
REBUTTAL TESTIMONY

Of

WALTER E. EDGE JR.

FOR

INTERSTATE NAVIGATION COMPANY

DOCKET No. 3573

APRIL 2004

1 **Q. Are you the same Walter Edge who has previously filed direct testimony in this**
2 **docket?**

3 A. Yes I am.

4

5 **Q. What is the purpose of you testimony?**

6 A. I would like to respond to the direct testimony of the Town and the Division in this
7 docket.

8

9 **Q. Mr. Edge you filed testimony for Interstate Navigation requesting a rate**
10 **increase of \$2,750,712 or about 40%. The Division recommends a rate increase of**
11 **\$902,951 or about 12% and the Town recommends a rate increase of \$244,160 or**
12 **about 3%. Why are the recommendations so drastically different?**

13 A. There are a few very large issues in this docket. I believe that the Division and the
14 Town have taken extremely unfair, unreasonable positions on these large issues that if
15 accepted by the Commission will result in a significant decrease in the level of service
16 provided by Interstate to its ratepayers. Their positions range from unrealistic to
17 impossible.

18

19 **Q. Can you provide a list of the larger issues in the Docket?**

20 A. Certainly, The major issues and approximate impact are as follows:

21

| Issue | Amount * | Comment |
|--------------------------|-------------------|--|
| Cost of the M. V. Anna C | \$ 287,479 | Depreciation adjustment |
| | 323,310 | Return on rate base (7.33%) and Division revenue multiplier 1.5343. |
| Total Anna C adjustments | <u>\$ 610,789</u> | |
| Legal fees | \$ 264,093 | Reduction to last docket level (1996) plus an increase for inflation. |
| Homeland Security | \$ 151,514 | Five year average approach |
| Advertising | \$ 111,730 | Ignored need to compete |

Continued:

| | | |
|----------------------|--------------------|----------------------------------|
| Wharfage - Montville | \$ 107,532 | Division ignored signed contract |
| Salaries and Wages | <u>\$ 95,596</u> | Reduction of management salaries |
| Total | <u>\$1,341,254</u> | |

* Using the Division position.

1

2 **Q. What were the additional issues raised by the Town?**

3 A. The other two major adjustments proposed by the Town relate to revenue growth and
4 homeland security. I will address these issues after I finish with the issues proposed by
5 both the Division and the Town.

6

7 **Q. What is the issue regarding the purchase of the M. V. Anna C?**

8 A. As I stated in my pre-filed testimony, Interstate wishes to purchase the M. V. Anna C
9 from Nelseco Navigation (a non-regulated ferry company). With Commission approval,
10 Interstate Navigation's management has leased the M. V. Anna C on numerous occasions
11 over the years. Interstate strongly believes that the addition of the M. V. Anna C to the
12 Interstate fleet on a full time basis will significantly improve service to Interstate's
13 ratepayers.

14

15 Because Nelseco is a somewhat related party (similar ownership but not exactly the
16 same) to Interstate Navigation, Interstate expected that the Division and the Commission
17 would look very carefully at the sale of the Anna C by Nelseco to Interstate. Therefore,
18 Interstate obtained an independent appraisal of the Anna C to determine the appropriate
19 fair value for the sale. That appraisal stated that the M. V. Anna C is worth \$3,100,000
20 and her replacement value is \$9,500,000. Interstate included the purchase price of
21 \$3,100,000 in the rate request. The Division (and in turn the Town) allowed only
22 \$225,215 in the revenue requirement for the purchase of the M. V. Anna C.

23

24

25

1 **Q. Can the M. V. Anna C be purchased from Nelseco for \$225,215?**

2 A. No, it cannot be purchased for any amount less than the \$3,100,000 appraised value.
3 Nelseco's non-voting (yet majority) stockholders have advised Interstate's management
4 that they will not allow the boat to be sold for a penny less than the appraised value. It
5 should be noted at this time that the Linda family owns only 17% of Nelseco. If the
6 Commission does not allow the sale at \$3,100,000, Nelseco's management will be forced
7 to sell the Anna C on the open market and probably ask more than the appraised
8 \$3,100,000.

9

10 When asked if the Division thought that the Anna C could be purchased from Nelseco for
11 \$225,215, the Division replied that "Ms. Crane has no opinion as to whether or not
12 Nelseco will sell the Anna C to Interstate for \$225,215. Her recommendations relate
13 solely to the ratemaking treatment to be used by Interstate."

14

15 If I understand her position correctly, Ms. Crane does not care if Interstate can purchase
16 the boat for \$225,215 or not. Her position is that no matter what Interstate pays for the
17 Anna C, Interstate should only be allowed to include \$225,215 in rates. If Nelseco will
18 not sell the boat for less than \$3,100,000 then there are only two possibilities that can
19 happen.

20

21 The first and most likely possibility is that the boat will be sold to someone other than
22 Interstate and the service level for Interstate's ratepayers will be reduced. The other
23 possibility implied by the Division (but not realistic) is that Interstate will somehow buy
24 the boat for \$3,100,000 and only collect \$225,215 from the ratepayers. I can see no
25 reason why Interstate would purchase the Anna C as a regulated asset to be used
26 exclusively for the ratepayers of Interstate Navigation for an amount many times greater
27 than the amount that can be included in rates. Anyone who believes otherwise is living
28 in another world.

29

30

1 **Q. How will the sale of the Anna C to someone other than Interstate Navigation**
2 **impact the current operations of Interstate Navigation?**

3 A. Interstate will lose its full size winter back-up boat. The summer mid-day weekend
4 and holiday run from Block Island to Point Judith (and back) will be also lost.

5

6 This weekend and holiday run is key to the Company because it serves the tourists who
7 are leaving the island after a week of renting and it brings to the island the tourists for the
8 next week. Further, Interstate will be forced to continue the use of the M. V. Nelseco a
9 much older, slower and passenger only boat on the Point Judith run. The Nelseco
10 provides an uncomfortable, rough ride during high seas. In short, the loss of the M. V.
11 Anna C will be detrimental to the passengers, will adversely impact service, will result in
12 lost revenue and in the long run increase the cost of providing lifeline service.

13

14 **Q. How did the Division and the Town justify the fact that they are only allowing**
15 **\$225,215 in the revenue requirement to purchase the M. V. Anna C?**

16 A. It appears that they believe that the boat should be transferred to Interstate
17 Navigation for the net book value of the boat on Nelseco's books. The argument
18 presented by the Division and accepted by the Town is that the boat should be transferred
19 at the lower of cost or market. Further, the Division states that the cost to the ratepayers
20 should be no more than if they purchased the boat themselves (this idea will be addressed
21 in more detail later in this testimony).

22

23 **Q. What is wrong with their position?**

24 A. First of all, their position assumes that because Interstate has leased the Anna C in
25 the past (at a rate approved by the PUC) that somehow Interstate's ratepayers have
26 obtained some form of hypothetical "ownership" of the Anna C, with the exception of the
27 remaining book balance on Nelseco's books, which represents the original purchase price
28 less depreciation. Given that the PUC approved the lease amounts that Interstate has
29 paid for the use of the Anna C, without reference to ownership transfer, the Division's
30 position that the transfer should be made at net book value is simply wrong.

