

**Prefiled Direct Testimony
of
Walter E. Edge Jr., MBA, CPA**

**Interstate Navigation Company
Docket _____**

December 1, 2003

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INTRODUCTION

1
2
3 **Q. Will you state your name and business address for the record?**

4 A. Yes. My name is Walter E. Edge Jr. MBA, CPA and I am the Consulting Department
5 Director and President of the firm of Bacon & Edge (B&E) at One Worthington Road, Cranston,
6 Rhode Island 02920.

7
8 **Q. Mr. Edge, have you testified before the Rhode Island Public Utilities Commission
9 (PUC) as an expert accounting witness prior to this docket?**

10 A. Yes, many times. I was formerly the chief rate analyst for the Division of Public Utilities
11 and Carriers (DPU) for five years and while in that position I was required to testify on numerous
12 occasions relating to all of the utilities that the R.I. PUC regulates. In addition to my testifying
13 experience at the R.I. PUC, I have also testified before a Rhode Island Grand Jury, the Rhode
14 Island Superior Court, Federal Courts in R.I. and Massachusetts, the Federal Communications
15 Commission (FCC) and the Power Authority of the State of New York (PASNY).

16
17 **Q. Since leaving the DPU have you testified before the R. I. PUC?**

18 A. Yes I have. During the last thirteen years I have provided consulting services (expert
19 testimony, etc.) through B&E to Interstate Navigation Company (Interstate), Block Island Power
20 Company, Narragansett Bay Commission, Providence Water Supply Board, Newport Water,
21 Pawtucket Water Supply Board, Stone Bridge Fire District, North Smithfield Water, Prudence
22 Island Ferry, and Osram Sylvania Company.

23
24 **Q. What is your knowledge of Interstate?**

25 A. I presented expert testimony for Interstate in its last two full rate filings Docket #2484, and
26 Docket #1935 (Commission) and Docket D-89-7 (Division). Docket #1935 and Docket D-89-7
27 became a joint Docket because of an issue of regulatory jurisdiction.

1 **Q. What were the results of Docket #2484?**

2 A. Interstate, the Town of New Shoreham, the Town of Narragansett, the Block Island
3 Residents Association, Inc. and the Division agreed to and this Commission approved a
4 "Stipulation and Settlement" signed the 21st day of March 1997. It has been about seven years
5 since Interstate's last full rate filing.

6
7 **Q. Mr. Edge, do you have additional knowledge and experience relating to Interstate
8 Navigation Company?**

9 A. Yes. I presented expert testimony for Interstate in its cargo service rate hearings in Docket #
10 2127. Also, B&E has prepared Interstate's PUC annual report for the past dozen years and I
11 reviewed each of the reports before filing. Most recently I filed intervener testimony on
12 Interstate's behalf relating to a competing new ferry service operating between Galilee (Point
13 Judith) and Block Island since mid-summer 2001.

14
15 **Q. What is the purpose of your testimony in this filing?**

16 A. My testimony is in support of Interstate's rate increase request for new rates effective January
17 1, 2004. In this testimony, I will address the test year (June 1, 2002 - May 31, 2003), the rate
18 year (June 1, 2004 - May 31, 2005), cost of service/revenue requirement, rate base, rate of return
19 and rate design. Lastly, I have evaluated the impact of this rate increase on ratepayer classes.

20
21 **Q. Did B&E audit the test year?**

22 A. No.

23
24 **Q. How did you develop the test year?**

25 A. I was provided the FYE May 31st, 2003 financial statements from Interstate's Certified Public
26 Accountant which was prepared from the books of Interstate, but was identified as a compilation,
27 not an audit. I obtained the detailed trial balance that supported the financial statements in order
28 to complete a more thorough review.

29

1 I also reviewed the adjusting entries made to put the trial balance on an accrual basis and I
2 reviewed in some detail certain expense accounts and supporting information. Further, I
3 selected, on a test basis, a number of transactions to review in detail. As a result of my review, I
4 was able to make the necessary normalizing adjustments to the test year in preparation for this
5 filing. This test year, along with the information I developed from my review of the test year,
6 became the basis, or starting point, for the development of the rate year.

7

8 **Q. Does that conclude your introduction section of your testimony?**

9 A. Yes.

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1 **OVERVIEW**

2

3 **Q. What "full" rate filings has Interstate made in the past eleven years?**

4 A. There have been only two full rate filings within the past fourteen years as follows:

5

<u>DATE FILED</u>	<u>DOCKET NUMBER</u>	<u>INCREASE</u>
1989	1935	\$ 770,000
1996	2484	1,171,000

9

10 **Q. What were the findings or stipulations as a result of Docket 2484?**

11 A. They were as follows:

- 12 1) In addition to setting the increased revenue requirement at \$1,171,000, the stipulation set
- 13 the rate base at \$11,150,814 and the rate of return on equity at 11.50%.
- 14
- 15 2) Interstate agreed to increase rates on an across-the-board basis (approximately 22%) with
- 16 the exception of three items. First, the truck rate for hazardous materials transported on
- 17 special charter runs without passengers was set at 150% of the per linear foot truck rate.
- 18 Second, the commuter rate for year round islanders was increased to \$9.00, and third,
- 19 separate commuter vehicle rates were established for the first time for BI registered autos,
- 20 passenger vans and pick-up trucks.
- 21
- 22 3) Interstate agreed to a 20 year life for the new boat the MV Block Island.
- 23
- 24 4) Interstate agreed to amortize the proceeds from the sale of either the Manitou or the
- 25 Manisee over 60 months to provide the ratepayers the benefit from the sale.
- 26
- 27 5) There were also agreements on selling a round trip children's ticket, certain schedule
- 28 changes, the completion of a freight study, a pilot program for the pre-selling of tickets,
- 29 and one more year of the Providence to Newport to Block Island run.

1 **Q. Has Interstate complied with all of these stipulations?**

2 A. Yes.

3

4 **Q. Mr. Edge, what are the major reasons which have caused the need for rate relief at this**
5 **time?**

6 A. The major reasons are as follows:

7

8 1) Revenues were flat in FYE May 31st 1999 and 2000. Interstate had some revenue growth
9 in FY 2001 and FY 2002. Unfortunately, there was a significant reduction of revenue in
10 FY 2003 and it appears from the summer of 2003 that there will be a continued drop in
11 revenue in FY 2004. This loss of revenue has resulted in a deterioration of the return on
12 equity (which in FY 2003 was a negative return on equity as a result of a loss from
13 operations for the year).

14

15 2) It has been about seven years since Interstate's last rate filing and costs have increased
16 faster than revenues. I will present these increases by individual line item and explain
17 each and every increase. Of course any reductions such as the reduction in interest
18 expense will likewise be explained in detail.

19

20 3) Interstate has a number of capital projects that are needed to maintain quality services to
21 the island. These projects will require additional revenues to pay the debt service. These
22 capital items will be discussed in great detail in this testimony.

23

24 **Q. Are there any rate design changes?**

25 A. Yes. Interstate is requesting a number of rate changes designed to provide Interstate some
26 flexibility in its rates to allow for a better competitive position. (See Ms. Linda's testimony and
27 the Rate Design Section of this testimony).

28

29

1 **Q. What is the increase in revenue requirement requested by Interstate in this filing?**

2 A. Interstate is requesting an increase in revenue of \$2,750,712 or 39.8%.

3
4 **Q. What is the increase in the same day round trip adult ticket from Point Judith to Block**
5 **Island excluding landing fees?**

6 A. The increase is from \$12.80 to \$17.90.

7
8 **Q. Does that conclude your overview?**

9 A. No, I think that it would be helpful for the Commissioners who were not present seven years
10 ago during the last rate filing if I provide a brief description of the current vessels owned by
11 Interstate and the routes they travel as follows:

	Vessels	Routes	Capacity
1.	Block Island (Built 1997)	Runs from Point Judith to Block Island year- round	1,000 passengers and 35 cars
2.	Carol Jean (Built 1984)	Runs from Point Judith to Block Island during the non-winter months.	1,300 passengers and 35 cars
3.	Manitou (Built 1970)	Runs from Newport to Block Island (Summer only but has year round capability)	394 passengers with 0 cars, or 280 passengers with 8-10 cars
4.	Nelseco (Built 1981)	Runs from Point Judith to Block Island during the non winter months	839 passengers with 0 cars

12
13 **Q. Does the Company lease any vessels?**

14 A. Yes, the Company leases the M. V. Anna C from the Nelseco Navigation Company. The
15 Anna C runs from Point Judith to Block Island during the winter months as needed and makes
16 one run from Block Island to Point Judith and back to Block Island on Saturdays, Sundays and
17 Holidays from June through September. Also, the Anna C has been used as a back-up boat for
18 the other two large boats when they are out of service. The Anna C has the capacity of 1,300
19 passengers and 35 cars and was built by Nelseco in 1986.

20

1 **Q. Would you explain why the Company needs to charter the M. V. Anna C when it owns**
2 **four other boats?**

3 A. Yes, during the last docket it was agreed by the Commission and the Division, after
4 significant review and testimony, including a formal fleet study, that the Anna C fills two very
5 important needs of the Company which could not be addressed by the Company's own fleet as
6 follows:

- 7
- 8 1) The Company needs a back-up winterized, full-size vessel.
 - 9
 - 10 2) The Company needs to lease the Anna C to address the increased weekend and
11 holiday summertime demand, which could not effectively be serviced without an
12 additional weekend run (Saturday, Sunday and Holidays) with a large vessel. During
13 the summer, tourists travel to Block Island, often for a weekly stay. However, many
14 day-trippers also travel to the Island.

15
16 Most of the turnover takes place in the rental cottages and hotels on the Island on
17 Saturdays and Sundays and most day-trippers also travel on weekends and holidays.
18 As a result, Interstate's greatest demand for passengers and vehicles occurs on
19 Saturdays, Sundays and Holidays. In order to satisfy this demand, Interstate added
20 one run with the vessel Anna C. This run generally leaves Block Island for Point
21 Judith at around noon and leaves Point Judith for Block Island in the early to mid
22 afternoon.

23
24 The above information was provided in a similar format in the last Docket and is included in this
25 testimony to give background information for the Commission and the Division.

26
27 **Q. Does that conclude your overview testimony?**

28 A. Yes.

29

1 **TEST YEAR**

2
3 **Q. What test year did you use?**

4 A. I used the test year June 1st 2002 to May 31st 2003.
5

6 **Q. Please describe the steps you took to prepare the test year.**

7 A. As stated earlier, I reviewed the auditor's year end trial balance used to prepare the
8 compilation and the adjusting entries made to put the trial balance on an accrual basis. I found
9 that the auditor's compilation included less than 20 expense accounts, while the trial balance
10 reflected over 70 expense accounts. Knowing that the greater the level of detail the better and
11 that I needed to make adjustments in the rate year, by boat, I have shown the test year and the rate
12 year using the trial balance detail. B&E reconciled the auditor's compilation to the year end trial
13 balance.
14

15 **Q. Did you do any detailed testing of transactions?**

16 A. Yes. I selected, on a test basis, a number of transactions to review in detail. For example, I
17 reviewed in detail accounts such as insurance, utilities, telephone, fuel, professional fees and
18 payroll. All other accounts were reviewed in less detail as considered necessary and all accounts
19 were reviewed to determine that a proper cut off was made at the beginning and end of each year.
20 As a result of my review, I was able make the necessary normalizing adjustments to the test year.
21

22 **Q. What adjustments did you make to normalize the test year?**

23 A. I made 7 adjustments as follows:
24

- 25 1. I removed interest income (\$18,529.43) from revenue because cash is not part of ratebase
26 and the return on cash investment is stockholder not ratepayer revenue.
27
- 28 2. I added one fifth of the net proceeds of the sale of the Manisee (Per Stipulation).
29

1 3. I reduced depreciation expense for the one time amortization of refinancing costs in the
2 amount of \$563,362.

