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Patrick C. Lynch, Attorney General

October 27, 2006

Via Electronic Mail and Regular Mail

Luly Massaro, Clerk
Public Utilities Commission
89 Jefferson Blvd.
Warwick, RI 02888

Re: Interstate Navigation Company – General Rate Filing – Traditional Rates – Docket No. 3762

Dear Ms. Massaro:

Enclosed for filing in the above-captioned proceeding are the original and nine (9) copies of the pre-filed testimony and exhibits of Mr. David J. Effron on behalf of the Rhode Island Division of Public Utilities and Carriers.

Very truly yours,

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cc: Service List PUC Docket No. 3762

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the within pre-filed testimony and exhibits was served this 27th day of October, 2006, via electronic and first class mail, postage prepaid, upon each person on the official service list in this proceeding.

INTERSTATE NAVIGATION COMPANY

TRADITIONAL SERVICE RATES

RIPUC DOCKET NO. 3762

**BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION**

**TESTIMONY AND EXHIBITS
OF DAVID J. EFFRON**

ON BEHALF OF THE

**DIVISION OF
PUBLIC UTILITIES AND CARRIERS**

OCTOBER 27, 2006

RIPUC DOCKET NO. 3762
DIRECT TESTIMONY
OF DAVID J. EFFRON

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is David J. Effron. My business address is 12 Pond Path, North Hampton, New Hampshire, 03862.

Q. What is your present occupation?

A. I am a consultant specializing in utility regulation.

Q. Please summarize your professional experience.

A. My professional career includes over twenty-five years as a regulatory consultant, two years as a supervisor of capital investment analysis and controls at Gulf & Western Industries and two years at Touche Ross & Co. as a consultant and staff auditor. I am a Certified Public Accountant and I have served as an instructor in the business program at Western Connecticut State College.

Q. What experience do you have in the area of utility rate setting proceedings?

A. I have analyzed numerous electric, gas, telephone, and water filings in different jurisdictions. Pursuant to those analyses I have prepared testimony, assisted attorneys in case preparation, and provided assistance during settlement negotiations with various utility companies.

I have testified in over two hundred cases before regulatory commissions in Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia, and Washington.

Q. Please describe your other work experience.

A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was responsible for reports and analyses concerning capital spending programs, including project analysis, formulation of capital budgets, establishment of accounting procedures, monitoring capital spending and administration of the leasing program. At Touche Ross & Co., I was an associate consultant in management services for one year and a staff auditor for one year.

Q. Have you earned any distinctions as a Certified Public Accountant?

A. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest scores in the May 1974 certified public accounting examination in New York State.

Q. Please describe your educational background.

A. I have a Bachelor's degree in Economics (with distinction) from Dartmouth College and a Masters of Business Administration Degree from Columbia University

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Rhode Island Division of Public Utilities and Carriers ("the Division").

Q. What is the purpose of your testimony?

A. I am addressing the revenue requirement of Interstate Navigation Company ("Interstate" or "the Company") based on its proposed test year consisting of the twelve months ended November 30, 2005 and its proposed rate year of calendar 2007. I also address the design of rates necessary to produce the Company's required revenues.

In addition, I present the Division's proposal to implement an incentive based rate plan for Interstate. Such incentive based rate plans have worked well for Narragansett Electric Company and New England Gas Company, and the Commission should consider implementation of a similar rate plan for Interstate.

Q. Please summarize your testimony.

A. I have calculated a net revenue requirement of $8,931,394 for services provided pursuant to rates established by the Rhode Island Public Utilities Commission ("Commission"). This net revenue requirement represents the total cost of service less miscellaneous revenues. The net revenue requirement of $8,931,394 represents an increase of 10.48% over the revenues produced by base rates presently in effect for traditional services.

Rates for freight should not be increased at this time. Rates applicable to commuter passengers and vehicles should not be increased by more than 5%. The remaining revenue deficiency should be spread equally to other rates regulated by the Commission. Based on the revenue deficiency I have calculated, this would result in an increase of 12.35% to those other rates.