1 Ms. Crane points out that she never suggested that the boat be sold for \$225,215, but that
2 only \$225,215 should be allowed in rates. After careful consideration of real world
3 financial considerations, I see no difference in these two positions and I will continue my
4 testimony as if there is none.

5
6 **Q. Are there any other problems with the Division's position which was also**
7 **adopted by the Town?**

8 A. Yes, there are many. One could infer from the Division's testimony that the
9 Interstate rate payers have paid all of the depreciation that reduced the book value of the
10 Anna C to \$225,215. This is simply not true.

11
12 Also, the Division testimony suggests that Nelseco was paid a return on the Anna C by
13 Interstate's ratepayers. After reviewing the record in the last two dockets, I believe that
14 this observation is also not true. I would note, however, that even if Interstate's
15 ratepayers did pay some return to Nelseco through the lease payments, that those
16 payments alone could not confer ownership on Interstate's ratepayers.

17
18 **Q. How do you know that Interstate's ratepayers did not pay all of the**
19 **depreciation on the Anna C?**

20 A. There are a number of reasons. First, Interstate has not paid over \$2,000,000 of
21 depreciation to lease the Anna C over the past fourteen years. Also, one must remember
22 that Nelseco has its own ratepayers that travel from Connecticut to Block Island. I
23 believe that Nelseco's own ratepayers and the Nelseco owners have paid the lions share,
24 if not all, of the depreciation.

25
26 **Q. Why does the Division believe that the Interstate ratepayers have paid all of the**
27 **depreciation?**

28 A. I don't think that the Division believes that the Interstate ratepayers have paid all of
29 the depreciation. I believe that their position is that regardless of how much, if any, of
30 the depreciation was paid by the Interstate ratepayers, Interstate's ratepayers should get
31 the full benefit of the depreciation in the reduced value of \$225,215.

1 One might ask that if the Interstate ratepayers have not paid the depreciation then
2 wouldn't the book value for Interstate's ratepayers be the original price plus the carrying
3 cost of the investment? Given that Interstate's ratepayers did not pay the depreciation, I
4 believe that the appraised value is the appropriate amount for the sale.

5
6 **Q. Mr. Edge, didn't you say that the Division stated that the amount allowed in**
7 **rates for the purchase of the Anna C should not be more than if Interstate**
8 **Navigation had purchased the boat in the first place?**

9 A. Yes. The Division believes, as do I, that the ratepayers have to be protected against
10 excess profits being earned in affiliated companies. And if the Interstate ratepayers had
11 paid all the depreciation and return on the Anna C for every day since the Anna C was
12 built even through leased payments, I would agree that the transfer amount should be at
13 net book value. However, given that the Interstate ratepayers have paid in my opinion
14 none of the depreciation or the return over the last fourteen years then the Interstate
15 ratepayers are not entitled to ownership of the Anna C for net book value.

16
17 **Q. Why didn't Interstate build the Anna C in the first place?**

18 A. They tried to. Interstate filed for a rate increase July 29, 1985 (Docket 1835) which
19 included a new larger winter vessel which Interstate's management believed was needed
20 to significantly improve service for its ratepayers. The request for a \$525,597 rate
21 increase was met with a great deal of negativism by the Town of New Shoreham, the
22 Departmental of Environmental Management and in turn the Division of Public Utilities
23 and Carriers. In an attempt to quite the uproar, Interstate management decided to
24 remove the new boat from the requested rate increase and then the Department of
25 Environmental Management withdrew its motion to intervene.

26
27 Mr. John H. Wronowski, President of Interstate at the time was so sure that the bigger
28 winter boat would eventually be needed he decided to build a new boat in a related
29 company, Nelseco. That boat was named the M. V. Anna C. When the projected need
30 arrived, Nelseco leased the Anna C to Interstate.

31

1 The Interstate ratepayers found that Mr. Wronowski was correct and in a subsequent rate
2 filing the Town of New Shoreham supported Interstate's request to lease the Anna C in
3 the winter and one trip on weekends and holidays. The Division, the Town and
4 Interstate entered into a stipulation agreeing that the Anna C would be leased for 243
5 days per year.

6
7 The winter lease of the Anna C ended for the most part when Interstate decided with
8 Town, Division and Commission approval that Interstate should buy its own winter boat
9 and stop leasing the Anna C in the winter. The M. V. Block Island was the result of that
10 decision. Since the Block Island has been on the Point Judith run the lease of the Anna C
11 has been reduced.

12
13 **Q. Do you have any other observations or comments relating to the purchase of the**
14 **Anna C?**

15 A. Although I have presented all of my concerns there are a few facts that I determined
16 during my review of past dockets that might be helpful to the Commission in its
17 deliberations as follows:

- 18
19 1. The Division calculated and proposed a lease rate for Interstate to pay Nelseco
20 for the use of the Anna C of \$1,771/day, which included the Division's
21 calculation of depreciation for the Anna C (which was less than the
22 depreciation rate Nelseco was using for its books) and return on investment
23 (Interstate's return on investment not Nelseco's return on investment).
24 2. The \$1,771/day rate calculated by the Division was never used. Instead a rate
25 of \$1,235/day (calculated as \$300,000/243 days) for 243 days was stipulated
26 to by the parties. The 243 days was the level of usage by Interstate in 1988.
27 3. The winter lease of the Anna C was in place from December 1989 to May
28 1997.

29
30

1 **Q. Have you made any adjustments to your position on either the depreciation or**
2 **the return on investment relating to the purchase of the Anna C?**

3 A. No. My original position on the purchase of the Anna C is the correct position and
4 the Division's and the Town's position is extremely dangerous to the service level
5 provided to Interstate's ratepayers and simply not doable. It would result in a major
6 disruption in service at the worst possible time and would almost guarantee that Interstate
7 will continue to incur operating losses which in turn would result in increasing rates to
8 the life line service.

9

10 **Q. What would you like to discuss next?**

11 A. I believe that the next largest issue raised by the Division is the reduction (\$264,093)
12 that they have made for legal fees. The legal fees (a part of the professional services
13 account) is always a difficult item to project (quantify) and in the past the Division and
14 Interstate have used the average of prior years to estimate legal costs for the rate year. In
15 this docket Interstate used the test year level of \$308,443 for legal expense (when in
16 doubt the test year has always been safe ground) and the Division used the level of legal
17 expense approved in the last docket (filed in 1996) \$37,000 plus an allowance for the
18 increase in the CPI from July 1998 through June 2005. The Division's resulting
19 allowance for legal fees is only \$44,350. Given that the past three year average for legal
20 expense is \$329,217 and the past five year average for legal expense is \$331,604 the
21 Division's proposal is woefully short of what Interstate needs to operate and Interstate's
22 request is less than the three and five year averages.