3
4 4. I removed interest expense (\$265,522.63) from the cost of service because interest
5 expense will be accounted for in the return on ratebase calculation.

6
7 5. I adjusted the wharfage expense account to remove rent expense.

8
9 6. Employee pension was understated because Interstate does not pay pension contributions
10 annually but rather catches up when times are good. B&E calculated that the pension
11 contribution for the test year to be about \$69,633 (3% of gross payroll). An adjustment
12 increasing the test year pension expense by \$15,633 was made.

13
14 7. I eliminated the cash over/short amount of \$4,621.91 because it is not a proper cost of
15 service item and fluctuates between revenue and expense from year to year.

16
17 **Q. Mr. Edge is that all of your test year adjustments?**

18 A. Yes. See WEE-1 and WEE-2 for the test year.

19
20 **Q. Did you prepare a comparative analysis of revenues and expenses for any period prior
21 to the test year to determine if the test year was a normal year?**

22 A. Yes. I was provided information for four years and the test year for both revenues (WEE-3)
23 and expenses (WEE-4). These schedules show that the test year ended May 31, 2003 is a
24 "normal" year which reflects a relatively normal progression of revenues and expenses for
25 Interstate.

1 **Q. Did the stockholders of Interstate Navigation take their allowed dividends during the**
2 **period from the last rate case to now?**

3 A. No. Interstate's stockholders did not take any of the earnings authorized by the Commission
4 in the last rate case, but rather, continued to reinvest all of the profits earned by the Company
5 over the past six years back into the Company. To the best of my knowledge Interstate has never
6 paid dividends to its stockholders electing instead to increase the value of the stock by
7 reinvestment in the company. This allowed the Company's retained earnings (equity) to grow
8 and has put the Company in a much stronger financial position.

9

10 **Q. Does that conclude your test year testimony?**

11 A. Yes.

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1 **RATE YEAR COST OF SERVICE**

2
3 **Revenues:**

4
5 **Q. In general what revenues does Interstate earn?**

6 A. Interstate received revenue from 11 sources in the test year. They include the following:

Passenger Revenue	50.8%	Down from 56% in the last docket
Car/Truck Revenue	30.8%	Up
Bike Revenue	1.8%	Down from 3.0% in the last docket
Freight Revenue	7.8%	Slightly down from 8% in the last docket
Bar Revenue	6.2%	Up
Charter Revenue	1.3%	Down from 3.0% in the last docket
Mail Revenue	<1%	No change
Landing Fees Commission	<1%	No change
Other Income	<1%	No change
Interest Income	<1%	No change
Amortization of Manisee sale	<1%	New

7
8 The first four revenue accounts (passenger, car/truck, bike and freight), which make up 91% of
9 all revenue, are tariff related activities and as such they are regulated by the PUC. Bar revenue,
10 mail revenue, landing fees, other income and the amortization of the Manisee sale are all minor
11 unregulated revenues that are used in the rate making process to reduce the annual revenue
12 requirement for the ratepayers. Interest income is the return on cash investment and not
13 included in the cost of service.

14
15 Charter revenue for the transport of hazardous materials was once an unregulated revenue source
16 used to reduce the revenue requirement, but it is now a regulated revenue item. This revenue
17 account has remained relatively constant for the last three years.

18
19 Most of Interstate's revenue is directly affected by seasonal changes, winds, temperature
20 variances (degree days), rain and other weather. Further, Interstate is a summer peaking utility
21 that derives the overwhelming majority of its revenue in June, July and August.

1 When looking at just one year, it is imperative to consider the weather in that year. When trying
 2 to project the revenue for the rate year one would like to have all normal revenue years in the
 3 calculation but unless you eliminate years from your calculation this is not possible. Often,
 4 weather (good or bad) in any given year can obscure revenue trends either by showing a lower
 5 than normal revenue year caused by bad weather or a larger than normal revenue year caused by
 6 good weather.

7
 8 During my review of the comparative revenue levels (WEE-3) for the past few years, I
 9 determined that the increase in total revenue from 2001 (adjusted to remove the sale of the MV
 10 Manisee) to 2002 was 3.5%. This is far greater than the other revenue increase on schedule
 11 WEE-3. This is due to a good summer of 2001 included in FYE 2002 a very good revenue year.

12
 13 **Q. How did you project the rate year passenger, car/truck and bike revenues?**

14 A. I reviewed these three revenue accounts together because in the past they were often
 15 impacted by the same externalities such as the weather. I have listed the revenue amounts for
 16 the past four full years (1999-2002) and the revenue amount for the test year (May 31, 2003) as
 17 follows:

FYE	Passenger Revenue		Car/Truck Revenue		Bike Revenue	
	\$ (000)	% Growth	\$ (000)	% Growth	\$ (000)	% Growth
5/31/1999	\$3,909		1,951		156	
5/31/2000	3,932	.58%	1,912	(2.0%)	146	(6.4%)
5/31/2001	3,805	(3.2%)	2,074	8.5%	135	(7.5%)
5/31/2002	4,007	5.3%	2,167	4.5%	143	5.9%
5/31/2003	3,708	(7.5%)	2,248	3.7%	133	(7.0%)

18
 19 Ignoring FYE May 31st 2002 (a revenue aberration year) from the above analysis, results in a
 20 three-year downward trend in passenger revenue. From the above table we can also see that bike
 21 revenue has done even worse than passenger revenue with a revenue reduction in 2000, 2001 and
 22 2003 and only a modest recovery in 2002. In both cases the one year 2002 recovery was more
 23 than wiped out in 2003.

1 Only car and truck revenue (not impacted by competition) has shown increasing revenue in 2001
2 2002 and 2003 after an off year in 2000. Interstate believes that this is an adequate reflection of
3 what would have happened to all revenue sources if Interstate were not faced with competition.
4

5 From this analysis, I believe there should be revenue growth projected in car/truck revenue in the
6 rate year. However, passenger and bike revenue should be projected to reflect the downward
7 trend caused primarily by competition. Interstate does not believe that all of its lost revenue is
8 the result of the direct competition from Island Hi-Speed ferry. Revenue is down because of
9 fewer travelers after 9/11, the drop in the economy, and most recently the new Hi Speed ferry
10 from Quonset Point to Martha's Vineyard.
11

12 Items that I considered in my analysis are as follows:
13

- 14 ➤ Island Hi-Speed ferry did not start operations to Block Island until mid summer of 2001
15 (a very good summer) which is included in Interstate's FYE 5/31/02. Impact on
16 Interstate was minimal because of Hi-Speed's late start and the great summer.
17 Interstate chose not to file for a rate increase but rather to investigate expense
18 reductions (including refinancing its debt) and to reevaluate the need for a rate filing the
19 next year.
20
- 21 ➤ In the test year (5/31/03 which includes the summer of 2002), Hi-Speed ferry ran a full
22 season from May to October. About half way through (8/2/2002) Hi-Speed was
23 allowed to increase its carrying capacity from 149 passengers to 250 passengers. This
24 increase in capacity and the full schedule negatively affected Interstate's revenues as
25 shown by the table above.
26
27
28
29

1 A summary of my projection for these three accounts is as follows:

2

FYE	Passenger Revenue		Car/Truck Revenue		Bike Revenue	
	\$ (000)	% Growth	\$ (000)	% Growth	\$ (000)	% Growth
5/31/1999	\$3,909		1,951		156	
5/31/2000	3,932	.58%	1,912	(2.0%)	146	(6.4%)
5/31/2001	3,805	(3.2%)	2,074	8.5%	135	(7.5%)
5/31/2002	4,007	5.3%	2,167	4.5%	143	5.9%
5/31/2003	3,708	(7.5%)	2,248	3.7%	133	(7.0%)
Projection:						
5/31/2004	3,397	(8.4%)	2,333	3.8%	123	(7.0%)
5/31/2005	3,111	(8.4%)	2,422	3.8%	115	(7.0%)

3

4 The 5/31/04 projection of passenger revenue (negative 8.4%) is the result of my analysis of the
5 summer of 2003 (June July and August) a significant factor in the FYE May 31, 2004 passenger
6 revenue compared to the summer of 2002 (June, July and August). The actual passenger
7 revenue in the summer of 2002 was \$2,518,888 compared to the actual passenger revenue in the
8 summer of 2003 \$2,307,487 a reduction of 8.4%. This continued increasing trend of decreasing
9 passenger revenue has no end in site. My projection of an additional 8.4% reduction in the rate
10 year may be inadequate if the increasing trend continues.

11

12 The actual bike revenue in the summer of 2003 included in the FYE May 31, 2004 showed an
13 even greater than 7% reduction in bike revenue (about 20%). Nevertheless, to be conservative, I
14 continued only the 7% reduction in bike revenue for the FYE 2004 and 2005 projections.

15

16 Car and truck revenue has not been impacted by competition. Further, the accumulation of data
17 relating to the actual car/truck revenue for the summer of 2003 was not completed at the time of
18 this writing. Therefore, I used the average car/truck increase from FYE 1999 through FYE 2003
19 (3.8%) to project the car/truck revenue level for FYE 2004 and FYE 2005. It would be
20 appropriate when the information is available to replace the FYE 2004 projection with actual
21 car/truck revenue and recalculate the 2005 projection.

22

1 **Q. Mr. Edge, how did you calculate the rate year freight revenue?**

2 A. Again, I reviewed the revenue amounts for four years and the test year. I found the
3 following:

FYE	Amount	Percentage Increase (Decrease)
5/31/1999	\$555,888	
5/31/2000	502,752	(9.56%)
5/30/2001	600,788	19.50%
5/30/2002	613,724	2.15%
5/30/2003	569,337	(7.2%)

4
5 Freight revenue varies up or down each year and to some extent is more a function of
6 construction on the Island rather than weather. Because Interstate's competition carries no
7 freight, freight revenue has not been impacted in the same way as passenger and bike revenues.
8 Further, there is no definite revenue trend for freight so I considered using a five-year average for
9 freight revenue of \$568,498. However, since the five year average was less than the test year and
10 I did not expect any significant change in freight revenue in the future, I left the freight revenue at
11 the test year level \$569,337.

12

13 **Q. Mr. Edge, how did you project the rate year revenue for the bar, charter, mail, other**
14 **revenue, interest and landing fees commission?**

15 A. Given the fact that bar revenue is generally a function of the number of passengers (which I
16 am projecting will continue to decline due to competition) I could have reduced this revenue
17 source for the rate year and the related expense. However, due to the relatively minor nature of
18 the bar account and the fact that bar revenues are offset to some extent by bar cost, I chose to
19 simply use the test year level for both bar revenue and the related bar expenses for the rate year
20 which I believe is a conservative approach.

21

22 Mail revenue and charter revenue do not change much from year to year so both accounts were
23 set at the test year level for the rate year. Neither of these accounts represents a significant
24 revenue source.

25

1 Landing fees commission revenue increased in the test year due to the addition of the
2 Narragansett landing fee. The only change in landing fee revenue from this point forward will
3 result from increases or decreases in passenger travel. Since I have projected a 8.4 percent
4 reduction in passenger revenue for the rate year I have likewise decreased the landing fee revenue
5 by the same percentage.

6
7 Other revenue was simply set at \$10,000 which is higher than the test year to provide for any
8 growth in revenue that may occur as a result of the tariff changes requested in the rate design
9 section of this testimony. Interest revenue is not a cost of service revenue for ratemaking
10 because it is the result of the return on available cash which is not included in the ratebase.
11 Therefore, I have projected no interest revenue for the rate year.