The Commission should consider the implementation of an incentive based rate plan for Interstate with the following elements: a five year term, a rate freeze with limited exceptions for certain rate classes, and an earnings sharing mechanism.

III. REVENUE REQUIREMENT

A. SUMMARY

Q. Have you prepared a summary of Interstate's net revenue requirement?

A. Yes, I prepared a summary on my Schedule DJE-1. On this schedule, I compare the Company's presentation of its revenue deficiency to the Division's recommendation. I have begun with Interstate's total cost of service. The cost of service includes all elements of the Company's revenue requirement, including the return on rate base. I then subtract the miscellaneous revenues earned by Interstate. The miscellaneous revenues include bar, mail, landing fee commissions, miscellaneous charter, miscellaneous income, and other. These revenues come from services that are not provided pursuant to Interstate's Commission approved tariffs for traditional ferry service. The cost of service net of miscellaneous revenues is the revenue requirement from services that are provided pursuant to Interstate's Commission approved tariffs. The difference between the net revenue requirement and the test year revenues earned from tariff service is the Company's revenue deficiency.

Interstate has calculated a revenue deficiency of $2,438,522, which is equal to 30.26% of test year tariff revenues. I have calculated a revenue deficiency of $873,587, which is equal to 10.84% of test year tariff revenues

B. COST OF SERVICE

Q. What are the elements of the cost of service?

A. As presented by Interstate, the elements of the rate year cost of service are cash operating expenses (which include operation and maintenance expenses and taxes other than income taxes), depreciation, income taxes, and return on rate base. These elements of the total cost of service are summarized on my Schedule DJE-2.

Q. Are you proposing adjustments to the rate year cost of service calculated by the Company?

A. Yes. The Company has calculated a pro forma cost of service, based on its 2007 rate year, of $11,333,579. Based on the adjustments to the Company's position that I have identified, I am proposing a total cost of service of $9,990,570. I address the individual adjustments to the Company's cost of service in the following testimony.

1. Cash Operating Expenses

a. Payroll

Q. How has Interstate calculated its pro forma payroll expense?

A. Interstate calculated its pro forma payroll expense by escalating the actual test year payroll expense 5% annually from the test year to the rate year. The purpose of the escalation is to provide for the wage rate increases that would normally be granted to Interstate employees from year to year.

Q. Is the 5% annual escalation rate appropriate?

A. No. As noted in the testimony of Mr. Edge, 5% is the cap established by Interstate for year to year increases in payroll costs. I understand a cap to mean that the annual increases can be less, but not more. To justify his projection of 5% annual increases, Mr. Edge presents an analysis of payroll increases from fiscal 2003 to the test year. In his analysis, he includes payroll related to Homeland Security, which was 0 in fiscal year 2003 and $193,710 in the test year.

It is inappropriate to include payroll related to Homeland Security in this analysis. That payroll is included in a separate account, and the increases in payroll related to the addition of Homeland Security personnel have nothing to do with increases related to changes in wage *rates*. In the Company's last rate case, the Homeland Security expenses, including payroll, were treated as being incremental to the Company's other operations and subjected to a reconciling mechanism. Importantly, Interstate has not identified any prospective factors that would cause the same increase in payroll that the implementation of the Homeland Security programs caused. Therefore, the increase in payroll related to the implementation of the Homeland Security programs should not be included in the determination of the likely increase in payroll expense from the test year to the rate year.