23

24 **Q. Did the Division leave open any room for negotiations on determining the**
25 **appropriate legal expense level for the rate year?**

26 A. Yes they did. Ms. Crane stated that she was willing to review additional information
27 that she had requested from Interstate that at the time of her direct testimony she did not
28 have. Interstate has provided this information in great detail which shows the legal
29 expenses for the past three years and I am hopeful that the Division will reconsider its
30 current position.

31

1 **Q. Why is legal expense so difficult to project?**

2 A. By its nature, legal expenses incurred each year often relate to items that should not
3 have to be litigated each year. Each year although the total legal expense amount is
4 relatively consistent different legal matters are addressed. For example, if passenger "X"
5 files a suit against Interstate in one year and that suit is resolved then one would hope that
6 the same passenger "X" would not file a suit in the next year. However a different
7 passenger "Y" may file a suit in the next year and so on and so on. Unfortunately
8 Interstate is subject to suits from passengers just as any company that carries the public
9 from place to place.

10

11 Interstate made a financial decision years ago, which was approved by the Commission,
12 to reduce insurance expense with a high deductible. This means that for run of the mill
13 slip and fall cases or property damage claims Interstate will often handle these suits
14 directly rather than pay high insurance premiums to have these suits fully covered by
15 insurance and fully handled by an insurance company. This decision has resulted in
16 significant savings for the ratepayers.

17

18 **Q. Are there other reasons why the Division's estimate is inadequate?**

19 A. Yes. Legal fees (hourly rates) have increased faster than the increase in the CPI.
20 For example, Mr. McElroy's fees have increased from \$195 to \$275 per hour, an increase
21 of about 6% per year. The CPI increase has been only about 3% per year. Therefore
22 even if the Commission were to accept that the level of litigation should be the same as in
23 1996 (a completely unrealistic assumption) the Division's position should be raised to
24 about \$90,000.

25

26 **Q. Is the level of legal assistance provided now the same as it was in 1996?**

27 A. Absolutely not. Interstate operates now in a much more complex post 9/11 world.
28 The level of legal assistance is far greater than it was in 1996 when the greatest legal
29 challenge at that time was dealing with the PUC. Now Interstate must deal with many
30 Federal and State agencies.

1 Further Interstate is changing its operations daily to address the challenges of
2 competition. Legal matters are significantly increasing each year rather than decreasing.

3
4 **Q. Don't you think that the Division has a point that legal expenses such as the
5 legal actions regarding Island Hi-Speed Ferry are likely to be less in the future?**

6 A. Yes, but it is also quite possible that if Interstate requests Division permission to run
7 its own high speed ferry in the future, should the need arise, then I would expect that
8 Island Hi-Speed Ferry would fight Interstate to protect its customer base. Therefore,
9 there could be significant legal fees relating to Interstate's request for its own high speed
10 ferry. Regardless of whether or not there will be legal expenses relating to Island Hi-
11 Speed Ferry, the level of legal expense incurred in the test year is expected to continue
12 into the future and Interstate respectfully requests that the test year level of expense be
13 approved for the rate year in this docket.

14
15 **Q. The next item on your list is homeland security. Do you agree with Ms. Crane's
16 adjustment?**

17 A. No, I do not. Although Ms. Crane has made an attempt to adequately address the
18 homeland security requirements, unlike the Town that eliminated all of the homeland
19 security expense, Ms. Crane's testimony itself shows that the amount that she is
20 recommending is inadequate for the rate year. Per Ms. Crane's Schedule ACC-16 one
21 can easily see that she is recommending a five year average allowance for homeland
22 security.

23
24 **Q. What is wrong with the five year average?**

25 A. The use of a five year average when the cost in the first year is greater than in the
26 following years will result in an inadequate allowance in the rate year. Interstate faces
27 many uncertainties in the rate year and this would be just one more. Since Interstate
28 agrees with the Division's position that the revenues collected for homeland security
29 should be held in a restricted account to be used exclusively for homeland security
30 activities, Interstate requests that the first year cost (rate year) per the Federal Register be
31 approved by the Commission. See Chief McCombe's testimony.

1 **Q. What is the issue with advertising?**

2 A. The Division has recommended an increase to advertising expense of 10% per
3 annum over the test year level. Normally I would accept the Division's recommendation
4 of a 10% increase for advertising as fair and reasonable. However at this time, given
5 Interstate's need to protect its customer base and try to reduce its current downward spiral
6 of revenues (which if it continues will result in more rate increases to Interstate's lifeline
7 customers) I believe that the advertising expense level requested by Interstate is
8 reasonable. Further, the implementation of new and exciting changes in the rate design
9 to attract new customers and create additional revenue sources require increased
10 advertising expense to inform ratepayers of the changes in rates. Interstate's request of
11 \$350,000 is not only reasonable but any reduction of this line item by the Commission, I
12 believe will cost the lifeline ratepayers dearly in the future.

13
14 I believe that Interstate is unfortunately in the "Perfect Storm" of competition. Across
15 the dock they compete directly with Island Hi-Speed Ferry. To the west, Interstate and
16 Island Hi-Speed Ferry will compete for passengers with the new Connecticut ferry that
17 intends to run a very large, luxurious, and high speed ferry four to five times a day from
18 New London to Block Island in 55 minutes at \$25 round trip (worst still to Old Harbor).

19
20 And to the north, Interstate will continue to lose customers to the new Martha's Vineyard
21 high speed ferry. One should ask oneself, how many people would travel to Block
22 Island if they could get to Martha's Vineyard in about the same amount of time with less
23 driving? Everyone living north of Quonset R. I. will be able to get to Martha's Vineyard
24 in about the same amount of time as they currently take to get to Block Island and they
25 will have to drive less.

26
27 Further those living south of Point Judith and closer to New London than Point Judith (a
28 very large Interstate customer base) will be enticed to take the New London high speed
29 ferry. Interstate faces competition from all directions.

30

1 Given this combination of high speed competition, I believe that it is essential for
2 Interstate to not only continue to hold its customer base with advertising and better
3 service (addition of the Anna C and the up-grade of the Carol Jean) but Interstate must
4 also devise ways through pricing to encourage greater use of its boats in the off peak days
5 (weekdays). I will discuss the rate design changes that I believe will increase the future
6 revenues of Interstate in my rate design section of this testimony.

7
8 To achieve the above goals Interstate must spend significant advertising dollars to
9 educate the ratepayers about both the improvements in service and the changes in rate
10 design. Interstate continues its request the full \$350,000 advertising allowance presented
11 in my direct testimony. Interstate's competition is spending far more than \$350,000 to
12 lure Interstate's customer base away. As stated earlier, but worth repeating, the
13 ratepayers that will suffer the most are Interstate's lifeline customers if Interstate's
14 revenue base continues to shrink.

15
16 **Q. Do you have any comments regarding the wharfage allowance recommended by**
17 **the Division relating to the Montville dock?**

18 A. Yes, I do. First of all the Division disregards a contract that Interstate signed. That
19 contract is in force at this time and Interstate is legally required to pay the amount set
20 forth in the contract. Otherwise, it will be sued and could lose the wharf. Second the
21 Division has calculated the wharfage fees using the net book value of the Montville dock.
22 No consideration has been given to the value of the land that the dock is secured to.