12
13 **Q. What is your rate year revenue projection at current rates?**

14 A. The total rate year gross revenue projected at current rates is \$6,907,030 (See WEE-6).

15
16
17 **Expenses:**

18
19 **Q. Mr. Edge, would you explain how you projected expense balances for the rate year?**

20 A. Yes. Many of the expense accounts were reviewed individually due to the volatility of the
21 accounts from year to year. These individual accounts were reviewed to determine all "known
22 and measurable" changes. Some accounts were projected using a simple average of the last four
23 years, plus the test year. Many (some minor) accounts were left at test year levels. Whenever
24 possible, B&E used known and measurable changes for expenses.

25
26 **Q. How was rate year payroll expense projected?**

27 A. Because Interstate primarily hires different summer help each year, it is difficult to project
28 future payroll expense based upon a detailed payroll listing. Interstate tries to control payroll
29 spending by establishing a 5% cap on salary expense increases from year to year.

1 The success of this policy has been compromised due to a significant reduction in the number of
2 crew willing to work long hours for modest pay. The recent history shows that Interstate payroll
3 expense has average a 7.4% increase per year as shown in the following table:

4

Year	Payroll Exp.	% Increase
1999	\$1,790,860	
2000	1,859,567	+3.8%
2001	1,996,967	+7.4%
2002	2,336,464	+17.0%
2003	2,321,102	-1%
Ave.		+7.4%

5
6
7 The large increase in 2002 was the result of a Department of Labor lawsuit that resulted in
8 retroactive overtime pays to certain employees. Backing out the retro pays in 2002 results in an
9 average increase for 2002 and 2003 of 8%.

10
11 Interstate hired a consultant to review and evaluate the company's scheduling of employees
12 procedures and overtime costs. The consultant was able to help the Company reduce overtime
13 labor costs in the summer of 2003 reducing the impact of the average 7.4% increase in payroll
14 expense. Interstate projects that after the overtime savings the increase in payroll for the interim
15 year will be only 2.5%. Further, Interstate is prepared to continue its policy of trying to hold
16 payroll expense to a 5% increase in the rate year. Therefore, I have projected a 2.5% increase
17 for FYE 2004 and a 5% increase for FY 2005.

18
19 Next, I added to my projected payroll amount the cost of one additional crewmember to cover the
20 increased staffing for the MV Anna C (which will replace the MV Nelseco on the Point Judith
21 run). This very modest increase of one crewmember is required by law and Coast Guard
22 regulation. The replacement of the MV Manitou with the MV Nelseco on the Newport run and
23 the decision to place Manitou on standby results in no change in the number of crew needed.

24

1 My last payroll adjustment is to reflect the salary increases that will be given to the management
 2 team January 1, 2004 to raise their salaries to more appropriate levels. The increases are as
 3 follows:

	<u>Interim Year</u>	<u>Rate Year</u>
Susan Linda CEO, Treasurer	\$99,278	\$150,000
Ray Linda COO	93,659	125,000
Josh Linda VP, Manager	73,162	100,000
	<u>\$266,099</u>	<u>375,000</u>
		(266,099)
Adjustment		<u>\$108,901</u>

4

5 **Q. What were the reasons for the increase in management salaries at this time?**

6 A. In addition to the fact that Interstate's management salaries are below market salary levels
 7 for CEO/CFO, COO, and managers of a nearly \$10,000,000 regulated company the increases are
 8 justified by the following additional tasks required of management:

- 9 ➤ Additional work involved in designing, engineering, and implementing the rehabilitation
 10 of the *Carol Jean*, including re-powering the vessel and upgrading the interior of the
 11 cabin.
- 12
- 13 ➤ Work involved in designing, engineering, permitting, and implementing improvements to
 14 the Point Judith terminal, including construction of a new freight terminal and
 15 reconstruction of the existing passenger terminal.
- 16
- 17 ➤ Becoming familiar with and implementing extensive new Homeland Security Coast
 18 Guard regulations. Meetings with the Coast Guard, assessing all vessels, assessing all
 19 facilities, drawing up security plans for vessels and facilities, appointing and training
 20 security officers, designing and installing security equipment on vessels and facilities, and
 21 overseeing increased day-to-day security responsibilities.
- 22
- 23 ➤ Dealing with increasing competition, including Island Hi-Speed Ferry and the new high
 24 speed ferry from Quonset Point to Martha's Vineyard and coming up with advertising
 25 plans and marketing strategies to attempt to retain, to the extent possible, existing market
 26 share and to protect the lifeline service.
- 27
- 28 ➤ Work required purchasing and financing the new vessel MV ANNA C and implementing
 29 her into the schedule.
- 30
- 31

1 My salary calculation is as follows:
2

Test Year	<u>\$2,321,101</u>
FYE 2004 (T/Y * 1.025)	<u>2,379,129</u>
FYE 2005 (FY 2004 * 1.05)	2,498,085
Management Salary Increases	108,901
Additional Crew	<u>30,000</u>
Total payroll	<u>\$2,636,986</u>
Adjustment (\$2,636,986-\$2,321,101)	<u>\$315,885</u>

3

4 **Q. How were payroll taxes calculated?**

5 A. Payroll taxes were calculated using the test year relationships between payroll and the payroll
6 tax. (See calculations on Schedule WEE-8).

7

8 **Q. How was fringe benefits calculated?**

9 A. Pension cost was calculated and normalized in the test year. For the rate year I used the
10 company standard 3% of gross payroll to project the pension contribution (WEE-9).

11

12 Health benefits were calculated using the most current rates (August 2003 rates) times the
13 employees that get coverage to arrive at the interim year cost of health insurance, \$225,194. The
14 FYE 2004 level of health expenditure was increased by 6% to arrive at the rate year cost of
15 \$238,706 (WEE-9).

16

17 **Q. What would you like to review next?**

18 A. The next account that I would like to address is the charter expense account. In the test year
19 Interstate needed to charter the Anna C for its normal summer usage (one run on weekends and
20 holidays) plus significant additional time because the MV Carol Jean (which needs a major
21 overhaul) required more repairs than anticipated and was late in returning from dry dock.

22

1 Also the MV Block Island was out of service for a week in November and the Anna C was
2 pressed into service. The test year charter expense amount was \$363,000. As a result of
3 Interstate purchasing the MV Anna C there will be no charter expense in the rate year. This is a
4 significant savings from the test year level of cost.

5
6 **Q. Were you able to evaluate any accounts as a group?**

7 A. Yes. Certain miscellaneous type accounts show no definitive trend from year to year. These
8 accounts can either increase or decrease one year to the next. Since these accounts can not be
9 projected using known and measurable information, inflation or trend analysis, I have calculated
10 the rate year level of expense for these accounts by averaging the account balances over the last
11 four fiscal years (1999-2002) and the test year (2003). The adjustment for these 9 accounts is an
12 increase to the revenue requirement in the rate year of \$25,183 (See WEE-10).

13
14 **Q. Mr. Edge, did you leave any expense accounts at the test year level for the rate year?**

15 A. Yes. Many small accounts and some specific accounts such as bar expense did not warrant
16 detail review or testing and therefore I used the test year level of expenditure for the rate year.
17 Generally these account balances are less than 1% of the total cost of service. Twenty four
18 expense accounts were left at the test year level (See WEE-7).

19
20 **Q. How did you calculate the fuel cost for the rate year?**

21 A. First, it was important to determine the additional fuel cost required on the Newport to Block
22 Island service for the larger boat the Nelseco rather than the small boat the Manitou. In addition,
23 I projected the additional fuel cost required for the Anna C to replace the MV Nelseco on the
24 Point Judith to Block Island run. In addition, I observed that fuel costs have increased steadily
25 during the test year and into the interim year. Since Interstate purchases all of its fuel for the
26 boats from Drew Oil, I called Drew Oil and asked if they had industry projections for fuel costs
27 for the rate year. They provided me with the rate year projection information reflected on WEE-
28 11.

1 **Q. How did you calculate wharfage and rent?**

2 A. I reviewed all of the current wharfage and rental contracts which extend through the rate
3 year and calculated the actual known and measurable wharfage and rent that will be paid in the
4 rate year (See WEE-12). There is anticipated a significant increase in the wharfage charge by
5 Interstate Nav. as a result of an independent appraiser's appraisal of the appropriate wharfage
6 charge. Since the current lease does not expire until September 30, 2004, I used the current
7 lease amounts for four months and the new lease amount for eight months.

8
9 **Q. How did you calculate the insurance and casualty expense for the rate year?**

10 A. Interstate in fact pays directly small injury and damage claims by having a large deductible
11 on its primary insurance policy on the boats. In addition Interstate carries a separate umbrella
12 policy to protect against large claims.

13
14 This management decision has resulted in savings when compared to a lower deductible and
15 higher insurance costs for these nuisance claims. Property insurance that combines Hull and
16 Liability and excess protection and indemnity insurance are maintained by Interstate as follows:

17

<u>Insurance Type</u>	<u>Test Year</u>	<u>Rate Year</u>
Commercial Property	\$5,088	7,398
Piers and Docks	2,166	3,150
Commercial General Liability	1,109	1,613
Hull and Machinery	72,041	104,755
Breach of Warranty	2,567	3,733
Vessel Pollution Liability	3,320	4,828
Excess Marine Liabilities	16,400	23,847
Primary Bumbershoot	3,281	4,771
Excess Bumbershoot	10,505	15,275
Protection and Indemnity	43,800	63,690
Total	<u>\$160,277</u>	<u>\$233,060</u>

18
19 The rate year includes all items increased for the addition of the MV Anna C (total increase of
20 \$61,685) plus a 5% increase in the rate year.

1 **Q. Mr. Edge, did you calculate rate case expense?**

2 A. Rate case expense for this docket was estimated as follows:

Cost of Service (Accounting)	\$50,000
Legal	50,000
Division	30,000
Commission	<u>20,000</u>
Total	<u>\$150,000</u>
Divided by 3 year	<u>\$50,000</u>

3
4 Interstate has in the past agreed (and does now) to adjust rate case expense to actual at the end of
5 the case. The above balance is in addition to the yearly PUC administrative cost expense.
6 It should be noted that since Interstate's last rate case was over 6 years ago and in that docket rate
7 case expense was amortized over three years that there is no unamortized rate case expense from
8 the last docket. The only rate case expense needed for this docket is the \$150,000 calculated
9 above. There was no rate case expense in the test year.

10

11 **Q. How did you calculate professional fees for the rate year?**

12 A. The last three years show professional fees have been increasing steadily. Professional fees
13 were \$256,213 in 2001, \$353,598 in 2002 and \$377,844 in 2003. This increasing trend is
14 primarily the result of ever increasing legal needs in the last three years. See attached schedule
15 WEE-13. In addition to legal fees, Interstate also paid in the test year other professional fees as
16 follows:

	<u>Test Year</u>
John Kanabis (CPA) (General Accounting Services)	\$29,600
B&E pc (Regulatory Related Accounting Services)	39,800
Pension Administration	4,303
Trion Communications (Lobbyist)	<u>33,246</u>
Total	<u>\$107,246</u>

17
18 Although there has been a definite increase in legal and other professional expense over the past
19 few years I have chosen to leave these accounts at the test year levels for the rate year.

1 **Q. Mr. Edge, you have reviewed and projected a number of accounts already, what are**
2 **the remaining expense accounts that you have to review and if necessary adjusted for the**
3 **rate year?**

4 A. There are only eleven expense accounts left that will require a detail review and adjustment:

- 5 1. Depreciation
- 6 2. Advertising
- 7 3. Credit Card Administration
- 8 4. Telephone
- 9 5. Municipal Taxes (real estate and personal property)
- 10 6. Gross Receipts Tax
- 11 7. Maintenance – Vessels
- 12 8. Computer Expense
- 13 9. CT Corporation tax
- 14 10. Federal Income Tax
- 15 11. Homeland Security

16
17 **Q. Do you have to review each of these accounts separately?**

18 A. Unfortunately, yes. However, items 1 (WEE-15a), 6 (WEE-5), 9 (WEE-7) and 10 (WEE-17)
19 are math calculations that I will address each of them after I complete my rate base/rate of return
20 testimony.

