitsap Airporter, Inc., in suspended Docket TC-001846" because "….. it appears that this company is able to absorb whatever reasonably anticipated increased fuel expenses it may experience now and into the future." Company officials argued in favor of the fuel surcharge. The Commissioners concluded the information in the rate case should not be used in the fuel surcharge docket, and they approved the surcharge.

Q. What was the information from the general rate case that caused your concern?

A. We thought Mr. Asche's total compensation was too high.

Q. Why didn't you just say that?

A. We were talking about a suspended case with a protective order issued. The ex parte wall was up, and owner's allowance was known to be the major issue in the case. We couldn't discuss any specifics of the case, knowing that the Commission would one day sit in judgment on it.

Q. For Pro-Forma Adjustment 3 in Column (d), "Current Average Fuel Price", why did you restate fuel to the most recent 12 month average fuel price, rather than just the most recent purchase price?

A. Fuel prices change continuously. No one knows where the price will be at any moment in time. Staff has adopted the position that for fuel pro-forma adjustments, the average price over the most recent 12 months is the best level to use to set rates. Otherwise we risk setting rates based on one moment in time which could be either unreasonably low or high. A recent 12 month average smoothes the peaks and valleys. I would recommend that the Company keep the Commission informed of its fuel prices throughout the duration of this proceeding.

Q. Is the 12 month average practice used in any other industry group regulated by the Commission?

A. Yes. The Commission approved that practice in the recent Solid Waste rulemaking in Docket TG-990161 that became effective April 23, 2001.

Q. Explain Pro-Forma Adjustment 2 in Column (c).

A. Pro-Forma Adjustment 2 restates payroll expense and resulting taxes after giving effect to current employee pay rates.

Q. What does Exhibit ___, (RC-15) represent?

A. Exhibit ___, (RC- 15), is a two-page exhibit showing five year history of earnings with owner compensation split between base pay and bonus amounts, and compared with current rate base. Page one of this document is a recap of Company operations for the last five years, excerpted from the Company's Response to Staff Data Request Nos. 16 and 17. Fuel tax refunds and (Gain)/Loss on Sale have been moved "above the line" and appear on Line 12 and Line 46, respectively. Additionally, Officer Salary Expense has been split between Officer Base Salary amounts on Line 47 and a subtotal at Line 48, and Officer Bonus amounts on Line 51 and a total at Line 52. Cumulative totals for the indicated five years are shown in Column (g).

Q. What do you observe?

A. For the five years summarized, cumulative bonuses paid to Mr. Asche have totaled $1,055,000. With the major adjustments as proposed by Staff in this case (before depreciation related items), the adjusted and unproformed cumulative results for the five years yields an operating ratio at Line 50 of 82.82 percent. This is an astonishing 10 percentage points better than the 93.00 percent standard adopted by this Commission to determine revenue requirements in the auto transportation industry in general, and particularly as authorized by the Commission in the last litigated cases with B-K Airporter. See Ex ___, (RC- 10) and Ex ___, (RC- 11). If we divide the operating expense subtotal of $6,119,248 at Line 48, Column (g) by .93, the resulting revenue requirement would be $6,579,836. That amount is $808,788 <u>less</u> than the $7,388,624 actual Company revenues of the period shown at Line 7, Column (g).

Q. What is displayed on page two of the Exhibit?

A. Page two is a different way of looking at the same thing, with one additional step. The titles at the top of each column are self explanatory. Column (c) is the Consumer Price Index for Urban & Clerical Wage Earners (CPI-W), specific to the metropolitan Seattle-Tacoma-Bremerton area, as published by the Bureau of Labor Statistics, U.S. Dept. of Labor. The starting place for the index is for the second half of 1991, the date when the present level of rates for B-K Airporter was last set by the Commission in Docket TC-911279. At that time, the amount of Mr. Asche's compensation allowed in rates was $64,808. Subsequent indexes are shown in Column (c) for each indicated year, and the starting compensation is adjusted annually in Lines 1 – 9 by the same ratio as the indicated index. The amounts in Column (g) represent the excess of total CEO compensation actually paid to Mr. Asche over the last five years compared with the CPI-indexed compensation appearing in Column (b). The total of Column (g) is shown at Line 10. This $981,564 amount can be compared with the current net book value of all revenue equipment currently on the books and operated by B-K Airporter. In effect over the last five years, customers have already paid for the entire net investment in revenue equipment now in service almost three times over.

Q. What is the significance of that comparison?

A Even after inflationary adjustments to owner's allowance, the excess of the actual total compensation of Mr. Asche over reasonably anticipated levels based on the last rate increase docket allowed by the Commission in Docket TC-911279 is almost $1,000,000.