23
24 Further, the Division continues its crusade to have non-regulated entities provide goods
25 and services to Interstate at less than fair market value. In the Division's perfect world,
26 Interstate would own all of its landing and docking locations that they need to use and
27 then Interstate would have to pay almost nothing for the use of those docks. In the real
28 world, despite reinvesting every penny of its earnings into the Company and never
29 declaring a dividend, Interstate never was provided with an adequate return to invest in
30 all of the docking areas.

31

1 One last point on this matter, the Division uses a 7.33% weighted return on rate base for
2 the calculation of required return. This is the weighted cost of debt and equity that the
3 Division has calculated for Interstate. How does this rate relate in any way to Waterfront
4 Realty's cost of capital? Also the Division has increased the required return by a
5 revenue multiplier that reflects gross receipts tax (not paid by Waterfront Realty).
6 Clearly the Division's recommended illegal "Pro Forma Expense" for the Montville
7 wharfage must be rejected.

8

9 **Q. Mr. Edge, what is the next issue on your list of largest issues?**

10 A. Although it represents less than \$100,000 in adjustments, I have listed as one of the
11 larger adjustments the reduction proposed by Ms. Crane to the increase requested in
12 management salaries. Interstate is no longer operating as a small family business.
13 Demands are being put on the management team that are far greater than they were in the
14 past.

15

16 As I stated in my prefiled testimony, I have reviewed the responsibilities of the
17 management team and found their salaries woefully low compared to similar salaries paid
18 in today's business environment. To her credit, Ms. Crane did recognize the fact that the
19 management salaries were in fact low and she has proposed a 10% increase across the
20 board for all of the management team in an effort to catch up the management salaries to
21 current levels. This 10% increase is greater than the 5% increase allowed for all other
22 positions and is a step in the right direction.

23

24 Interstate believes that the Commission is well aware of what reasonable salary levels are
25 for management in utility companies in Rhode Island and New England. Interstate
26 stands by its original testimony and is willing to let this issue be decided by the
27 Commission. Interstate's management team is confident that the Commission will
28 provide an appropriate level of compensation in the rate year.

29

30

1 **Q. Mr. Edge is there other smaller adjustments made by Ms. Crane to the**
2 **operating expense accounts?**

3 A. Yes there are. Ms. Crane provides a list of the Company's beginning balance (item
4 1) and sixteen operating expense adjustments on her Schedule ACC-5. I have already
5 discussed items 2, 5, 7, 9, 10 and 15. Items 16 and 17 are eliminations of Federal
6 Income Tax and Gross Receipts Tax that Ms. Crane states in her testimony are added
7 back at a latter time using her "Revenue Multiplier". The remaining 8 items total
8 \$183,440. I will review each the remaining adjustments on a limited basis and otherwise
9 rely on my original prefiled testimony on these issues.

10

11 **Q. Do you wish to take them in the order that they appear on Ms. Crane's**
12 **schedule?**

13 A. No, I will address them in the order of their relative importance to the case. The
14 largest remaining issue is the wharfage expense adjustment in the amount of \$69,289 for
15 Interstate's landing at Old Harbor. The Division has eliminated the increase needed to
16 pay the new rental fee that we are proposing to be effective September 2004 (Note: the
17 fee was determined by an independent appraiser). This adjustment makes it impossible
18 for Interstate to secure its lease to land on Block Island. See the testimony of Mr. Robert
19 T. Tobin regarding the position of the stockholders that control the Old Harbor facility.

20

21 The next largest item is the lobbying expense reduction in the amount of \$33,246. This
22 issue is addressed in the rebuttal testimony of Dave Preston.

23

24 Moving down the list the next largest item is the adjustment for telephone expense, a
25 reduction of \$24,445. Ms. Crane has chosen to use the test year level for telephone
26 expense (a method per Ms. Crane that is not acceptable for the legal expense calculation)
27 while I increased the test year level of expense to reflect the last three year trend of better
28 than 10% increases. I believe that Ms. Crane's assertion that telephone expense will not
29 increase in the rate year is somewhat overly optimistic. I stand by my original approach
30 of projecting a continuance of the 10% annual telephone expense increase.

31

1 The next issue is the “pay me now or pay me later” issue of amortization of rate case
2 expense (a \$20,000 reduction). There is no dispute that the rate case expense will be
3 about \$150,000. And Interstate agrees to adjust the rate case expense to actual at the
4 completion of the docket if the Commission so chooses. The only item in dispute is the
5 amortization period. I proposed a three year amortization and Ms. Crane has proposed a
6 5 year amortization.

7

8 I believe that in this case we are both wrong. I believe that Interstate will be back in for
9 rate relief next year. The reasons for my pessimism are the facts that Interstate is in a
10 very difficult position: the “Perfect Storm” of high speed competition, faced with
11 unknown homeland security expense, the impact of new rate design changes, and the
12 possible loss of the Anna C. These four items alone could combine to result in a
13 significant revenue shortfall. If so, Interstate will be back next year. Given that I have
14 used the shorter of the two amortization periods it would appear reasonable to use three
15 years for the amortization of rate case expense rather than five. To accept the Division’s
16 position will simply defer the collection of this expense to the future and make the rate
17 case expense greater next year.

18

19 The next item is the reduction of depreciation expense for the Montville Dredging
20 project. Ms. Crane stated that she would be open to increasing her allowance in this area
21 if she were provided with additional documentation that showed that the project was in
22 fact going to proceed before or during the rate year. Interstate has obtained additional
23 documentation (See attachment A). Interstate hopes that this new information (a bid to
24 complete the work for \$510,485) will assist Ms. Crane in her analysis and provide
25 adequate support so that she can eliminate this adjustment.

26

27 The next adjustment, a \$10,592 reduction of payroll taxes, is the direct result of Ms.
28 Crane’s payroll adjustment. Since Ms. Crane’s methodology for calculating this
29 adjustment is not in dispute, once the Commission decides the issue the payroll tax
30 adjustment can be recalculated.

31

1 The last two operating expense adjustments are not worth the Commission's time. Ms.
2 Crane has reduced miscellaneous expense by \$5,305 and pension expense by \$2,868.
3 The pension adjustment is a calculation that can be recalculated after the Commission
4 reaches its decision on the Ms. Crane's payroll adjustment. To assist the Commission
5 and remove the final issue from consideration, I will accept the Division's miscellaneous
6 expense adjustment.

7

8 **Q. Does that complete your rebuttal of Ms. Crane's operating expense**
9 **adjustments?**

10 A. Yes, however, I still have to address her one revenue adjustment.

11

12 **Q. Would you like address Mr. Rothschild's direct testimony at this time or**
13 **continue with Ms. Crane's testimony?**

14 A. I believe that it would be much clearer for the Commission if I address the one
15 additional large operating expense adjustment made by Mr. Rothschild before proceeding
16 on to the revenue adjustments of both Ms. Crane and Mr. Rothschild.

