

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In re Application of

MEI NORTHWEST LLC

For a Certificate of Public Convenience and
Necessity to Operate Vessels in Furnishing
Passenger Ferry Service

Docket TS-160479

TESTIMONY OF

WELDON BURTON, CPA

ARROW LAUNCH SERVICE, INC.

November 1, 2016

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17

I. INTRODUCTION

18 **Q: Please state your name, business and business address.**

19 A: My name is Weldon T. Burton. I am a CPA licensed in Washington and Oregon for the
20 past 41 years. My business address is 2 South 56th Place, Suite 201-E, Ridgefield, WA
21 98642.

22 **Q: Please provide a brief background of your experience.**

23 A: I was licensed in Washington as a CPA in 1975 and Oregon in 1992. Almost
24 immediately I began working with logging companies subject to trucking rates
25 established by the Washington Utilities and Transportation Commission. In the mid
80's I began working with regulated solid waste collection companies subject to the
rules and regulations established by the Commission. I began working with Arrow
Launch Service, Inc. in 2013 providing financial statement, income tax preparation
general and regulatory accounting advice and services. My curriculum vitae, which
includes a more detailed explanation of my background, is attached as Exhibit No. ____
(WB-2).

II. SUMMARY OF TESTIMONY

18 **Q: Can you briefly summarize the purpose of your testimony in opposing this
19 application?**

20 A: I was requested by Arrow Launch Service, Inc. to read and evaluate the Commercial
21 Ferry Application filed by MEI Northwest, LLC, seeking a certificate of convenience
22 and necessity to operate a motor launch service within certain geographic areas of
23 Puget Sound.

24 **Q: Please explain your findings.**

25 A: Question 12 of the Commercial Ferry Application form requests the applicant to
complete the following financial statement. MEI Northwest, LLC has handwritten in

1 \$300,000 in cash and \$105,000 in other assets without indicating any liabilities or
2 capital (net worth). Therefore the financial statement was incomplete and does not
3 balance. A careful reading of the financial statement portion of the Commercial Ferry
4 Application further reflects that information was added then removed, using “white-
5 out” or some type of ink removing liquid. If a reader carefully reviews the liability
6 portion you will see broken lines in the narrative lines and figure lines which indicate
7 that information and figures were written in then removed.

8 **Q: Did MEI Northwest, LLC provide a pro forma financial statement which was**
9 **included in the application?**

10 A: Yes, they did provide a one page profit and loss statement which outlined their
11 anticipated revenues and operating costs.

12 **Q: Do you have any comments or questions about the one-page Pro Forma Financial**
13 **Statement?**

14 A: I find it interesting that they show \$500,000 of revenue providing launch services from
15 the tariff pages they filed concurrently with the Commercial Ferry Application.
16 Further, when I review the charges and anticipated hours assessed it indicates the
17 following:

	Tariff Rate	Billed Hours	Billed Revenue
Deck hand	\$46.25	1,659.75	\$76,763.44
Launch	\$255.00	1,659.75	\$423,236.25
Totals			\$499,999.69

23 **Q: What does that table suggest to you?**

24 A: The table reflects they will be billing customers approximately 1,600 hours which is
25 only three fourths (3/4) of a normal work year of 2,080 hours. Yet Mr. Esch testifies
they will be providing launch services to vessels 3 to 4 times a week for 4 to 8 hours

1 per day. (RSE-T1, pg. 9, lines 12 & 13). If they are providing launch service 3 times a
2 week for 8 hours a day that is only 1,248 billable hours. If they are providing launch
3 service 4 times a week for 8 hours per day that is 1,664 of launch hours. If they can
4 maintain 4 times a week launch service for 8 hours per day they will achieve their
5 targeted revenue yet their application does not include any verifiable customer demand
6 for services requested in this Commercial Ferry Application and for their projected
7 demand levels.

8 **Q: The pro forma financial statement also indicates MEI Northwest, LLC expects to**
9 **generate \$150,000 in accessorial services and \$50,000 in project management fees.**
10 **Does that seem reasonable in your experience?**

11 A: Ancillary unregulated revenues are clearly able to be generated, however there are no
12 price lists included in the application or indication of customer demand for these
13 nonregulated services to check this assumption against. But, the pro forma depends
14 heavily on these ancillary revenues to provide the desired profitability that MEI
15 Northwest, LLC reflects on its pro forma financial statement. Moreover, if the ancillary
16 unregulated revenue objectives are not met, the entity will be operating at a sizeable
17 loss. Again, there are no separated or identified expenses for these ancillary services
18 provided by the applicant.