Q. What does Staff recommend?

A. RCW 81.04.360 requires the Commission to " … take official notice … whenever any public service company earns excess profits for a period of five consecutive years immediately preceding a Commission order fixing rates …. and may consider such facts in fixing rates for such company." I am recommending that in this case, the Commission take note of the information presented in my testimony and included particularly in Exhibits ___, (RC-9) and ___, (RC-15) and to set rates differently than it has in the past. The Commission has historically used a 93.00 percent operating ratio in setting rates for airporter operations. As discussed previously in my testimony (page 10, line 11), Operating Ratio is calculated before interest, taxes, and profit. The operating margin, the complement of the operating ratio, is designed to cover those expenses. B-K Airporter has a 100 percent equity capital structure; it pays no interest. The Company also pays relatively little Federal Income Tax, electing instead to pay "operating income" to the owner as bonuses for his work as CEO. Staff recommends that the Commission use a 97.00 percent operating ratio to establish a revenue requirement for B-K Airporter in this case. This is the figure that the Company has, in effect, experienced in the last five years when bonuses have been included in the Owner Salary account. It is derived on the bottom of page one of Exhibit ___, (RC-15) at Column (g), Line 54.

Q. Wouldn't your proposal constitute retroactive ratemaking to the extent that it would offset the rates that are to be applied prospectively based on past overearnings?

A. To some extent, it does, but RCW 81.04.360 clearly provides for an exception where a transportation company has had a five year period of over-earning. For all the reasons I have described so far, this is an exceptional situation. I'm not advocating tracking down and giving refunds to prior customers, but I do think that future ratepayers should now begin receiving the benefits of reduced fares because, as a class, customers have paid too much over the past five consecutive years. Conversely, the Company has reaped a windfall and, rather than reinvesting for the benefit of customers, it has paid grossly excessive salaries to its CEO.

Q. Please describe Pro-Forma Adjustment 4.

A. Pro-Forma Adjustment 4 calculates Federal Income Tax expense based on B-K Airporter results after giving effect to all of the preceding pro-forma adjustments.

Q. What about Pro-Forma Adjustments 5 through 10?

A. These adjustments are space holders only, to be used if other pro-forma adjustments come to light. The total of all indicated pro-forma adjustments are accumulated in Column (l) "Total Pro-Forma Adjustments" and carried forward into Column (e) "Pro-Forma Adj." on page one of Exhibit ___, (RC-6).

Q. Please explain page four of Exhibit ___, (RC- 6).

A. Page 4 takes the pro-forma total company present revenues and expenses per Column (f) of page one of Exhibit ___, (RC-6) and separates them between the two routes that B-K Airporter operates: Column (d) on page four is the separated Kitsap County operations, serving the greater Bremerton area, and Column (e) on page four is the separated Pierce County operations serving Ft. Lewis and McChord Air Force Base. Column (c) of page four shows the allocation factor that is the basis upon which the separation was made. We can see that the Company is making a considerable profit on the Bremerton/Kitsap route, and it operates at a slight loss on the Ft. Lewis-McChord AFB/Pierce runs.

Q. What is the significance of the amounts appearing on Lines 6 – 8 in Columns (d) and (e) on page four?

A. The amounts on Line 6 are the net changes in total revenue at Line 5 that would need to occur to achieve a 97.00 percent operating ratio appropriate to each separate route. In the case of the Kitsap operation in Column (c), revenues would have to decrease by $292,576; in the case of the Pierce operation in Column (d), revenues would have to increase by $31,776. One-way passenger counts are shown on Line 7 for each segment, and that revenue differential divided by the number of passengers is displayed on Line 8.

Q. Is this your recommendation regarding the ultimate revenue requirement of this company, and the rate design that will accomplish it?

A. Yes it is. Based on a 97.00 percent operating ratio, it is my opinion that the Company is currently over-earning approximately $260,800 annually. Present rates to and from Kitsap County should be reduced by $3.00 per one-way fare, and present rates to and from Pierce County should be increased by $1.75 per one-way fare. These amounts have been rounded to the nearest quarter ($0.25) to facilitate the drivers' ability to make change and is carried forward to Lines 4 and 9 of the summary pro-forma income statement at page one of Ex. ___, (RC- 6). As can be observed in Columns (e) and (f), collectively this will decrease overall revenues by approximately $261,686, yielding an operating ratio at staff revised rates of 96.64 percent. No other changes from present rates will be necessary.