17

18 **Q. Would you please proceed?**

19 A. Mr. Rothschild's testimony is long on narrative but short on facts. For the most part
20 Mr. Rothschild's operating expense adjustments mirror the Division's operating expense
21 adjustments but Mr. Rothschild simply reduced certain accounts to the test year level
22 rather than attempting to provide some increase in cost for the rate year as the Division
23 did in certain cases.

24

25 The major expense adjustment difference is Mr. Rothschild's elimination of the
26 Homeland security expense \$547,460. Mr. Rothschild attempts to soften the impact of
27 his proposal by suggesting that Interstate be permitted to accrue the Homeland Security
28 expense for three years (using the Division's estimate that would be about \$1,200,000).
29 Mr. Rothschild shows his big business mind set by making such a recommendation.

30

1 There is absolutely no way that Interstate could fund the homeland security expense of
2 \$400,000 per year (the Division's estimate) either from a bank borrowing or from its less
3 than \$300,000 return on equity. Mr. Rothschild's \$547,460 adjustment and suggested
4 recommendation are simply not doable. The Division has suggested protecting the
5 ratepayers by putting all of the Homeland Security related revenues in a restricted
6 account. Interstate would appreciate Mr. Rothschild considering this method of
7 protection over his original recommendation.

8

9 **Q. Is the Homeland Security adjustment the only major expense adjustment made**
10 **by Mr. Rothschild that was over and above the Division's expense adjustments?**

11 A. Yes, it was. I would like to point out however that Mr. Rothschild supported the
12 Division's Anna C adjustments to ratebase and depreciation. Mr. Rothschild explains in
13 his testimony that he was informed by the Division's witness, Ms. Crane that the M. V.
14 Anna C had been paid for by the Interstate ratepayers over the last fourteen years using a
15 rate base rate of return methodology. Given that this is simply not true, I would hope
16 that Mr. Rothschild could reevaluate his position and agree that the \$3,100,000 appraised
17 value is the appropriate value for the Anna C in this docket.

18

19 **Q. Is this the appropriate time to discuss the revenue adjustment made by the**
20 **Division and the Town in their respective direct testimonies?**

21 A. Yes. To start it is important to point out the Division has agreed with all but my
22 passenger revenue projection. In my prefiled direct testimony I projected that the
23 passenger revenue in the rate year would continue to deteriorate at the same rate as it did
24 in the interim year, 8.4%. The Division does not believe that the rate of decline will
25 continue but rather they are projecting that the passenger revenue will actually increase in
26 the rate year by \$155,754 over the actual interim year level of passenger revenue. The
27 Town is even more optimistic. The Town is projecting an even greater increase in
28 passenger revenue in the rate year, an increase of \$311,000.

29

30

1 Given all of the high speed competition that Interstate faces including competition that
2 will start this summer from New London, I believe that the most conservative approach
3 to projecting rate year revenue is the most appropriate. To overstate rate year revenue at
4 current rates will have a huge impact on Interstate's ability to earn it authorize rate of
5 return and continue to provide a high level of year round lifeline service.

6
7 It would be appropriate at this time to review why both the Town and the Division want
8 to set the rate year revenue at current rates as high as reasonably possible. They both
9 want to protect the ratepayers against Interstate earning excessive profits. I find this
10 ironic given that none of Interstate's competitors are restricted in the amount of profit
11 they can earn. Yet Interstate, by far the most important lifeline link to Block Island, is
12 held to a much stricter standard.

13
14 After reading Mr. Rothschild's testimony I am left with a feeling that this part of the rate
15 filing, determining the appropriate level of rate year revenue at current rates will be left
16 for the Commission to decide. He stated the following:

- 17
18 1. "Interstate is currently in a period of maximum uncertainty, making this a time to
19 be extremely careful about how permanent rates are set." Page 5, lines 13 and 14.
20 2. "Therefore it is impossible to say if passenger drop was all due to weather
21 conditions or if the high speed ferry service penetrated further into the business of
22 Interstate Navigation" Page 6, lines 2 through 4.
23 3. "The impact of normal business fluctuations from one season to another due to
24 factors such as weather and economic conditions makes it challenging to isolate
25 cause and effect." Page 7, lines 5 through 7.
26 4. "The above issues make the determination of likely future revenues at current
27 rates and the level of future expenses more uncertain than usual." Page 7, lines 17
28 and 18.
29

30 For the most part I agree with Mr. Rothschild's observations above but we draw different
31 conclusions. Mr. Rothschild has projected significant revenue growth in passengers and
32 vehicles. These "projections" have no valid basis. They are based upon certain
33 optimistic assumptions that he has made, upon conversations with friends on Block
34 Island, and based upon his many visits to the Island.

1 Although Mr. Rothschild's personal knowledge is noteworthy, I am sure that I have far
2 more experience with Block Island and Interstate Navigation's operations than Mr.
3 Rothschild. Further, I am sure that the Linda family has far more experience developed
4 in their combined 70 plus years of continuous operation with the transportation of
5 passengers, vehicles and freight to Block Island than either of us.

6

7 The fact is that no one knows for sure what the revenues will be next year at current rates
8 but my projections are based upon my discussions with the Linda family, my own
9 experience over the past twenty years dealing with Interstate Navigation Company, the
10 recent statistical trends relating to Interstate's revenue and the impact of not only Hi-
11 Speed ferry, but of all of the current high speed ferry competition Interstate is facing.

12

13 **Q. Why do you believe that the Division and the Town are putting too much**
14 **emphasis on the weather when they both assign some of the drop in revenue to**
15 **weather?**

16 A. As I pointed out in my prefiled testimony Interstate's vehicle revenue was higher in
17 FYE 2004 than in FYE 2003 while the passenger and bike revenue (impacted by
18 competition) were less in FYE 2004 than they were in FYE 2003. These trends were
19 also true for all three revenue groups in FYE 2003 compared to FYE 2002. We also
20 know that Hi-Speed Ferry carried more passenger in 2003 than in 2002 (despite the
21 weather) while Interstate carried almost 9% less passengers in 2003 than 2002. This
22 cannot be explained by weather. Also, no one knows what the weather will be like this
23 year. To simply ignore current history and demonstrated annual statistical trends is
24 inappropriate for proper ratemaking.

25

26 **Q. Mr. Edge, you stated that the Division only disagreed with your passenger**
27 **revenue projection for the rate year. Did the Town also only disagree with the**
28 **passenger revenue projection for the rate year?**

29 A. No, as I previously stated Mr. Rothschild has also made a significant adjustment to
30 vehicle revenue in the rate year in the amount of \$500,000. This increased projection is
31 simply not believable.

1 Mr. Rothschild states that this growth in vehicle traffic will be the result of “strong pent-
2 up demand” and the added capacity provided by the addition of the Anna C. Mr.
3 Rothschild provides no studies, calculations, or evidence that there is a “strong pent-up
4 demand” other than his personal observations and discussions with friends on Block
5 Island.