21
22 **Q. Mr. Edge, would you please proceed with item number two on your list, advertising.**

23 A. Certainly, I have projected advertising expense for the rate year as follows:

24
25 Interstate is currently faced with a one boat, summer only hi-speed competitor that has an
26 advertising budget of \$100,000 (approved by this Commission). If Interstate is to survive and
27 protect its lifeline service, it must advertise. Most of Interstate's ratepayers are discretionary
28 travelers who do not need to visit or vacation on Block Island (nor take Interstate's boats) and
29 therefore it behooves Interstate to encourage individuals to use Interstate's services in order to
30 increase revenue and spread fixed costs.

31
32
33

1 Before competition, Interstate, through advertising and increased service quality, had been very
2 successful in increasing its annual revenue. I fully expect that Interstate will need to increase its
3 advertising efforts to protect its lifeline service and maintain market share in addition to the
4 following reasons:

- 5 • Interstate has estimated that it will need to increase its advertising to retain the
6 Connecticut business previously carried to Block Island by Nelseco Navigation Company
7 from Connecticut.
8
- 9 • Reduce erosion of revenues due to competition from Island Hi-Speed Ferry, new high
10 speed ferry to Martha's Vineyard, and post-9/11 decrease in tourism.
11
- 12 • Necessity of letting passengers know of improvements to the fleet, including the addition
13 of the *Anna C*, the rehabilitation of the *Carol Jean*, and improvements to the terminal
14 facilities.
15
- 16 • Alert passengers to security improvements and issues related to implementation of
17 Homeland Security Coast Guard regulations.
18
- 19 • Advertising to familiarize passengers with the effect of the rate increase and new
20 scheduling opportunities due to the addition of the *Anna C*.
21

22 To cover the advertising cost needed for the above, Interstate has estimated that it will spend
23 \$350,000 for advertising in the rate year.
24

25 **Q. How did you project the rate year level of expenditure for credit card administration?**

26 A. Credit card fees have increased by well over 10% on average per year for the last four years.
27 This trend is expected to continue as more passengers use credit cards. I have projected a 10%
28 increase for the interim year and the rate year so the rate year level of credit card fees is projected
29 at \$89,186 an increase of \$15,480.
30

31 **Q. The next item on your list is telephone expense, what adjustment have you made for the
32 test year telephone expense?**

33 A. This is another account that has increased significantly over the last five years from \$76,000
34 in 1999 to \$116,000 in the test year, an increase in telephone expense of about 10.5% per year.
35

1 This significant increasing trend is expected to continue therefore I have increased the telephone
2 expense account by 10% in both the interim and rate years. The result is a rate year expenditure
3 level of \$140,854.

4
5 **Q. How did you calculate real estate and property taxes?**

6 A. I estimated that the Towns of New Shoreham and Narragansett would increase their property
7 tax rate by 5% per year and the improvements on Interstate's property and the addition of new
8 personal property would result in an additional 10% increase in the rate year. (See WEE-14).

9
10 **Q. Have you made any adjustments for vessel maintenance in the rate year?**

11 A. Yes I have. With the addition of the MV Anna C to the Interstate fleet it would normally be
12 necessary to increase the vessel maintenance account to reflect the maintenance on the MV Anna
13 C. However, there will be limited savings as a result of putting the Manitou into a standby
14 status and the MV Carol Jean's maintenance will be included the capital project to remodel and
15 re-power the boat in the rate year. Therefore, the only increase will be the increase that results
16 from the aging fleet. The net maintenance cost adjustment was calculated at a 10% increase or
17 \$19,660.

18
19 **Q. How have you adjusted computer expense for the rate year?**

20 A. I have increased this expense greater than inflation because Interstate is becoming more and
21 more computerized. I have used a 5% annual increase to project the computer expense for the
22 rate year.

23
24 **Q. The last account listed above is homeland security. Is this a new expense account?**

25 A. Yes. The Federal Government through the new Department of Homeland Security has
26 published "Port Security Regulations" in response to the 9/11 attacks in New York. The
27 Regulations are divided into six sections as follows:

- 28
29 1. Implementation of National Maritime Security Initiatives (Part 101)
30 2. Area Maritime Security (Part 103)

- 1 3. Vessel Security (Part 104)
- 2 4. Facility Security (Part 105)
- 3 5. Outer Continental Shelf Security (not applicable to Interstate) (Part 106)
- 4 6. Automatic Identification Systems (at this time not applicable to Interstate) (Part 161)

5
6 Interstate will be required to spend significant amounts of money in the future (rate year and
7 beyond) on security. The cost of compliance with the regulations is very difficult at this time to
8 calculate so I chose to use the amounts reflected in the Federal regulations to project the costs for
9 Interstate. The costs per the regulations are as follows by Part:

- 10
11 ➤ Part 101 no costs listed to comply with part, because it is primarily definitions and
12 applicability.
- 13 ➤ Part 102 is reserved for the future.
- 14 ➤ Part 103 first year cost is estimated at \$12,800 per stakeholder (Interstate is a
15 stakeholder).
- 16 ➤ Part 104 relates to vessel security. The estimated first year cost per vessel is \$21,165 and
17 Interstate will have five vessels in the rate year. Five times \$21,165 is \$105,825.
- 18 ➤ Part 105 relates to landing facilities of which Interstate has two. The estimated first year
19 cost is \$225,000 per facility. For Interstate the cost is estimated at \$450,000 for two
20 facilities. In addition the regulations estimate Company compliance costs of between
21 \$1,942,500 and \$133,500. Given Interstate's size, I have used the lesser \$133,500
22 amount.
- 23 ➤ Parts 106 and 107 are not at this time applicable to Interstate.
- 24

25 The total cost of implementation of the regulations for Interstate is estimated at \$702,105 in the
26 rate year. I therefore have added \$702,105 to the rate year expenses.

27

28 **Q. Mr. Edge, what if it doesn't cost \$702,105 to implement the regulations will Interstate**
29 **have excess earnings?**

30 A. This is a very good question. I don't know if Interstate would have excess earnings or how
31 much but I understand the concern to protect the ratepayers.

1 I have discussed this issue with Interstate and Ms. Linda has agreed to put all of the monies
2 collected for Homeland Security in a restricted account to be used exclusively for the
3 implementation of the Port Security Regulations. Further, Interstate agrees to report the status of
4 the restricted account (collections, expenditures and balance) on an annual basis to the Division
5 and the PUC.

6

7 **Q. Does that conclude your rate year cost of service testimony?**

8 A. Yes, I would like to now discuss rate base/rate of return.

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1 **RATE BASE AND RATE OF RETURN**

2
3 **Q. Mr. Edge what is ratebase?**

4 A. Ratebase is a rate making term which relates to a utility's net investment in fixed assets plus
5 working capital and deferred debits. Interstate's rate base has been historically limited to net
6 utility plant and working capital. The largest item, by far, in rate base is net utility plant (net
7 fixed assets) which represents over 95% of Interstate's rate base. For this Docket, I have
8 calculated an average rate base for the rate year 6/1/04 through 5/31/05 (see WEE-15).

9
10 **Q. What do you mean by "net" investment?**

11 A. Original cost of utility plant "net" of (less) accumulated depreciation. My schedule WEE-15
12 shows the test year utility plant (5/31/03), all subsequent additions and deletions (depreciation) to
13 arrive at a beginning net utility plant for rate base at 6/1/04. This calculation was followed by a
14 second calculation reflecting rate year additions and deletions to arrive at the rate year ending
15 rate base at 5/31/05. The average of the resulting ratebase amounts from these two rate base
16 calculations plus a working capital allowance was used for the average rate year rate base.

17
18 **Q. Is rate base simply the result of Stockholder investment?**

19 A. No. Rate base is usually the result of both Stockholder investment and a Utility's long term
20 borrowing.

21
22 **Q. Why would assets that were obtained through borrowing be in rate base?**

23 A. Rate base is used in the rate process to determine the appropriate return (revenue above cost)
24 for the Utility. This return (on rate base) is used by the Utility to pay profit to the Stockholders
25 and interest paid to the bank, therefore, it is necessary to include assets which are purchased with
26 borrowed monies in the rate base calculation. Please remember that interest expense is a "below
27 the line" other expense for a regulated Utility and as such is not included in the cost of service
28 expense accounts. Payment of interest expense is provided from the revenue generated from the
29 return on rate base.

1 **Q. Mr. Edge how did you calculate working capital?**

2 A. Two rate case ago Interstate used what is normally referred to as the "45 day rule" to
3 calculate working capital. This method provides for a simple division of total expenses by 12
4 months times 1.5 to determine the average 45 day expenditure level. The Division pointed out
5 that this methodology is no longer generally used and rejected it.

6

7 The Division in that docket stated that although they preferred a "lead lag" study, they were
8 unable to complete one with the information available in the filing and that the "Balance Sheet"
9 method which they did use was more acceptable than the "45 day" methodology proposed by the
10 Company.

11

12 As part of a settlement agreement in that docket, Interstate accepted the Division's calculation of
13 working capital at \$655,054 using the Balance Sheet approach. In the last docket Interstate
14 calculated the working capital amount using both the 45 day rule and the balance sheet approach.

15 Both approaches resulted in excessive working capital amounts (as they do now in this docket,
16 see WEE-16). In the last docket Interstate recommended the continuation of the working capital
17 allowance of \$655,054, as approved in the previous docket. That amount has been adequate in
18 the past to allow Interstate the ability to get through the winter months when expenses far exceed
19 revenues. Once again Interstate is requesting the \$655,054 working capital allowance.

20

21 **Q. How is the percentage rate of return on rate base calculated?**

22 A. The percentage is calculated by adding the weighted cost of borrowing to the weighted cost
23 of capital. My schedule WEE-17 shows the rate of return requested by Interstate for this rate
24 filing.

25

26 **Q. Mr. Edge, please explain the items listed on your average ratebase calculation schedule
27 (WEE-15).**

28 A. The first item on my schedule is the net utility plant (asset value-depreciation) at May 31st
29 2003 obtained from the trial balance provided by Interstate's outside CPA.

1 To the May 31, 2003 utility plant balance I added "known and measurable" utility plant additions
2 for the interim year June 1, 2003 through May 31, 2004 as follows:

3

6/15/2003	Bulkhead - Block Island	\$ 638,274
6/15/2003	Ramp-Block Island	21,860
9/1/2003	Truck	33,000
3/1/2004	Forklift	20,000
5/1/2004	Dredging at Montville	<u>200,000</u>
		<u>\$913,134</u>

4

5 Next, I removed the depreciation that would be booked through the period from the test year to
6 the beginning of the rate year. At this point in my calculation, I have calculated a beginning of
7 the rate year net utility plant amount for the ratebase at 6/1/04.

8

9 Next I added to the beginning of the rate year utility plant balance the rate year activity (additions
10 and depreciation). The additions are projected as follows:

11

6/1/2004	Purchase of the MV Anna C	\$3,100,000
12/1/2004	Re-power and upgrade the MV Carol Jean	3,000,000
6/1/2004	Up-grade of computer ticketing system	136,233
6/1/2004	Complete Point Judith project	<u>270,000</u>
		\$6,506,233

12

13 **Q. Have you completed an analysis of the cost benefit of purchasing the MV Anna C**
14 **compared to continuing to lease the vessel?**

15 A. Yes I have, but it is important to point out that leasing the MV Anna C for one run on
16 weekends and holidays does not address the need to replace the MV Nelseco (an under-powered
17 smaller boat) that has not been well received by Interstate's ratepayers. In order to improve
18 service Interstate must improve its fleet and provide the larger more comfortable MV Anna C on
19 a full time basis on the Point Judith to Block Island run.