Q. What do you recommend?

A. I believe that the actual payroll increases from fiscal 2003 to the test year, excluding Homeland Security, is a proper basis for projecting the increase in payroll expense from the test year to the rate year. The payroll excluding Homeland Security increased from $2,321,102 in fiscal 2003 to $2,511,753 in the test year, an increase of 8.2% over that

2.5 year period. This translates into an annual rate of increase of approximately 3.2%. Projecting this annual rate of increase from the test year to the rate year, the result is a rate year payroll expense of $2,683,582 (Schedule DJE-3, Page 2). This is $101,790 less than the rate year payroll expense projected by Interstate. Accordingly the pro forma operating expenses included in the Company's revenue requirement should be reduced by $101,790.

b. Payroll Taxes

Q. Should the payroll taxes included in the Company's revenue requirement be adjusted?

A. Yes. The payroll taxes are a function of the payroll expense. Based on the Company's exhibits, payroll taxes are 11.66% of payroll. Consistent with my proposed adjustment to payroll expense, pro forma payroll taxes should be reduced by $11,873 (Schedule DJE-3, Page 2).

c. Employee Insurance

Q. Are you proposing any adjustments to the pro forma employee insurance expense calculated by the Company?

A. Yes. The employee insurance expense consists of health and dental insurance. First, as acknowledged in the response to DIV 2-6, the Company erroneously included health insurance expense related to an extra employee. The cost of the health insurance to this extra employee should be eliminated.

Second, employees are required to pay 15% of the gross health insurance premiums as a contribution (response to COM 1-9). The Company did not take this co-payment requirement into account in the calculation of pro forma health and dental insurance expense. Therefore, the Company's calculation must be corrected to recognize the employee co-payment requirement.

Finally, Interstate has projected an annual increase of 15% per year in its calculation of the projected rate year expense. The projected annual increase of 15% is based on the Company' calculation of the average annual percentage increase from Fiscal Year 2003 through Calendar Year 2006. However, the Calendar Year 2006 health insurance costs for the purpose of this calculation must be corrected to eliminate the extra employee and to recognize the effect of employee co-payment requirement. In addition, the calculation of the historic rate of increase is affected by the choice of the starting point. For example, the actual employee insurance expense decreased from Fiscal Year 2002 to Fiscal Year 2003. If the Company had chosen Fiscal Year 2002 instead of Fiscal Year 2003 as the starting point, the calculated annual rate of increase would be sharply reduced. Making the necessary corrections, and considering the rate of escalation from Fiscal Year 2002 as well as the rate of escalation from Fiscal Year 2003, I believe that an escalation rate of 10% would be more appropriate than the Company's calculated rate of 15%.

Q. With your proposed modifications, what rate year employee insurance expense have you calculated?

A. I have calculated rate year employee insurance expense of $329,625 (Schedule DJE-3, Page 2). This is $86,457 less than the rate year employee insurance expense of $416,082 calculated by the Company.

d. Crew Expense

Q. How did Interstate determine the rate year crew expense?

A. The Company adjusted the actual test year crew expense by the same percentage as it adjusted the actual test year payroll expense.

Q. Are you proposing to modify the Company's rate year crew expense?

A. Yes. As I have modified the Company's proposed adjustment to payroll expense, the percentage increase to the actual test year crew expense should also be modified. I am proposing an increase in payroll expense of 6.84% from the test year to the rate year. Increasing the actual test year crew expense by 6.84%, the result is a rate year expense of $136,283, which $5,171 less than the rate year expense calculated by the Company (Schedule DJE-3, Page 2).

e. Wharfage

Q. Has the Company proposed a pro forma adjustment to the actual wharfage expense incurred in the test year?

A. Yes. Wharfage is the cost of leases for Interstate to land its fleet at the docks where the vessels arrive. The Company has proposed an adjustment of $51,649 to the actual test year wharfage. The largest component of this adjustment is an increase of $39,124 to the wharfage fees at the Port Judith dock. This represents a doubling of the actual fees at Port Judith in the test year.

Q. Has the Company provided any documentation to support the increase of $39,124 to the wharfage fees at the Port Judith dock?

A. No. Based on the response to Division Data Request 1-5, the increase is based on conversations between Interstate's legal counsel and DEM's legal counsel.

