

Two, Area 4 by 3 percent; increased the rate in District Three, Area 6 by 4 percent; and increased the rate in Area 7 by 9 percent. There was a 5 percent decrease in the rate for Area 5, while the rate in Area 8 went unchanged.

As a result of a lawsuit filed by District Two, the Coast Guard published a temporary final rule on July 19, 2002. The rule returned the rate in District Two, Area 5, to the one that was in place prior to August 13, 2001. The result of this rule was a rate increase of 5 percent, which became effective August 20, 2002.

To accurately project 2003 revenues, we must adjust or "align" 2001 revenues to reflect the changes in the rates referenced above. Accordingly, the aforementioned percentage changes in pilotage rates for each pilotage area were applied (multiplied by a factor to reflect

an increase or decrease) to the total pilotage revenues in each area, collected prior to August 13, 2001 (the effective date of the rate adjustment), except for District Two, Area 5. The adjusted revenues for each area were then added to the revenues collected after August 13, 2001, in each area to obtain total adjusted revenue for each area. To account for the initial rate decrease and subsequent increase in District Two, Area 5, pilotage revenues collected after August 19, 2001, were adjusted to reflect the 5 percent increase effective August 19, 2002, (*i.e.*, $\$782,914 \times 1.05 = \$822,060$) and then added actual area revenues collected prior to August 19, 2001, to obtain the total adjusted revenue for Area 5.

In previous rulemakings, actual revenue for each pilotage area was not available. Only total revenue for the

districts was being provided in financial statements. As a result, total revenue for each district was apportioned among pilotage areas based on the number of pilots authorized. Often this apportionment did not accurately approximate or reflect the actual revenue collected in a given pilotage area, most notably in Area 7 of District Three, where in 2001 actual revenue exceeded the apportioned amount by approximately \$450,000. In the past, this apportionment caused an inflated pilotage rate in one area and also caused deflated rates in other areas. This year, with the cooperation of the districts, we were able to account for revenue in each of their respective pilotage areas. Using actual revenues greatly enhances the equity of the rate structure. The results of Step 3.A for each district are summarized below:

DISTRICT ONE

	Area 1 St. Lawrence River	Area 2 Lake Ontario	Total District One
Projection of revenue	\$1,105,233	\$629,149	\$1,734,382

DISTRICT TWO

	Area 4 Lake Erie	Area 5 Southeast Shoal to Port Huron MI	Total District Two
Projection of revenue	\$705,015	\$1,461,069	\$2,166,084

DISTRICT THREE

	Area 6 Lakes Huron and Michigan	Area 7 St. Mary's River	Area 8 Lake Superior	Total District Three
Projection of revenue	\$1,540,306	\$1,119,819	\$1,030,693	\$3,690,818

Step 4: Calculation of Investment Base

In 46 CFR part 404, Appendix A, Step 5(3), it states that "Assets subject to return on investment * * * must be reasonable in purpose and amount. If an asset or other investment is not necessary for the provision of pilotage services, that portion of the return element is not allowed for ratemaking purposes." In calculating rate of return the Director considers property, equipment and cash necessary to cover pilots' associations expenses during the three-month period the St. Lawrence Seaway is closed. Some pilots' associations throughout the course of the navigation season choose to accumulate large cash balances from revenue received for pilotage service rather than distribute the money as pilot

compensation. These large cash balances are reflected on their balance sheet as cash assets at the close of the calendar year (December 31). A significant portion of these cash assets are then immediately distributed the next calendar year as pilot compensation. The net effect inflates their investment base at the end of the calendar year. The Director's inclusion of cash assets in excess of what is required to operate during this period would encourage these associations to unnecessarily inflate their investment bases and provide a source of return available to few, if any, other private businesses. An analysis of pilots' associations' investment bases indicates that, ever since the concept of return on investment was introduced into the

ratemaking methodology, Districts Two and Three have greatly increased their bases. In District Two, the base went from \$265,488 in 1995 to \$413,998 in 1996, of which only \$116,041 represented property and equipment. In District Three, it went from \$119,823 in 1995 to \$994,896 in 1996, of which only \$25,583 represented property and equipment.

In addition to property and equipment, the Director is recognizing \$100,000, \$150,000, and \$200,000 for inclusion in the investment base for Districts One, Two, and Three, respectively, as cash necessary to cover operating expenses during the months the St. Lawrence Seaway is closed.