20

1 Nelseco Navigation, the owner of the MV Anna C, is willing to sell the boat to Interstate for
2 \$3,100,000. Interstate's appraiser confirmed that \$3,100,000 was a fair price for the boat and
3 that its replacement value of \$9,500,000 (over three times the purchase price). This is a very
4 good and Interstate is very familiar with this boat and it fits perfectly into the current schedule.

5
6 The breakeven analysis using the test year charter cost is as follows:
7

Test Year Cost (Lease)	<u>\$363,000</u>
RY Depreciation	\$310,000
RY Return	100,000
RY Crew	30,000
RY Insurance	62,000
RY Fuel	<u>40,000</u>
	<u>\$542,000</u>
Additional cost to own	<u>\$179,000</u>

8
9 For this additional amount Interstate can significantly increase the quality of the service it
10 provides. First the MV Anna C will be available for three runs per day on the Point Judith to
11 Block Island run replacing the much older, much smaller and much less comfortable vessel the
12 MV Nelseco. Second the MV Nelseco is then available to replace the much older, much smaller
13 and much less comfortable vessel MV Manitou on the Newport to Block Island run.
14

15 **Q. Mr. Edge, why is Interstate proposing to re-power and redesign the MV Carol Jean?**

16 A. Ms. Linda's testimony provides Interstate's reasons for upgrading the MV Carol Jean.
17 Nevertheless, it is important to point out that the MV Carol Jean is 20 years old and its engines
18 have outlived their useful life. In 2004, the MV Carol Jean is fully depreciated and in 2005 the
19 depreciation of greater than \$100,000 ends. The net cost to the ratepayers is reasonable in the
20 rate year.
21
22

1 **Q. What was your next step in the calculation of rate base?**

2 A. The beginning of the year and the end of year utility plant are averaged to determine the
3 average utility plant for ratebase for the rate year. To the average utility plant amount I added a
4 working capital of \$655,054 to arrive at the rate year ratebase.

5

6 **Q. Mr. Edge, how did you calculate the Rate of Return on Rate Base?**

7 A. I projected the rate year debt and equity, including the financing for the Anna C, the up-grade
8 of the MV Carol Jean and the other capital projects for the rate year. I then calculated the
9 weighted cost of debt and equity using the appropriate interest rates for debt and my calculated
10 return on equity.

11

12 **Q. Mr. Edge, how did you calculate the Return on Equity?**

13 A. First, I reviewed the return on equity allowed in the last rate case (about seven years ago) and
14 found that it was 11.50%. This rate was provided by the Division's witness and accepted by
15 Interstate. At that time I was Interstate's return on equity witness and calculated a return on
16 equity of 14.81%.

17

18 Given that the Commission has recently allowed rates of return between 10.5% and 11%, I could
19 not justify recommending that Interstate hire a cost of equity witness. Instead, I have calculated
20 an appropriate return on equity for Interstate for this case.

21

22 **Q. Did you calculate the return on equity using one of the more conventional**
23 **methodologies such as the Discounted Cash Flow (DCF) or the Capital Pricing Model**
24 **(CAMP) analysis?**

25 A. No, the discounted cash flow methodology doesn't work for Interstate because they never
26 distribute dividends and there are no regulated ferry companies that are comparative to Interstate
27 (in fact the Division's witness used totally unrelated water utilities to do her DCF analysis in the
28 last docket). The CAMP analysis has more merit assuming you can identify an appropriate
29 market risk premium and an appropriate Beta.

1 **Q. How did you calculate the return on equity?**

2 A. As I just stated, I started with the Return on Equity allowed in the last Interstate full rate
3 filing of 11.5% and compared it to the recent returns on equity allowed by the Commission. I
4 concluded that Interstate's return on equity should be at least equal to or probably greater than the
5 much larger electric and gas companies receiving allowances of 10.5% to 11%. Further, neither
6 the electric nor gas companies have direct competition as Interstate has now.

7
8 If I use a more recent authorized return on equity by the Commission of 11% and add a minor
9 factor (.5 percent) for Interstate's smaller more risky size and competition I arrive at the same
10 return on rate equity allowed in the last docket. In an attempt to save ratepayer dollars Interstate
11 is proposing the continuance of the 11.5% return calculated by the Division and approved by the
12 Commission in the last Interstate rate case.

13

14 **Q. Mr. Edge, does that conclude your Rate Base and Rate of Return testimony?**

15 A. Yes.

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1 **RATE DESIGN**

2

3 **Q. Mr. Edge, what rate design issues are in this filing?**

4 A. With the exception of cars, vans and SUV's Interstate has proposed an "across-the-board"
5 rate increase for all rates in this filing, however there a number of changes that are requested in
6 the tariffs to provide Interstate more flexibility in its rate structure in order to allow it to protect
7 its life line service. The changes being requested are described in detail in Ms. Linda's
8 testimony and the proposed tariffs.

9

10 **Q. Is Interstate requesting any tariff changes to it miscellaneous charges?**

11 A. Yes, see detail in the fled tariffs.

12

13 **Q. Mr. Edge, will any of the requested changes to the tariffs result in a significant change**
14 **in rate year revenue?**

15 A. The most significant change almost a 100% increase in the car, van SUV rates may result in
16 additional income but it is impossible to tell at this time. If the rate is doubled and the volume is
17 cut in half the revenue impact is zero. I have not made an allowance for either additional
18 revenue or less revenue for this increase.

19

20 The other changes may very well decrease revenue, but it is hoped that it will actually be good
21 for the company.

22

23 **Q. Does that conclude your rate design testimony?**

24 A. Yes.

1 **RATEPAYER IMPACT**

2

3 **Q. What is the impact on ratepayers of this rate increase?**

4 A. The across-the-board increase resulted in all rates increasing 39.8%. Some of the more
5 commonly used rates increase as follows:

6

Rate	From	To
Adult Round Trip (PJ-BI)	\$12.80	\$17.90
Adult One Way (PJ-BI)	7.80	10.90
Children Round Trip (PJ-BI)	6.40	8.95
Bikes	2.25	3.15
Cars	25.95	50.00
Trucks	31.30	60.40

7

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

9 A. Yes.

WEE-1

**Test Year Revenue
Interstate Navigation**

Account Name	Revenue Test Year	Adjustments	Adjusted Revenue Test Year
-Passengers	\$ 3,708,426		\$ 3,708,426
-Vehicles	2,248,003		2,248,003
-Bar	450,775		450,775
-Charter	94,704		94,704
-Freight	569,338		569,338
-Bikes, Mopeds, etc.	133,740		133,740
-Mail	33,515		33,515
-Other	5,326		5,326
Landing Fee Commissions	31,735		31,735
Interest Income	18,529	(18,529)	0
Sale of MV Manisee		67,800	67,800
Total Revenues	\$ 7,294,090	\$ 49,271	\$ 7,343,361

Test Year Cost Of Service Expenses
Interstate Navigation

Account #	Account Name	Test Year 5/31/2003	Test Year Adjustments	Adjusted Test Year
301000	Payroll	\$ 2,321,101		\$ 2,321,101
	Payroll Taxes - FICA expense	181,257		181,257
	Depreciation	1,267,653	(563,362)	704,291
	Interest Expense	265,523	(265,523)	(0)
	Terminal Maintenance	40,989		40,989
301013	Lube	15,416		15,416
301015	Crew Expense	132,283		132,283
301017	Supplies	26,900		26,900
301019	Other Vessel Expense	16,250		16,250
301021	Wharfage	227,830	(16,690)	211,140
301022	Building Maintenance	15,457		15,457
301023	Rent	-	16,690	16,690
301025	Charter	363,000		363,000
301027	General Maintenance	10,892		10,892
301031	Bar Supplies	141,396		141,396
301035	Utilities	72,963		72,963
301037A	Auto Maintenance	5,584		5,584
301037	Auto Expense	12,751		12,751
301041/39	Local Transfer	89,969		89,969
301043	Travel	532		532
301051	Advertising	196,917		196,917
301052	Trash Removal and dumping fees	24,296		24,296
301053	Other traffic expense	60,329		60,329
301061	Office	47,317		47,317
301065	Dues and Subscriptions	3,412		3,412
301066	Professional Services	377,844		377,844
	Other Professional Fees	52,815		52,815
	Credit Card Admin Fees	73,716		73,716
	Bank Charges	2,642		2,642
	Finance Charges	437		437
	Freight	4,454		4,454
301067	Contributions	1,470		1,470
301068	Miscellaneous	9,009		9,009
301069	Telephone	116,409		116,409
301071	Employee Insurance	203,738		203,738
301072	Employee Pension	54,000	15,633	69,633
301073	PUC Expense	16,879		16,879
301081	Insurance	160,277		160,277
	Bad Debts	448		448
301083	Workmans Comp	38,988		38,988
301088	Damages	20,566		20,566
	Cash Over/Short	4,622	(4,622)	(0)
	Returned Items	1,255		1,255
	Refunds, Voids and Credits	81,979		81,979
302011/20	Municipal Tax (Real Estate & Personal Prop)	40,089		40,089

Test Year Cost Of Service Expenses
Interstate Navigation

Account #	Account Name	Test Year 5/31/2003	Test Year Adjustments	Adjusted Test Year
302013	Gross Receipt Tax	90,672		90,672
302015	Annual Report	125		125
302017	Sale and use tax	32,955		32,955
302021	CT Corp Tax	-		-
302027A	Permits and Licenses	469		469
302027	Registrations	1,027		1,027
302031	Unemployment Comp	3,002		3,002
302032	Federal Unemployment	6,942		6,942
302035	RI Unemployment	65,994		65,994
302050	Vessel Maintenance	196,604		196,604
302055	Payroll Service	11,858		11,858
302060	Computer Expense	45,975		45,975
	Fuel Expense	430,009		430,009
	Total Expenses	7,687,285	(817,874)	6,869,411
	Revenue	7,294,090	49,271	7,343,361
	Gain/ (loss)	\$ (393,195)	\$ 867,145	\$ 473,950

Statement of Revenue
Interstate Navigation
Five Year Comparison

FYE 5/31/1999, 5/31/2000, 5/31/2001, 5/31/2002, 5/31/2003

	5/31/1999	5/31/2000	5/31/2001	5/31/2002	5/31/2003
Revenue					
-Passengers	\$3,909,189.26	\$3,932,038.86	\$3,805,403.80	\$4,006,553.54	\$3,708,425.65
-Vehicles	1,951,114.96	1,912,105.58	2,074,001.29	2,167,102.37	2,248,003.22
-Bar	413,625.64	410,514.09	403,428.05	447,340.45	450,774.84
-Charter	130,684.56	108,411.73	95,570.28	97,784.72	94,703.57
-Freight	555,888.22	502,752.29	600,788.15	613,724.35	569,337.93
-Bikes, Mopeds, etc.	156,477.65	146,034.95	135,289.30	143,110.80	133,740.45
-Mail	37,514.91	36,011.52	33,504.35	33,514.91	33,514.91
-Other	7,194.93	12,746.09	6,141.50	6,394.05	5,325.54
Landing Fee Commissions	19,762.43	19,855.43	19,164.00	20,273.72	31,734.51
Interest Income	2,502.91	80,832.51	167,939.57	63,819.81	18,529.43
Cash Over/Short		3,120.80	1,553.76	13.81	
Property (RE&PP)		18,308.19			
Misc. Removal of Barge (Sale of NV Manisee)			375,000.00		

Total Revenues \$7,183,955.47 \$7,182,732.04 \$7,717,784.05 \$7,599,632.53 \$7,294,090.05

Statement of Expenses
 Interstate Navigation
 Five Year Comparison
 FYE 5/31/1999, 5/31/2000, 5/31/2001, 5/31/2002, 5/31/2003