6

7 Further, his calculations relating to the extra capacity that the Anna C provides assumes
8 that the Anna C added capacity will be utilized at a level equal to about 75% of the
9 current vehicle carrying capacity. His calculation is replete with incorrect assumptions.

10

11 First, Interstate does not currently utilize 100% of its car carrying capacity on each run
12 seven days a week from May to September. Yet Mr. Rothschild is projecting that even
13 though there is currently available space on Interstate’s current car carrying vessels, that
14 the addition of the Anna C will somehow create additional demand that for whatever
15 reason does not use the currently available space.

16

17 **Q. What other assumptions has Mr. Rothschild made regarding the additional**
18 **revenue that will be generated simply because vehicle space is made available with**
19 **the use of the Anna C on a full time basis?**

20 A. He has assumed for his analysis that all of the vehicle space is used for cars. This
21 ignores that fact that Interstate’s boats carry freight, trucks, motorcycles and bikes on the
22 vehicle deck. Assuming 35 cars per trip on every trip from May to September when
23 Interstate carries freight, trucks, etc. on every run is not realistic.

24

25 **Q. Does Mr. Rothschild explain where these additional cars will come from?**

26 A. Mr. Rothschild suggests that Interstate will pick up some traffic from the elimination
27 of the Nelseco run from Connecticut. I do believe that Mr. Rothschild is partially correct
28 and there will be some additional vehicles that will come from Connecticut to Interstate,
29 but Nelseco never carried anything remotely close to the volume of vehicles suggested by
30 Mr. Rothschild’s projection calculations. My projected vehicle growth amount for the
31 rate year is more appropriate to cover the increase traffic from Connecticut.

1 **Q. What are you recommending for the vehicle revenue for the rate year at current**
2 **rates?**

3 A. The Division and I have agreed that the appropriate increase in vehicle revenue for
4 the rate year is \$174,000. Mr. Rothschild's additional projection of \$326,000 in
5 increased vehicle revenue is simply not supported by the record, or the facts.

6

7 **Q. Does that conclude your rebuttal testimony relating to operating expenses and**
8 **revenues?**

9 A. Yes, however I would like to add that Mr. Rothschild's "safety net" explained in his
10 testimony on pages 8 through 10 does not protect Interstate in any way and is provided
11 only as a "safety net" for the ratepayers. Careful reading of this proposal shows that Mr.
12 Rothschild simply does not understand the relative size of Interstate and its inability to
13 carry additional debt or risk. Interstate rejects Mr. Rothschild's "safety net".

14

15 **Q. The next area to discuss is rate of return on rate base. This area requires**
16 **discussion of the weighted cost of debt and the return on equity. Would you please**
17 **explain the positions of the parties?**

18 A. Certainly, all of the parties have included the wrong cost of debt (interest rate) for the
19 \$4,000,000 of the current debt. After filing its prefiled direct testimony in this docket
20 Interstate (in consultation with the Division) locked in its long term interest rate at a fixed
21 level of less than 6%. Due to a sharp drop in interest rates at that particular time and
22 given that Interstate expected that the Commission would prefer fixed rate debt over
23 variable rate debt, Interstate asked the Division if they felt that it was an appropriate time
24 to lock the fixed rates. The Division concurred that the interest rate should be locked in
25 and Interstate did so in February. My amended schedules will reflect the appropriate
26 interest rates.

27

28 Neither the Division nor the Town has included the debt service for the purchase of the
29 Anna C in their respective capital structures. Clearly if Interstate is allowed to purchase
30 the Anna C the debt will have to be added to the capital structure.

31

1 All parties have included the debt for the Carol Jean but the interest rate may be a little
2 optimistic because rates are now rising quickly. Nevertheless, Interstate hopes that it
3 will be able to borrow the money needed for the Carol Jean at the 6.4% rate included in
4 all three capital structure calculations.

5

6 **Q. Where do the parties stand on return on equity?**

7 A. Interstate is requesting 11.5% (the rate approved by the Commission in the last
8 docket before Interstate became involved in additional risk caused by competition), the
9 Division is proposing 10% (based upon water companies) and the Town is
10 recommending 9.5% (based upon one gas company). I believe that the Town's 9.5% is
11 totally irrelevant because according to Mr. Rothschild the rate is the cost of capital that he
12 calculated for South Jersey Gas. I fail to see how the cost of capital for a gas company
13 in New Jersey calculated by Mr. Rothschild is relevant to Interstate's appropriate return
14 on equity.

15

16 Mr. Rothschild's contention that Interstate and South Jersey Gas are both "weather
17 dependent" (although different seasons) is not enough reason for the Commission to
18 allow this proposed return on equity to even be considered. Further, Mr. Rothschild dose
19 not provide any documentation of his DCF model or his risk premium/CAMP model.
20 Surely one would want to see the assumptions of his models before any weight could be
21 given to his proposed 9.5% recommended return.

22

23 **Q. How did the Division calculate its return on equity?**

24 A. As they have done in the past the Division could find no regulated ferry companies
25 that they felt were appropriate for their DCF or CAPM models so they used water
26 companies. As I stated in the last docket water companies are significantly different
27 from ferry companies. The asset mix is different, competition is different and the need
28 for its service by the majority of its customers is significantly different. I believe that the
29 Division's use of water companies as a substitute for actual ferry companies in its model
30 weakens the value of the Division's rate of return models. My return on equity is the
31 only one that is specific to this jurisdiction, industry and Interstate.

1 **Q. Are there any other factors relating to return on equity that you would like to**
2 **point out to the Commission?**

3 A. Yes. I believe that all of the requested returns calculated do not adequately provide
4 Interstate a fair return on its equity. All three capital structure calculations show
5 Interstate has equity in the amount of \$4,125,242. When I take the return calculated by
6 the three parties in this case and divide it by Interstate's equity, I find that the return
7 being proposed is significantly less than the percentage shown in the testimony. The
8 calculations are as follows:

9

10 Interstate \$361,818/\$4,125,242 equals 8.8%

11

12 Division \$310,771/\$4,125,242 equals 7.5%

13

14 Town \$244,901/\$4,125,242 equals 5.9%

15

16 Given that Interstate has over \$4,000,000 of equity it doesn't seem reasonable to believe
17 that they should earn as little as even \$361,818 or 8.8%. Interstate believes that these
18 effective rates of return on equity should be considered by the Commission before it
19 decides which proposed return on equity it chooses in this docket.

20

21 **Q. Mr. Edge, why are the effective returns on equity and the proposed returns on**
22 **equity so different?**

23 A. The calculated returns on equity (cost of capital) are a function of rate base. In this
24 case, because rate base is significantly less than the total capital structures, the effective
25 returns on equity are lower. Because the Division, and even more so the Town, have
26 made adjustments reducing rate base, they have in fact significantly lowered Interstate's
27 calculated cost of capital and in turn the effective return on equity. With this in mind, I
28 would like to discuss the adjustments made to rate base.