Q**. What Commission precedents are there in situations such as this when a company initially asks for an increase, but the Staff investigation indicates the need for a decrease?**

A. There are a lot of possible outcomes within the mandates of RCW 81.04.360 and RCW 81.28.010 for fair, just, reasonable, and sufficient rates. Implicit within the decision to file rates and the Staff investigation that follows is the possibility the result may be something different than what was expected. Sometimes companies get all they asked for; most often they get a portion of their original request. Occasionally the staff analysis yields a negative revenue requirement, as in this case. I have already testified that present rates are at issue in this proceeding. As a result of the September 19, 2001, Order in this case is now a complaint investigation.

Q. **What about other dockets of other companies?**

A. I prepared an exhibit that will help me answer your question. Page one of Exhibit ___ (RC-16) is the order in Cause U-86-130 wherein the Commission instituted an investigation when Federal Income Tax rates decreased from 46.00 percent to 34.00 percent due to the Tax Reform Act of 1986. The Commission required the 16 major utility companies shown on page two to report back showing their current earning status and the impact the tax savings would have on their operations.

Q. Please explain page three of Exhibit ____, (RC-16).

A. Page three is a listing of significant past utility cases where the indicated companies originally filed for a rate increase, but the Commission instead ordered rate reductions after formal proceedings.

Q. Did you find any dockets involving transportation companies?

A. Yes, I did. Page four of Exhibit ____, (RC-16), is a spreadsheet showing examples I found where transportation companies lowered or were ordered to lower their rates in response to changing business conditions. It was provided to the Company in response to its Data Request No. 14 to the Staff. The 12 solid waste companies in the upper left portion of the spreadsheet responded to Staff information requests concerning a sustained, significant increase in commodity values in 1995 by lowering their recycle collection rates. Continued concern in this area led to the Staff development of a deferred recycle program in 1998 where rates are automatically tracked and adjusted annually. The carriers shown on the upper right of page four are the current participants of that deferred program.

A unique situation developed in Whatcom County in 1997 when a disposal "tip fee" war broke out between competing transfer stations. Area disposal fees fell substantially below the level included in rates. At Staff insistence, the three carriers shown on the lower left corner of page four first reduced their collection rates, then filed for a deferred disposal fee program similar to that described above for the recycle carriers.

Finally in 1999, Shuttle Express misrepresented what it purported to be a fuel price emergency, filing for and receiving a surcharge in Docket TC-990604. When the Commission became aware of the facts, it first scaled back the surcharge, then cancelled the program entirely when the company informed them that fuel prices had moderated.

Q. Do you still favor $3.00 rate reductions in Kitsap County in spite of the fact that B-K Airporter hasn't had a rate increase since 1991?

A. Yes, along with the increases I am recommending for the Pierce County runs. There are also other factors that contribute to their continued success in the intervening years:

- No other certificated auto transportation companies have authority between Kitsap County and Sea-Tac Airport; the Company operates only scheduled runs and has no expensive door-to-door service;
- the 20 plus percent population growth of Kitsap county and the Puget Sound region between 1990 and 2000;
- the fact that the Company is making the transition from 11 and 12 to 20 passenger vans with resulting increased load factors; and
- the greater proportion of passengers from the more profitable Kitsap County side of the operation.

Q. Do you have any other recommendations for the Commission?

A. Yes, I have three. First, I recommend the Commission require the Company to pay no more than the officer salary authorized in this case and prohibit the Company from issuing any bonuses to the officer. This will simply insure that the Company properly accounts for the excess revenues. Second, I recommend that the Commission require the Company to place all revenue that exceeds what would be required to generate a 97.00 percent operating ratio into a special "credit account" that will be used to lower rates in the future. When the Company files a rate case with the Commission, any money contained in this account will be used to offset any additional revenue requirement. Third, Staff recommends that the Commission set the previous two recommendations for a period of three years from the date that the rates from this proceeding become effective.

Q. How did you arrive at the three year length of time?

A. The Company over earned for at least five years, and Staff believes setting these conditions for three years is a conservative attempt to balance the overall Company operations: five consecutive years of substantial over earnings totaling $1,155,000, and three years at a slightly lower than normal return amounting to about $180,000.

Q. What is your recommendation with respect to recovery of the Commission's costs in this case?

A. B-K Airporter has a long history of making ill-advised rate applications. (See page nine of Ex.___, RC- 9, Column (k)). This case is no exception. When the Company found out the Staff would be contending for a rate decrease, it tried to withdraw the filing. The filing was then converted to a complaint proceeding. At this point, it is my recommendation that B-K Airporter be billed for all costs incurred by the Commission to the maximum extent possible under the provisions of RCW 81.20.020, and that those costs <u>not</u> be allowed to be passed on to its customers. Customers have been paying too much for too long already.

Q. Does this conclude your testimony?

A. Yes, it does.