19 **Q: Do you see other items in the pro forma financial statement that cause you**
20 **concern?**

21 Yes, their annual fuel cost is shown as \$15,000 in the pro forma. When I convert that
22 dollar figure into purchased gallons at the Port of Anacortes fuel dock, current price of
23 \$2.45 per gallon (when purchasing between 100 - 750 gallons), MEI would purchase
24 6,122 gallons of diesel per year. MEI has proposed using two vessels, the “Jamie Lee”
25 and “Stephanie Lynn.” The Stephanie Lynn is powered by twin Cummins, 6CTA8

1 engines which, according to the fuel consumption - prop curve published by Cummins
2 Engine Company, Inc., burn approximately 10.4 gallons of fuel per engine, per hour at
3 1900 RPM or 75 % throttle. The Jamie Lee is powered by twin Detroit Engines.

4 Assuming that just one vessel, the most economical (Stephanie Lynn), operated a total
5 of 1,659.75 billed hours per year, the fuel consumption would be 34,522.80 gallons of
6 fuel at an average cost of \$2.45 per gallon. That cost of \$84,580 would be almost six
7 times greater than Mr. Esch included in the pro forma financial statement.
8

9 **Q: What other items concern you in the pro forma financial statement?**

10 A: The wages on the pro forma financial statement appear to be inadequate which are
11 Captain labor and Deckhand labor of \$140,000 and \$80,000 respectively for a total of
12 \$220,000 (Exhibit No. ___ (RSE-4). There are no Federal or State Employment Taxes
13 included on the pro forma so I must assume Mr. Esch has included those taxes in his
14 calculation of gross wages. Mr. Esch also testified hiring 4 to 6 full-time employees.
15 The following are hourly wage costs for the marine industry according to the 2016
16 Marine Employees' Compensation Survey published by the Office of Financial
17 Management of the State of Washington in May 2016:

18 Average Pay Rate for Captains \$48.18, Exhibit I, pg. 18

19 Average Pay Rate for Able Seaman (deckhands) \$26.21, Exhibit V, pg. 20

20 **Q: What is your analysis of labor cost using the average pay rates from the Marine**
21 **Employees Compensation Survey?**

22 A: The average pay rate should be burdened for employment taxes at approximately 15%.
23 The burdened rate for captains would be \$55.41 and deckhands \$30.14 per hour.
24 2½ captains average work year of 2,080 hours which would equal 5,200 hours per year,
25 times \$55.41 per hour or \$288,132 per year. Mr. Esch has budgeted just half that of
\$140,000 per year for captains. 2 ½ deckhands average working each year 2,080 hours

1 which would equal 5,200 hours per year, times \$30.14 per hour or \$156,728 per year.

2 Mr. Esch has budgeted \$80,000 per year for deckhands. Mr. Esch states “We would
3 crew a boat around the clock to facilitate service on demand.” (RSE-T1, 21:3). Again,
4 Mr. Esch has under-budgeted by approximately one-half the required labor cost.
5

6 **Q: Are there other areas of concern on the MEI Northwest, LLC Pro Forma
7 Financial Statement?**

8 A: Yes. I also do not see any administrative wages for manning the local office Mr. Esch
9 testifies that the company will have in Anacortes. (RSE-T1, 13:1-2). There are also no
10 officer or supervisory wages shown on the pro forma.

11 **Q: Do you have any other concerns about additional costs in the MEI Northwest,
12 LLC Pro Forma Financial Statement?**

13 A: Yes. On the Pro forma Financial Statement Launch Charters, cost is shown at \$54,000
14 for two vessels.

15 **Q: Can you tell us if \$54,000 is a fair market rate for the annual lease of two water
16 taxis?**

17 A: I have not researched or determined if \$54,000 is a fair market value for these two
18 vessels. Considering the lease is an affiliated interest transaction, in my experience,
19 Commission Staff will review the original cost and accumulated depreciation of the
20 leased vessels to determine if the lease rate is excessive.

21 **Q: What about MEI’s proposed results of operations? Any concerns there?**

22 A: Yes, the WUTC has historically used an Operating Ratio methodology for ratemaking
23 for most Title 81 RCW companies. The historical operating ratio has been calculated
24 dividing allowable operating expenses (interest and income taxes are excluded as
25 allowable operating expenses) by 93 percent to determine allowable revenues for the
carrier. In simple terms, if a regulated carrier’s operating ratio falls to the 95-98%

1 range, a revenue increase is normally approved. A carrier with an operating ratio below
2 93 % generally will not be eligible for a rate increase under this methodology. MEI
3 Northwest, LLC's operating ratio reflected on its Pro Forma Financial Statement
4 submitted with the Commercial Ferry Application yields 79% by my calculations,
5 substantially higher than currently allowable by the Commission.