29

30

31

1 **Q. Mr. Edge, before we get into the detail adjustments I note that even your return**
 2 **on equity is lower than your cost of capital calculation, why is that?**

3 A. There are a number of built in differences. First the rate base is an average rate base
 4 for the rate year while the capital structure is at a point in time. For example, the fact
 5 that only one half of the Carol Jean improvements are included in rate base while the full
 6 cost of the improvements are in the capital structure, results in the ratebase being less
 7 than the capital structure. Also, there are certain deferred assets such as rate case
 8 expense that are no longer reflected in rate base that must be funded by the company's
 9 equity.

10
 11 Lastly there are some timing differences between the payment of debt and the
 12 depreciation of the assets acquired by the debt. Therefore, there is usually some
 13 relatively minor difference between rate base and capital structure. I would recommend
 14 that this difference be kept as low as possible to provide the utility a reasonable chance to
 15 earn its authorized rate of return.

16
 17 **Q. What reductions to rate base are the Division and the Town recommending?**

18 A. They are as follows:

| Item | Amount | Reason Given |
|-------------------------|----------------------|--|
| Division Adjustments: | | |
| Montville Dredging | (\$176,951) | Project not well defined or supported |
| Related Depreciation | \$17,695 | Calculation for Interim year |
| Reduction of the Anna C | (\$2,874,785) | Cost lowered to Nelseco net book value |
| Related Depreciation | \$305,174 | Calculation for rate year |
| Total net Adjustments | <u>(\$2,888,124)</u> | |
| Average | (\$1,444,062) | |
| Working Capital | <u>(\$655,054)</u> | Elimination of Interstate's request |
| Total Division | <u>(\$2,099,116)</u> | |
| Additional Town: | | |
| Capital Additions | (\$298,256) | In progress |
| Deferred Federal IT | (\$978,722) | |
| Additional Anna C | (\$146,152) | Per ACC-20 |

1 **Q. How would you like to proceed with this list of items?**

2 A. I would like to start with the additional Town rate base adjustments and then discuss
3 the Division/Town combined adjustments. The additional Anna C adjustment
4 (\$146,152) cites Schedule ACC-20 which in Ms. Crane's testimony is a schedule for rate
5 case expense. Clearly there has been a mix up between the two witnesses. Given that
6 Mr. Rothschild has relied on Ms. Crane for the Anna C adjustment, I believe that his
7 additional Anna C adjustment is an error and should be rejected by the Commission.

8

9 Having been on the opposite side from Mr. Rothschild on other occasions I am very well
10 aware of his fondness for deferred Federal Income Tax. This adjustment is new for
11 Interstate (never recommended by the Division or any other party) and I believe it is
12 inappropriate for this Company. First however it is important to point out how Mr.
13 Rothschild estimated the amount of Deferred Federal Income Tax.

14

15 Mr. Rothschild requested Interstate's calculation of Deferred Federal Income tax and
16 Interstate advised him that they do not calculate Deferred Federal Income tax for the
17 books of Interstate Navigation. Not concerned that Interstate had no Deferred Federal
18 Income Tax, Mr. Rothschild chose to look to Narragansett Electric's deferred tax
19 calculation to calculate his estimate of a "proper" deferred tax for Interstate. This
20 approach is totally unreasonable and similar to his approach for return on capital when he
21 used a New Jersey gas company's return on capital for Interstate. Mr. Rothschild
22 continues to confuse Interstate, a relatively small ferry company, with the financial and
23 operating resources of large gas and electric companies.

24

25 Anyone who knows what Deferred Federal Income tax is (for the most part it is the
26 difference between tax and book depreciation times the effective tax rate) would know
27 that if you depreciate assets the same for tax and book purposes, you have virtually no
28 deferred income tax. Since it is Interstate's outside accounting firm's policy (approved
29 by Interstate) to do just that over the years, Interstate does not have nor do they calculate
30 Deferred Federal Income Taxes. Mr. Rothschild's adjustment therefore is wrong and
31 should be rejected.

1 Lastly, Mr. Rothschild removes from rate base an item that he describes as “Capital
2 Addition Projects”. Mr. Rothschild fails to provide a reference as to where he got this
3 amount. I can find no reference to “Capital Additions Projects” in my testimony. It
4 appears from his testimony that the amount is included in the test year rate base. I see no
5 reason to remove rate base that was in place in the test year. Therefore I have to assume
6 that either this item is a mistake (as the first rate base adjustments discussed above) or the
7 item is simply appropriately in rate base in the first place. Without further explanation
8 by Mr. Rothschild the Commission should reject this adjustment.

9
10 **Q. Would you please continue and explain your position on the Division rate base**
11 **adjustments noted above.**

12 A. Certainly. I have already gone to great length explaining the risks to Interstate and
13 its ratepayers if the Anna C is not purchased from Nelseco. Further I have explained that
14 the Anna C is not available for \$225,215 (the amount included in rate base by the
15 Division for the Anna C). Therefore, the Division’s adjustment in this area is simply
16 wrong. Either there should be no adjustment at all, or the \$225,215 must also be
17 removed because the Division’s proposal, if accepted by the Commission, will result in
18 Interstate losing access to the Anna C and therefore, nothing would be included in rate
19 base for the Anna C. When the Commission decides this issue the proper rate base
20 adjustment (if any) can be calculated.

21
22 The last rate base issue is the Montville Dredging project adjustment. Interstate has been
23 trying to get the Montville Dredging project completed for quite a while and the Division
24 is concerned that the project may not get completed by the rate year. Their concern is
25 reasonable however as stated earlier Interstate has now obtained a bid (See attachment A)
26 in the amount of \$510,485 and has a permit that requires that the work be done before the
27 completion of the rate year. Given this additional information I would hope that the
28 Division would eliminate this adjustment. For purposes of this rebuttal testimony I am
29 not, at this time, changing my position in my prefiled testimony.

1 **Q. Are there any other items in the filing that you would like to discuss?**

2 A. Yes, although I do not like to get involved in rate design issues I believe that in this
3 docket the rate design issues will have an impact of future revenue requirements and
4 therefore I would like to provide a few of my observations. In addition, Interstate was
5 asked by the Commission counsel to provide an update of its terminal project in this
6 rebuttal testimony.

7

8 **Q. Could you then please provide a status update on the Point Judith terminal**
9 **project before you discuss your rate design issues?**

10 A. Certainly. As was stated in our data response to Commission Data Request No. 18,

11 **“we do not yet have all of the necessary approvals . . . although we are**
12 **expecting to get them soon. It must go to the state for bidding. We**
13 **have just received the DEM water quality certification and the CRMC**
14 **permit. Although we would like to be able to start the renovations**
15 **this winter, we are currently projecting a more likely start date of the**
16 **Fall of 2004 with completion before Memorial Day of 2005.”**

17

18 Interstate remains on track with this schedule. Since the preparation of that data
19 response, the Narragansett Fire Marshall and the State Fire Marshal have provided
20 Interstate’s architect with their comments. These require minor changes (doors, fire
21 alarms, etc.) but nothing major. Interstate’s architect has assured us that the changes will
22 be submitted shortly.