WEE-4

Account #	Account Name	5/31/1999	5/31/2000	5/31/2001	5/31/2002	5/31/2003
301000	Payroll	\$1,790,860.31	\$1,859,566.79	\$1,996,967.13	\$2,336,464.38	2,321,101.09
	Payroll - Officers Salaries					
	Payroll Taxes - FICA expense	141,538.64	136,252.93	152,473.90	178,860.19	181,256.84
	Provision for Federal Income tax	69,617.00	116,899.00	309,150.00	52,503.00	
	Depreciation	734,141.32	740,211.32	671,520.05	676,226.27	1,267,652.64
	Interest Expense	780,561.21	754,045.13	721,645.90	688,356.31	265,522.63
	Terminal Maintenance	43,858.66	89,552.69	168,165.31	36,208.02	40,989.28
301011	Terminal Expense	31,658.73	20,204.44	25,764.69	24,243.88	
301013	Lube	11,609.71	11,715.98	19,332.21	18,018.30	15,415.61
301015	Crew Expense	26,888.59	40,149.25	32,937.88	44,687.43	132,283.06
301017	Supplies	27,348.70	34,361.19	30,537.02	32,911.47	26,899.87
301019	Other Vessel Expense	125,920.22	126,865.95	122,770.08	113,925.18	16,249.60
301021	Wharfage	216,717.49	342,166.91	227,398.17	234,523.34	227,830.09
301022	Building Maintenance	10,740.42	15,924.81	12,376.43	10,061.77	15,457.28
301023	Rent					
301025	Charter	513,500.00	310,250.00	189,500.00	119,000.00	363,000.00
301027	General Maintenance	12,277.07	23,699.42	33,155.22	77,307.10	10,891.80
301031	Bar Supplies	131,915.45	135,271.90	130,381.09	149,980.53	141,396.47
301035	Utilities	56,985.58	73,998.43	68,344.83	70,570.40	72,962.66
301037A	Auto Maintenance	2,391.29	351.80	1,803.93	1,929.18	5,583.84
301037	Auto Expense	6,213.06	12,961.40	9,985.59	12,532.31	12,751.28
301041/39	Local Transfer	82,232.62	72,241.60	63,659.99	85,639.60	89,969.00
301043	Travel	284.00	333.81	1,366.12	184.64	531.50
301051	Advertising	152,217.25	172,807.00	174,269.73	230,738.06	196,917.23
301052	Trash Removal and dumping fees				20,415.28	24,296.21
	Misc - removal of barge	75,000.00				
301053	Other traffic expense	74,971.78	66,564.84	70,385.51	92,637.13	60,329.02
301061	Office	52,685.90	56,153.47	49,077.38	51,714.32	47,317.13
301065	Dues and Subscriptions	2,977.42	2,651.92	3,954.09	3,222.79	3,411.82
301066	Professional Services	377,198.05	293,171.16	256,212.90	353,597.71	377,843.76
	Other Professional Fees	46,739.10	26,181.42	33,217.60	69,755.04	52,814.56
	Credit Card Admin Fees	37,106.15	48,120.20	56,889.39	67,293.19	73,715.98
	Bank Charges	669.13	396.09	788.88	1,496.76	2,642.33
	Finance Charges	91.11	163.84	299.03	260.80	436.68
	Freight	6,306.79	4,226.25	3,567.76	7,239.77	4,454.46
301067	Contributions	1,320.00	875.00	1,585.00	1,555.00	1,470.00
301068	Miscellaneous	8,106.66		228.52	1,178.88	9,009.48
301069	Telephone	76,043.03	75,405.02	90,890.37	105,035.15	116,408.63
301071	Employee Insurance	174,189.06	166,529.74	176,650.70	209,467.64	203,737.80
301072	Employee Pension	100,153.64	48,458.80	48,458.80	123,020.73	54,000.00
301073	PUC Expense	18,353.50	37,354.75	18,403.86	19,234.19	16,879.21
301081	Insurance	157,397.31	144,659.43	154,574.33	131,539.99	160,277.02
	CT Bond Assessment	309.15	303.23	310.18		
	Bad Debts	4,549.27	4,071.12	2,380.08	1,946.52	447.78
301083	Workmans Comp	42,925.36	40,128.46	24,226.30	19,985.35	38,987.90
301088	Damages	9,259.73	9,318.71	20,456.64	24,612.75	20,565.69
301089	Penalties	263.91	277.41	250.00	1,944.61	
	Cash Over/Short	987.27				4,621.91
	Returned Items	3,501.12	1,170.07	217.95	699.75	1,255.48
	Refunds, Voids and Credits	70,536.66	63,712.43	63,611.72	77,055.79	\$81,979.04
302011/20	Municipal Tax (Real Estate & Personal Prop)	9,805.56		35,220.65	35,262.30	40,089.08
	Gross Earnings	91,209.00	91,769.00	86,101.00	81,351.65	90,672.35
302015	Annual Report	75.00	175.00	125.00	125.00	125.00
302017	Sale and use tax	31,924.45	32,442.37	34,348.31	38,859.77	32,954.54
302021	CT Corp Tax	250.00	545.00	250.00	250.00	
302027A	Permits and Licenses	1,195.00	3,667.00	1,120.00	7,853.29	468.80
302027	Registrations	224.45	198.45	251.45		1,027.45
302031	Unemployment Comp	831.40	717.46	704.37	2,119.41	3,002.08
302032	Federal Unemployment	5,145.63	5,552.01	5,331.39	6,227.87	6,942.28
302035	RI Unemployment	76,071.50	67,095.06	61,149.59	67,820.49	65,994.38
302050	Vessel Maintenance	251,209.64	185,267.52	284,442.72	244,225.06	196,603.66
302055	Payroll Service	6,249.60	7,121.21	7,329.59	9,370.19	11,858.41
302060	Computer Expense	18,405.49	24,091.61	29,391.83	24,037.02	45,975.03
	Fuel Expense	225,131.60	348,766.94	416,625.46	346,842.50	430,008.56
	Total Expenses	\$7,028,846.76	\$6,947,133.74	\$7,202,533.62	\$7,442,125.05	\$7,687,285.28
	Net Income (Loss)	\$155,108.71	\$235,598.30	\$515,250.43	\$157,507.48	(\$393,195.23)

Rate Year Summary
Interstate Navigation

	Adjusted Test Year	Adjustments	Rate Year Old rates	Rate Increase	Rate Year New rates
Revenue	\$ 7,343,361	\$ (436,331)	\$ 6,907,030	\$ 2,750,712	\$ 9,657,742
Expenses	6,869,411	1,829,489	8,698,901	40,651	8,739,552
Net Profit	<u>\$ 473,950</u>	<u>\$ (2,265,821)</u>	<u>\$ (1,791,871)</u>	<u>\$ 2,710,061</u>	<u>\$ 918,190</u>
Rate Base	\$ 8,795,532				\$ 11,465,519
Return on rate base	<u>-4.47%</u>				<u>8.01%</u>
Test Year Loss	<u>\$ (393,195)</u>				<u>\$ 918,190</u>
Test Year equity	<u>\$ 4,125,242</u>				
Return on Equity TY	<u>-9.53%</u>				

* Gross receipts tax of \$40,652 is 1.5% of the increase in expenses

**Statement of Revenue-Rate Year
Interstate Navigation**

	Adjusted Test Year	Adjustments	Adjusted Rate Year
Revenue			
-Passengers	\$ 3,708,426	\$ (597,000)	\$ 3,111,426
-Vehicles	2,248,003	174,000	2,422,003
-Bar	450,775	-	450,775
-Charter	94,704	-	94,704
-Freight	569,338	-	569,338
-Bikes, Mopeds, etc.	133,740	(18,000)	115,740
-Mail	33,515	-	33,515
-Other	5,326	4,674	10,000
Landing Fee Commissions	31,735	(5)	31,729
Sale of MV Manisee	67,800	-	67,800
	-	-	-
Total Revenue	\$ 7,343,361	\$ (436,331)	\$ 6,907,030

Expenses Summary-Rate Year
Interstate Navigation

Account #	Account Name	Adjusted Test Year	Adjustments	Adjusted Rate Year	REF
301000	Payroll	\$ 2,321,101	\$ 315,885	\$ 2,636,986	Test Pg - 19
	Payroll Taxes - FICA expense	181,257	24,668	205,925	WEE-8
	Depreciation	704,291	558,581	1,262,871	WEE-15a
	Interest Expense	(0)	-	(0)	TY LEVEL
	Terminal Maintenance	40,989	-	40,989	TY LEVEL
301013	Lube	15,416	-	15,416	TY LEVEL
301015	Crew Expense	132,283	(76,894)	55,389	WEE-10
301017	Supplies	26,900	(10,650)	16,250	TY LEVEL
301019	Other Vessel Expense	16,250	84,896	101,146	WEE-10
301021	Wharfage	211,140	177,794	388,934	WEE-12
301022	Building Maintenance	15,457	-	15,457	TY LEVEL
301023	Rent	16,690	835	17,525	WEE-12
301025	Charter	363,000	(363,000)	0	Test Pg - 19
301027	General Maintenance	10,892	20,574	31,466	WEE-10
301031	Bar Supplies	141,396	-	141,396	TY LEVEL
301035	Utilities	72,963	66	73,028	3% per year
301037A	Auto Maintenance	5,584	-	5,584	TY LEVEL
301037	Auto Expense	12,751	-	12,751	TY LEVEL
301041/39	Local Transfer	89,969	(11,220)	78,749	WEE-10
301043	Travel	532	-	532	TY LEVEL
301051	Advertising	196,917	153,083	350,000	Test Pg - 23
301052	Trash Removal and dumping fees	24,296	-	24,296	TY LEVEL
301053	Other traffic expense	60,329	12,649	72,978	WEE-10
301061	Office	47,317	4,073	51,390	WEE-10
301065	Dues and Subscriptions	3,412	-	3,412	TY LEVEL
301066	Professional Services	377,844	-	377,844	Test Pg - 22
	Other Professional Fees	52,815	-	52,815	Test Pg - 22
	Credit Card Admin Fees	73,716	15,480	89,196	Test Pg - 24
	Bank Charges	2,642	-	2,642	TY LEVEL
	Finance Charges	437	-	437	TY LEVEL
	Freight	4,454	-	4,454	TY LEVEL
301067	Contributions	1,470	-	1,470	TY LEVEL
301068	Miscellaneous	9,009	-	9,009	TY LEVEL
301069	Telephone	116,409	24,445	140,854	Test Pg - 24
301071	Employee Insurance	203,738	34,968	238,706	WEE-9
301072	Employee Pension	69,633	9,477	79,110	WEE-9
301073	PUC Expense	16,879	-	16,879	TY LEVEL
301081	Insurance	160,277	72,783	233,060	Test. Pg - 21
	Bad Debts	448	-	448	TY LEVEL
301083	Workmans Comp	38,988	-	38,988	TY LEVEL
301088	Damages	20,566	-	20,566	TY LEVEL
	Returned Items	1,255	-	1,255	TY LEVEL
	Refunds, Voids and Credits	81,979	(10,600)	71,379	WEE-10

Expenses Summary-Rate Year
Interstate Navigation

Account #	Account Name	Adjusted Test Year	Adjustments	Adjusted Rate Year	REF
302011/20	Municipal Tax (Real Estate & Per	40,089	8,018	48,107	WEE - 14
302013	Gross Receipt Tax	90,672	-	90,672	Adj. onWEE-5
302015	Annual Report	125	-	125	TY LEVEL
302017	Sale and use tax	32,955	-	32,955	TY LEVEL
302021	CT Corp Tax	-	250	250	Prev Yr Lev.
302027A	Permits and Licenses	469	2,392	2,861	WEE-10
302027	Registrations	1,027	(687)	340	WEE-10
302031	Unemployment Comp	3,002	409	3,411	WEE-8
302032	Federal Unemployment	6,942	945	7,887	WEE-8
302035	RI Unemployment	65,994	8,981	74,976	WEE-8
302050	Vessel Maintenance	196,604	19,660	216,264	Test. Pg - 25
302055	Payroll Service	11,858	-	11,858	TY LEVEL
302060	Computer Expense	45,975	4,712	50,688	Test. Pg - 25
	Fuel Expense	430,009	43,756	473,765	WEE - 11
	Homeland Security *	-	547,460	547,460	Test. Pg - 25
	FIT	-	105,701	105,701	WEE-17
	Rate Case Expense	-	50,000	50,000	Test Pg - 22
	Total Expenses	6,869,411	1,829,489	8,698,901	
	Revenue	7,343,361	(436,331)	6,907,030	
	Gain/ (loss)	\$ 473,949	\$ (2,265,821)	\$ (1,791,871)	

* Please note that the amount per this schedule does not agree with the testimony due to an oversight in updating the schedule. The \$702,105 amount in the testimony is the correct amount. This will be corrected on rebuttal.