6 **Q: Does this create any particular concerns for you?**

7 A: Clearly, as I've testified, the projected operating expenses of the applicant appear
8 artificially low which would in turn derive this type of extraordinarily low operating
9 ratio suggesting something is amiss with its financial projections.

10 **Q: If MEI Northwest, LLC is granted the certificate authority requested, what would
11 you project the effect to be on Arrow Launch Service?**

12 A: Well, the most immediate effect would be almost instantaneous staff reductions and
13 layoffs of Arrow employees in the Anacortes area. The northern Puget Sound area
14 sought by the docketed application represents approximately 48% of Arrow's gross
15 annual revenues.

16 **Q: What would the effect of the elimination of \$700,000 of gross annual revenues be
17 on Arrow Launch Service, in your opinion as the company accountant and
18 regulated rate specialist?**

19 A: If \$700,000 of gross revenue is removed from Arrow, approximately \$280,000 of gross
20 margin revenue would be lost which, in turn, would necessitate substantial reductions in
21 operating costs and overall operations which would adversely affect services in all areas
22 of Puget Sound.

23 **Q: And what would you project the effect would be on Arrow's customer base?**

24 A: Well, in my view, Arrow would have to recoup that amount of lost revenue by raising
25 rates across the board to all remaining customers, not only in Anacortes but throughout
its certificated territory or otherwise be forced to sell off operating assets, reduce its

1 work force and considerably scale back its regulated operations.

2 **Q: Mr. Esch's testimony also projects estimated regulated launch revenue of \$500,000**
3 **in the first year. Are you accounting for this in your projections about the impact**
4 **of an overlapping application in the Anacortes/Vendovi/Bellingham area on**
5 **Arrow's operations?**

6 A: Yes. According to Mr. Esch's testimony, he believes the total annual launch revenue of
7 the applicant would be as much as \$1,000,000 in the requested territory. (RSE-T1,
8 pg.9, lines 1-4). If this estimate is correct and, for instance, if the total combined
9 nonregulated and regulated income reduction for Arrow would be \$1,000,000, Arrow's
10 consequent reduction in gross revenue margin would be approximately \$400,000,
11 thereby reducing total net income as reported on the 2015 WUTC Annual Report to
12 virtually zero. This would require fleet reductions, personnel reductions and
13 diminished service levels to all customers.

14 **Q: Does that conclude your testimony?**

15 A: Yes it does.

2 CERTIFICATE OF SERVICE

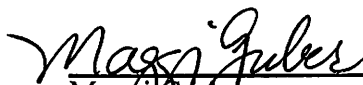
3 I certify that on November 1, 2016, I caused to be served the original of the foregoing
4 document to the following address via FedEx to:

5 Steven V. King, Executive Director and Secretary
6 Washington Utilities and Transportation Commission
7 Attn: Records Center
8 PO Box 47250
9 1300 S. Evergreen Park Dr. SW
10 Olympia, WA 98504-7250

11 I further certify that I have also provided to the Washington Utilities and Transportation
12 Commission's Secretary an official electronic file containing the foregoing document via the
13 WUTC web portal; and served a copy via email to the following parties:

<p>12 For Washington Utilities and Transportation Commission Staff: 13 Julian Beattie 14 Office of the Attorney General 15 Utilities and Transportation Division 16 1400 S. Evergreen Park Drive SW 17 P.O. Box 40128 18 Olympia, WA 98504-0128 19 Phone: (360) 664-1225 20 Email: jbeattie@utc.wa.gov</p>	<p>For MEI Northwest, LLC: Mr. Dan Bentson Bullivant, Houser, Bailey, PC 1700 Seventh Ave, Suite 1810 Seattle, WA 98101 Email: dan.bentson@bullivant.com</p>
<p>17 For Pacific Cruises Northwest, LLC: 18 Captain Drew M. Schmidt 19 President 20 Pacific Cruises Northwest, Inc. 355 Harris Avenue, Suite 104 Bellingham, WA 98225 Phone: (360) 738-8099 Email: drew@whales.com</p>	<p>Administrative Law Judge Judge Marguerite E. Friedlander Washington Utilities and Transportation Commission Email: mfriedla@utc.wa.gov</p>

21 Signed at Seattle, Washington this 1st day of November 2016.

22
23 
24 Maggi Gruber
25 Legal Assistant
Williams Kastner & Gibbs PLLC
mgruber@williamskastner.com