23

24 Interstate has also been in contact with the State Building Official’s office (Dan
25 D’Dentro). Mr. D’Dentro has no other comments. The approval letter from Mr.
26 D’Dentro should therefore be forthcoming once the State Fire Marshall signs off.

27

28 Interstate will then go to the state to wrap those approvals into the Project Manual and
29 submit everything to the RI Purchasing Dept. for bidding the project. Interstate will
30 continue to provide updates to the project as they reach each milestone.

31

32

33

1 Summer Tourist Partial Rate Deregulation

2 **Q. Mr. Edge would now continue with you rate design comments?**

3 A. Yes I will. First of all I do not see why there is a concern if Interstate exceeds its
4 authorized rate of return as long as the excess earnings are collected from the tourist
5 traffic (not part of Interstate's life line service) which in everyone's opinion do not need
6 to use Interstate's service. In fact there is great competition for these day trippers.

7
8 The summer tourists have many options on how they can spend their vacation money and
9 going to Block Island is just one of those options. Further, if they chose to travel with
10 Hi-Speed Ferry then Hi-Speed Ferry's owners get to keep whatever profit they earn.

11
12 In Interstate's case rates are set for a rate year on a rate base rate of rate of return basis
13 with all revenues and expenses accounted for in the rate determination. If Interstate has
14 excess revenues and in turn excess profits in a given year and those excess revenues are
15 projected to continue into the rate year in the next Interstate filing then the ratepayers will
16 get the benefit of the additional revenue. In other words, Interstate would only be able to
17 retain its excess earnings until it filed for a rate increase at which time all revenues and
18 expenses would be identified for the rate year and a new return on rate base calculated.
19 This process would eliminate any excess profit prospectively.

20
21 **Q. Mr. Edge, what if Interstate never returned to the PUC for rate relief?**

22 **Wouldn't that hurt the lifeline service?**

23 A. Absolutely not. Under that scenario the life line rates would be kept in place at the
24 rate approved by the PUC indefinitely and all future increase in expenses apparently
25 covered by the increases charged to the summer tourists. It is for this reason that I
26 believe that it would be beneficial to the life line customers (the customers that regulation
27 is intended to protect) to allow Interstate to increase its rates on summer tourists in the
28 same manner currently allowed to Hi-Speed Ferry (which just increased its round trip
29 adult passenger rate by \$3.00 virtually without hearings).

30

1 As was pointed out by the experts, the market will control the prices on those ratepayers
2 that have options and can use Interstate's competition if they chose. I therefore believe
3 that the Commission should partially deregulate Interstate's summer tourist rates (subject
4 to a floor) in the exact same way Hi-Speed has been deregulated, and let the market
5 control the competition for summer tourists.

6
7 **Q. What are your other comments?**

8 A. It is clear to me that Interstate has to find new sources of revenue in order to avoid
9 returning to the PUC for rate relief every year as their revenue continues to decline. For
10 years Interstate has made every effort to cut costs and there have been very few
11 adjustments made over the last fifteen years as a result of excess spending. I believe that
12 Interstate's management has properly recognized that the old ways of doing things do not
13 work in the competitive environment that they now find themselves operating in. It is
14 very important to identify new ways of increasing revenue without constantly returning to
15 the PUC for rate relief.

16
17 Fifteen Percent Group Discount

18
19 Interstate's proposal for a 15% group discount rate is a perfect example of encouraging
20 new ridership and developing additional revenues. I do not see what the down side of
21 this request is for the life line ratepayers or for that matter any passengers. If Interstate
22 puts this new rate in place and it works, in a year or so when Interstate returns for rate
23 relief, these new revenues will go to the benefit of the ratepayers. Should the new
24 discount rate result in a loss the loss will be borne by the Company's owners until
25 Interstate returns for rate relief at which time the Commission could either eliminate the
26 discount rate or simply increase it to a more appropriate discount rate. Either way the
27 ratepayers are covered.

1 Ticket Books

2

3 The next issue is one of convenience. I believe that the convenience is for the ratepayers
4 and the Company. Selling ten ticket books for the price of nine tickets results in those
5 ratepayers not having to stand in line ten times but just once. Individuals planning a
6 family outing on the island can buy the book and provide family members flexibility as to
7 when they travel. I believe that this ten ticket book proposal will end up not costing
8 Interstate any more than selling ten tickets for the price of ten tickets. This is because
9 studies have shown that often not all of the tickets are used.

10

11 **Q. Are there any other reasons why Interstate should be allowed to sell ten ticket**
12 **books for the price of nine tickets?**

13 A. Yes. Island Hi-Speed Ferry has also proposed a ten round trip ticket book for the
14 price of nine tickets in its recent rate filing, and the Division has supported that request.
15 Interstate must stay competitive and like its competition, Interstate must provide this
16 convenience to its ratepayers.

17

18 Weekday Discount of up to 50%

19

20 **Q. Do you have any other rate design observations?**

21 A. Yes. Interstate would like to try a weekday discount program for passengers in July
22 and August in an effort to encourage new revenues. If it works it benefits the ratepayers,
23 and if it doesn't, Interstate will absorb the loss and file with the PUC to eliminate the rate.
24 In any circumstance the ratepayers are protected just as they are in the group discount
25 rate design request. Also, the fact that the discount rates as proposed will be off-peak is
26 very important because the more revenue that can be generated off-peak the better. Off-
27 peak revenue does not result in the need for more capital investment and it helps cover
28 fixed costs and marginal costs off-peak.

29

30 **Q. Mr. Edge did you read Mr. Stutz's testimony?**

31 A. Yes I have.

1 **Q. Do you agree with his conclusions?**

2 A. Not entirely. Mr. Stutz did point out that I made an error on my revenue check
3 schedule showing an across the board rate increase on even those rates that are not tariff
4 rates and will not be increased. I shall correct that in the compliance filing. I believe
5 that his recommendation to put all of the increase on vehicles (including trucks) is short
6 sighted. Interstate carries both freight and trucks. An increase on trucks without an
7 increase in freight will result in many ratepayers changing their current practice of
8 shipping by truck to shipping by individual freight pallets. This would cause Interstate to
9 hire more employees to handle the additional freight, and would not generate the needed
10 additional revenue because freight rates would not be going up, and trucks carried would
11 decline.

12

13 **Q. What would you recommend?**

14 A. As I recommended in my original prefiled testimony I believe that the rates should be
15 increased on an across the board basis. Interstate's current rates were set after
16 completing an extensive cost allocation schedule. These rates have served the Company
17 and the ratepayers well for the last few years and I see no reason to change them now.

18

19 **Q. Mr. Edge didn't Interstate recommend a significant increase on cars in its
20 prefiled testimony?**

21 A. Yes, we did. Interstate did so at the request of the Town. However, the Town has
22 not filed testimony in support of the significant increase on cars and therefore Interstate is
23 withdrawing its request for a disproportionate increase on cars and other passenger
24 vehicles. Interstate is requesting at this time that whatever rate increase is approved by
25 the Commission be implemented across the board.

26

27 **Q. Does that conclude your testimony?**

28 A. Yes it does.

29