**Payroll Tax Calculations-Rate Year
Interstate Navigation**

Payroll Expense for the rate year \$ 2,636,986

Payroll Tax Accounts:

Payroll Taxes - FICA expense	205,925
Unemployment Comp	3,411
Federal Unemployment	7,887
RI Unemployment	74,976

The above was calculated using the same ratio as the test year:

Payroll Taxes - FICA expense:

$\frac{\text{TY FICA}}{\text{TY Payroll}}$	equals	$\frac{181,257}{2,321,101}$	times	\$ 2,636,986	equals	<u>\$ 205,925</u>
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Unemployment Comp:

$\frac{\text{TY UC}}{\text{TY Payroll}}$	equals	$\frac{3,002}{2,321,101}$	times	\$ 2,636,986	equals	<u>\$ 3,411</u>
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Federal Unemployment:

$\frac{\text{TY FU}}{\text{TY Payroll}}$	equals	$\frac{6,942}{2,321,101}$	times	\$ 2,636,986	equals	<u>\$ 7,887</u>
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RI Unemployment:

$\frac{\text{TY RIU}}{\text{TY Payroll}}$	equals	$\frac{65,994}{2,321,101}$	times	\$ 2,636,986	equals	<u>\$ 74,976</u>
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**Fringe Benifs - Rate Year
Interstate Navigation**

Pension expense:

Payroll Expense for the rate year	\$ 2,636,986
Pension Funding Rate 3%	<u>0.03</u>
Pension expense	<u>\$ 79,110</u>

Health Insurance:

Test Year Level of expenditure:

Interim Year:

Blue Cross - RI	\$ 202,548
Delta Dental - RI	1,528
Delta Dental - Conn	<u>21,118</u>
Total	<u>\$ 225,194</u>
Interim Year times 6%	<u>\$ 238,706</u>

**Five Year Average Expenses Summary
Interstate Navigation**

Account Name	5/31/1999	5/31/2000	5/31/2001	5/31/2002	5/31/2003	Rate Year Average
Crew Expense	\$ 26,889	\$ 40,149	\$ 32,938	\$ 44,687	\$ 132,283	\$ 55,389
Other Vessel Expense	125,920	126,866	122,770	113,925	16,250	101,146
Total	\$ 152,809	\$ 167,015	\$ 155,708	\$ 158,613	\$ 148,533	\$ 156,535
General Maintenance	12,277	23,699	33,155	77,307	10,892	31,466
Local Transfer	82,233	72,242	63,660	85,640	89,969	78,749
Other traffic expense	74,972	66,565	70,386	92,637	60,329	72,978
Office	52,686	56,153	49,077	51,714	47,317	51,390
Refunds, Voids and Credits	70,537	63,712	63,612	77,056	81,979	71,379
Permits and Licenses	1,195	3,667	1,120	7,853	469	2,861
Registrations	224	198	251		1,027	340
					291,982	309,162
					<u>\$ 440,515</u>	<u>\$ 465,698</u>
Difference						<u>\$ 25,183</u>

NOTE: Charges to Crew Expense and Other Terminal Expense were classified differently in 2003

**Calculation of Fuel for the Rate Year
Interstate Navigation**

Sample of fuel prices during the test year:

Month/Year	Rate	Dollars	Gallons	%	Weighted
June 2002	\$ 0.825	\$ 1,929	1,591	0.03	\$ 0.0252
July 2002	0.866	2,780	3,000	0.06	0.0499
August 2002	0.888	3,169	3,335	0.06	0.0569
September 2002	0.935	6,002	6,000	0.12	0.1078
October 2002	0.943	6,072	6,018	0.12	0.1090
November 2002	0.899	3,124	3,248	0.06	0.0561
December 2002	1.02	5,457	5,000	0.10	0.0980
January 2003	1.084	5,924	5,107	0.10	0.1063
February 2003	1.33	6,706	4,712	0.09	0.1204
March 2003	1.238	6,378	4,815	0.09	0.1145
April 2003	1.057	4,749	4,199	0.08	0.0853
May 2003	0.921	4,963	5,036	0.10	0.0891
Total gallons			<u>52,061</u>	1.00	\$ 1.0184
Current Price November 2003					<u>\$ 1.0500</u>
Increase					<u>\$ 0.0316</u>
Percentage increase (\$.0316/\$1.0184)					3.11%
Test Year Dollars					<u>\$ 430,009</u>
Price Adjustment (\$430,009*3.11%)					\$ 13,356
Net additional fuel for the MV Anna C					<u>30,400</u>
					<u>\$ 43,756</u>

NOTE: Per Drew Oil it is impossible to predict the increase or decrease in fuel prices for FY 2005. Therefore, I simply used the current price to project the rate year fuel cost.

**Wharfage and Rent for the Rate Year
Interstate Navigation**

Wharfage:

	<u>Test Year</u>	<u>Rate Year</u>
Point Judith Dock (State of R I)	\$ 39,356	43,390
Old Harbor:		
Test Year	120,000	
6/1/04 - 9/30/04		40,000
10/1/04 - 5/31/05		158,333
Fort Adams	8,500	9,105
Montville Dock	43,284	138,105
	<u>\$ 211,140</u>	388,934
Total		
Test Year Wharfage		<u>211,140</u>
Adjustment		<u>\$ 177,794</u>

Rent:

	<u>Test Year</u>	<u>Rate Year</u>
RIDEM Restrooms	1,525	1,601
Conn. Office	13,500	14,175
Lakeside Storage	325	341
Office Trailer	1,340	1,407
	<u>\$ 16,690</u>	17,525
Total		
Less T/Y		<u>16,690</u>
Adjustment		<u>\$ 835</u>

Schedule 13

Legal Matters Handled By Schacht & McElroy For Interstate Navigation Company -- September 2000 - September 2003.

1. General Litigation:

- Assist in defense of various claims and lawsuits from passengers for personal injuries and/or property damages.
- Defense of sign citations from the Town of Narragansett.
- Research and implement 1-year statute of limitation for the filing of suits by ferry passengers.
- Handle suit to stop Island Hi-Speed Ferry from using "Block Island High Speed Ferry" in its advertising and signs.
- Research regarding failure of reduction gear on *M/V Block Island* and whether Interstate has a legal claim regarding the same.
- Defense of lawsuit filed by the Town of Narragansett seeking \$85,000 and preparation of counter claim regarding the same and Narragansett's failure provide agreed upon services.

2. Emergency preparedness matters post 9/11:

- Assist with port security activity, including, but not limited to, implementing new extensive port security regulations.
- Obtain various approvals necessary in order to implement the port security project.
- Assistance with Red Cross collection effort for 9/11-disaster relief fund.
- Assistance with Coast Guard terrorism survey and related matters.
- Legal research regarding the authority of common carriers to search passengers in response to terrorism threats.
- Research regarding Coast Guard authority to order security upgrades.
- Exchange of correspondence with the Coast Guard regarding emergency preparedness issues.
- Various discussions and meetings with Block Island Chief of Police regarding emergency preparedness issues, training of crew personnel, purchase of emergency response equipment, preparation of security assessment, and related matters.
- Research and implement application for a port security grant and coordinate the same with Block Island police chief.
- Preparation of extensive documentation required to support port security grant.
- Review of new homeland security regulations related to ferries and ports and summarize for client.

3. Negotiations with Coast Guard:

- Regarding status of captain of *M/V Nelseco*.

4. Dealings with the Town of Block Island (New Shoreham):

- Assistance with proposed parking lot zoning ordinance on Block Island.
- Review of legislation and negotiations regarding proposed Block Island Transportation Committee.
- Negotiations with the Town of New Shoreham regarding construction of hospitality center on Interstate property.
- Review of Block Island traffic study and comment on the same and related meetings.
- Assistance to Interstate with regard to negotiating changes in the schedule with the Town of New Shoreham.
- Challenge the placement of an internet web camera on Block Island and obtain its removal from viewing Interstate's passengers and activities.
- Handle annual disbursements of landing fee receipts to the Town of New Shoreham.
- Negotiations regarding proposed construction of a dock in Old Harbor that would interfere with Interstate's operations.
- Handle annual renewal of landing fee contract with the Town of New Shoreham.
- Handle tax abatement request to the Town of New Shoreham.
- Review of revised comprehensive plan for the Town of Block Island as it relates to ferry and transportation issues.
- Represent Interstate with regard to issues related to a possible Jitney running between Old Harbor and New Harbor.
- Represent Interstate with regard to moving Town sewer trucks from regular runs to hazardous waste runs. Participate in negotiations with Town regarding the same. Formulate agreed upon tariff and obtain tariff approval from the PUC.

5. Representation at CRMC:

- At hearing on ferry terminal expansion.
- Defend Interstate on CRMC investigation regarding Block Island landing facility and negotiate resolution of the same.
- Research new law regarding expanded jurisdiction of the CRMC.

6. Negotiation and Preparation of Leases:

- Prepare documentation exercising options to renew Point Judith leases.
- Prepare Beach Avenue lease. Prepare Montville Dock lease. Provide advice to Interstate regarding interpretation of Old Harbor lease payments provisions.

7. Contracts:

- Review of bulkhead replacement contract with engineer for bulkhead on Block Island.
- Annually negotiate and renew license with the State of Rhode Island for dock in Newport.

8. Negotiations and dealings with the Town of Narragansett:

- Handle annual disbursements of landing fee receipts to the Town of Narragansett.
- Legal challenge of the Town of Narragansett's taxation of Interstate's vessels.
- Negotiations with the Town of Narragansett regarding police details.
- Negotiation of new landing fee contract with the Town of New Shoreham and Island Hi-Speed Ferry.
- Assist with the implementation of new Narragansett 35¢ landing fee.
- Represent Interstate with regard to Galilee special district plan and zoning issues related thereto and amendment to the Narragansett comprehensive plan related thereto, including sign ordinance amendments.
- Research regarding legal prohibitions against Narragansett enacting overnight parking restrictions or requiring off-site parking.
- Negotiations in an attempt to resolve Narragansett landing fee litigation.

9. Point Judith Project:

- Negotiations regarding escrow of funds for Point Judith terminal relocation project and agreement regarding the same.
- Review and comment upon new Galilee port operation rules.
- Assist with negotiations regarding possible development of Connector Road lots and possible use of ISTEA funds in connection with the same.
- Handle request for additional ISTEA federal funding and draft documentation and negotiate regarding the same.
- Review of bid specifications for terminal project.
- Represent Interstate at pre-bid conference for terminal project.
- Attend terminal expansion bid opening and discuss options available regarding rejection of the same because they were so high.
- Assist in developing strategy to reduce the cost of the terminal expansion project.
- Assist with the design of possible parking lot in Galilee at the request of DEM and make proposal regarding the same for employee parking for Galilee businesses.
- Prepare for and represent Interstate at Galilee Lease Committee meeting to obtain approval of revised terminal plans.
- Assist in appeal for terminal building variance in Galilee.
- Research issues related to the availability of the Sunflower Restaurant, especially with regard to zoning prohibitions regarding the same.

10. Financial:

- Numerous reviews of financial operating results in consultation with Walter Edge and Susan Linda.
- Review annual PUC reports prepared by Walter Edge and discuss the same with him and its implications with Susan Linda.
- In light of floating portion of new loan rates, chart on a daily basis the same for analysis by accountant and Susan Linda to elect balance of fixed rate portion of loan at the appropriate time.

11. Legislation:

- Assist lobbyist in all legislation introduced in the Rhode Island Legislature that may affect Interstate, provide information to him for his use in representing Interstate at the Legislature.
- Assist with attempts to receive partial legislative reimbursement for repair by Interstate of the state's bulkhead at Galilee.
- Research and advice regarding laws applicable to employment of teenagers and federal wage and hour laws.
- Research regarding air emissions requirements for ferries.
- Research regarding ferry holding tank requirements.
- Meet with Senator Celona and representatives of the Division to discuss pending legislation.

12. PUC/DPUC Matters:

- Assist in finalizing annual schedule and filing of the same with the PUC.
- Prepare filing with the Division for loan refinance approval.
- Prepare for and represent Interstate at Division hearing on refinance of Washington Trust loan. Review report and order regarding the same.
- Research regarding PUC condemnation authority.
- Implement 1.4% rate reduction and implement collection of 35¢ Narragansett landing fee and preparation of necessary notifications to the PUC.
- Review of new bill regarding notification to Block Island of PUC filings.
- Assist in the preparation of DPUC testimony for modification of DPUC loan modification approval.
- Review of revisions to the Public Utility Act and summarize for client.
- Represent Interstate in negotiations with PUC regarding filing of annual reports and request for rule-making regarding the same.
- Assist in implementation of fuel surcharge, including filings with the Division regarding the same.
- Review PUC memorandum regarding revised rules for filing of notice and publication of rate changes.
- Prepare petition to DPUC for permission to provide free tickets in connection with 100,000th passenger celebration.
- Preparation of comments on water carrier financial reporting regulations proposed by PUC.
- Prepared comments regarding new digital filing requirements.
- Represent Interstate at water carrier financial reporting hearings.
- Represent Interstate at DPUC rule-making hearing regarding digital filings.
- Represent Interstate in connection with negotiations regarding possible global settlement of all issues with the DPUC and IHSF and the Town of Block Island.
- Handle initial legal aspects of 2003 rate filing.

13. Organizational Matters:

- Various negotiations with minority shareholders, their attorney and accountant and provide information to them at each annual meeting.
- Prepare summary of activities and represent Interstate at each corporate annual meeting.
- Assist with regard to the legal aspects of the installation of automated telephone equipment.
- Advice regarding issuance of Coast Guard certificates of inspection.
- Drafting of sexual harassment notice required by recent new law regarding the same.
- Extended negotiations with Washington Trust Company and various Rhode Island financial institutions regarding refinancing Interstate's debt at a lower interest rate.
- Research regarding whether tickets can be non-refundable.
- Analyze whether purchase or lease of forklifts would be better. Review of forklift leases.
- Develop final strategy for negotiating substantially reduced pre-payment penalty on Washington Trust loan and implement the same.
- Preparation of Secretary of State annual report forms. Prepare annual meeting forms and related correspondence.
- Research regarding Rhode Island overtime laws.
- Review of AGM contract regarding construction of bulkhead on Block Island. Review of engineering specifications regarding the same. Review of Block Island lease regarding the same and approval needed by the lessor. Review of loan documents regarding whether lender approval is necessary. Prepare notice to lessor regarding bulkhead reconstruction.
- Discuss implementation of additional safety procedures in light of Cross Sound Ferry accident.
- Discuss with client the pros and cons of purchasing the M/V Anna C from Nelseco Navigation and analyze the same.
- Negotiations regarding extension of Old Harbor lease.

14. Stockholder Issues:

- Legal advice regarding implications of deaths of certain shareholders.
- Legal research regarding minority shareholder rights and obligations. Preparation of opinion letter regarding the same.
- Handle various negotiations regarding death of minority stockholders and revise corporate records regarding the same.
- Assist in the preparation of new stock certificates as a result of minority stockholder deaths.
- Research regarding valuation of minority shares.

15. Handled various matters relating to Island Hi-Speed Ferry:

- Division litigation related to IHSF application for a Certificate of Public Convenience and Necessity (CPCN).
- Superior Court appeal of Division's decision granting a CPCN.
- Intervention in IHSF's first PUC rate case.

- Supreme Court appeal of PUC decision setting rates for IHSF.
- Superior Court suit regarding service mark infringement by IHSF.
- PUC and Supreme Court litigation related to whether IHSF's financial reports will be held as secret.
- Attempted intervention in IHSF's second rate case.
- Litigation at the Division regarding increase in IHSF passenger capacity from 149 to 250.
- Division litigation regarding IHSF's carrying bikes for free and whether a rate needed to be imposed for bikes.
- Participation in Division approval of transfer of 50% ownership in IHSF to Boston Harbor Cruises.
- Advice regarding IHSF's landing in New Harbor and resulting Superior Court and Supreme Court litigation regarding the right to land in New Harbor, despite a zoning ordinance prohibiting it.
- Division litigation regarding IHSF's petition to bar Interstate from operating a high speed ferry and subsequent Superior Court and Supreme Court litigation regarding the same.
- Advice regarding IHSF's attempts to run a ferry from New London to Block Island.
- Monitor lawsuit between IHSF partners.
- Request for investigation regarding IHSF failure to file lease for its vessel.
- (Note: some of the IHSF work extends past the 3-year cut-off, but was included in the interest of completeness.)

**Municipal Taxes
Interstate Navigation**

Interstate paid the following municipal property taxes in the past three years:

	<u>5/31/2001</u>	<u>5/31/2002</u>	<u>5/31/2003</u>
Town of New Shoreham	\$ 25,022	\$ 20,792	\$ 24,631
Town of Narragansett	4,765	5,063	4,325
Town of Montville	4,255	8,251	9,520
City of New London	<u>1,177</u>	<u>1,156</u>	<u>1,612</u>
	<u>\$ 35,219</u>	<u>\$ 35,262</u>	<u>\$ 40,088</u>
Per the F/S	<u>\$ 35,221</u>	<u>\$ 35,262</u>	<u>\$ 40,089</u>

**Rate Base
Interstate Navigation**

Net Utility Plant 5/31/03 \$ 8,140,478

Additions 6/1/03 through 5/31/04 (Interim Year):

6/15/2003	Bulkhead - Block Island	638,274
6/15/2003	Ramp-Block Island	21,860
9/1/2003	Truck	33,000
3/1/2004	Forklift	20,000
5/1/2004	Dredging at Montville	200,000
		<u>913,134</u>

Less Depreciation FYE 5/31/04 864,827

Utility Plant -Beginning of Rate Year \$ 8,188,784

Rate Year Additions

6/1/2004	Purchase of the MV Anna C	3,100,000
12/1/2004	Repower and upgrade the MV Carol Jean	3,000,000
6/1/2004	Up-grade of computer ticketing system	136,233
6/1/2004	Complete Point Judith project	270,000
		<u>6,506,233</u>

Rate Year Depreciation 1,262,871

Utility Plant - End Of Rate Year \$ 13,432,146

Average Utility Plant \$ 10,810,465

Working Capital (WEE-16) \$655,054

Average Rate Base for the Rate Year \$ 11,465,519

**Calculation of Depreciation by Year By Asset Group
Interstate Navigation**

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Vessels	\$ 547,306	\$ 547,306	\$ 883,408
Vessel Impro and equip	12,531	12,531	10,442
Office Equipment	70,969	76,541	122,248
Buildings	24,114	36,332	36,332
Docks and Ramps	21,150	157,840	157,840
Point Judith Project	12,288	12,288	25,397
Vehicles	15,933	20,322	25,204
Dredging		1,667	2,000
	<u>\$ 704,291</u>	<u>\$ 864,827</u>	<u>\$ 1,262,871</u>

**Working Capital for Rate Base
Interstate Navigation**

45 Day Rule:

Total Expenditures	\$ 8,698,901
45 days divided by 365	<u>12.30%</u>
Working Capital	<u><u>\$ 1,069,965</u></u>

Balance Sheet Method:

Current Assets	\$2,535,519
Current Liabilities	<u>676,372</u>
Working Capital	<u><u>\$1,859,147</u></u>

Working Capital Requested: \$655,054

**Rate of Return and Federal Income Tax
Interstate Navigation**

Description of Test Year Long Term Debt at Year End:

All borrowing is with Washington Trust and all assets are pledged.

Fixed rate 15 year loan at 6.1%	\$ 2,000,000
Variable rate 15 year amortization loan (prime less 1%)	<u>4,307,974</u>
Total per 5/31/03 Balance Sheet	<u><u>\$ 6,307,974</u></u>

Proposed Capital Structure fo the Rate Year

	Amount	% of Total	Rate	Weighted Return
Current Long Term Debt:				
Phase 1 - Fixed rate 15 year	\$ 2,000,000	13.30%	6.10%	0.0081
Phase 2 - Fixed rate 15 year	2,000,000	13.30%	7.00%	0.0093
Phase 3 - Fixed rate 15 year	2,307,947	15.35%	7.50%	0.0115
New Debt:				
Loan for Carol Jean Fixed 15 year	2,000,000	13.30%	6.40%	0.0085
Loan For Anna C Fixed 15 year	2,600,000	17.30%	6.40%	0.0111
Equity (no gain or loss in interim year)	<u>4,125,242</u>	<u>27.44%</u>	11.50%	<u>0.0316</u>
Total Capital structure	<u><u>\$ 15,033,189</u></u>	<u>100.00%</u>		<u><u>0.0801</u></u>

Calculation of Federal Income Tax:

Rate Base (WEE-15)	\$ 11,465,519
Return On Equity	<u>0.0316</u>
Taxable Income	\$ 361,817.76
Tax 1st \$100,000 (25%)	\$ 25,000
Tax on the remainder (32%)	<u>80,701</u>
Total Tax	<u><u>\$ 105,701</u></u>

NoteA: There was no FIT in the test year because of the operating loss

Note B: Deferred FIT is the result of the difference between book and tax depreciation.

**Revenue Check
Interstate Navigation**

Interstate Navigation is applying the rate increase across the board to all revenues as follows:

Revenue			
-Passengers	\$ 3,111,426	1.3982	\$ 4,350,396
-Vehicles	2,422,003	1.3982	3,386,445
-Bar	450,775	1.3982	630,273
-Charter	94,704	1.3982	132,415
-Freight	569,338	1.3982	796,048
-Bikes, Mopeds, etc.	115,740	1.3982	161,828
-Mail	33,515	1.3982	46,861
-Other	10,000	1.3982	13,982
Landing Fee Commiss	31,729	1.3982	44,364
Sale of MV Manisee	67,800	1.3982	94,798
	<u>\$ 6,907,030</u>		<u>\$ 9,657,409</u>
Per WEE-5			<u>\$ 9,657,742</u>
Rounding			<u>\$ 333</u>

**Reconciliation of Financial Statements and Test Year
Interstate Navigation**

Interstate has filed the test year using the trial balance used for the financial statements therefore, there are no reconciling items.

**Related Party Transactions
Interstate Navigation**

Interstate has the following related part transactions:

	<u>Test Year Expense</u>
Anna C Charter	\$363,000
Wharfage:	
Interstate Nav.	120,000
Waterfront Reality	<u>43,284</u>
Related party total	<u><u>\$526,284</u></u>