Q. Is this adequate support for the pro forma adjustment to the Port Judith wharfage fees?

A. No. Unless the Company can provide documentation supporting the forecasted doubling of the wharfage fees at the Port Judith dock, this pro forma adjustment should be eliminated from the determination of the Company's revenue requirement. Elimination of this unsupported adjustment reduces the Company's cost of service by $39,124 (Schedule DJE-3, Page 1).

f. Homeland Security

Q. Please describe the Homeland Security expense included in the Company's revenue requirement.

A. The Homeland Security expense is an allowance for expenses incurred to comply with port security regulations implemented by the federal government subsequent to September 11, 2001. The annual allowance for such expenditures has been $395,956, with this annual allowance for Homeland Security being reconciled to actual expenditures. That is, the annual allowance is accrued to a liability, or reserve, account, and actual expenditures are charged against the reserve. This treatment has been in effect since the beginning of Fiscal Year 2005.

Q. What is the status of the reserve account?

A. Based on Schedule WEE-8, the total "expenditures" in Fiscal Year 2005 were $417,516 and the expenditures in Fiscal Year 2006 were $340,946. As of May 31, 2006, there was a credit balance of $33,450.

Q. Is the Company's accounting appropriate?

A. No. Included in the expenditures in Fiscal Year 2005 is a "Contingency Reserve" of $50,000. This is not really an expenditure at all, but simply an accounting entry that has the effect of overstating the actual expenditures. In addition, such an entry is inappropriate and unnecessary, as any credit balance in the reserve account is itself a reserve for future expenditures. The actual expenditures in Fiscal Year 2005 were $367,516, and the credit balance in the reserve account as of May 31, 2006 should be $83,450.

Q. What is the Company's proposed Homeland Security expense for the rate year?

A. Interstate is forecasting total Homeland Security expenditures of $417,650, but is proposing to maintain the annual allowance included in its revenue requirement at $395,956.

Q. Are you proposing to adjust the Company's proposed Homeland Security expense?

A. Yes. After wages and salaries, the largest component of the rate year Homeland Security expense account is capital additions of $144,730. Expenditures on capital additions should not be treated as period costs and charged to expense in the year of the expenditures. Capital additions, by definition, are expected to have a useful life of more than one year. Such expenditures should be capitalized and depreciated over their useful lives, in order to achieve a proper matching between the cost of the capital additions and the customers getting the benefits of the capital additions. In other words, it is improper to require ratepayers in a given year to pay for the full cost of capital additions in that year when the purpose of such additions is to provide service to ratepayers over a number of years. Accordingly, the expenditures for capital additions should be eliminated from the rate year Homeland Security expense. The capital additions should be charged to their appropriate capital accounts and depreciated over their useful lives.

The rate year Homeland Security expense also includes $57,420 for the line item designated as "operations". In Fiscal Year 2005 actual operations expense was $26,466, and in Fiscal Year 2006 actual operations expense was $15,046. Interstate has not described any circumstances that would indicate an increase in the operations expense being forecasted. The forecasted operations costs included in the Homeland Security expense should be reduced.

Q. What do you recommend?

A. Interstate has forecasted personnel expense of $202,900 for the rate year. Based on the historical level of personnel expense, that amount does not seem unreasonable. The actual average operations expense for the last two years was approximately $21,000 per year. Adding these two categories of expense together, the total is $223,900.

The mechanism of accruing $395,956 per year for Homeland Security was established before any data on actual spending were available. After two years, there is a better idea of the actual level of Homeland Security expense. Therefore, the accrual mechanism should be discontinued and the actual Homeland Security expense, not including capital expenditures charged to plant accounts, should be charged to operation and maintenance expense, as are the other elements of the Company's cost of service. Further, the balance in the reserve account as of May 31, 2006 should be flowed back to customers. Amortization of that balance, $83,450, over three years reduces the pro forma Homeland Security expense by $27,817. I am proposing a pro forma Homeland Security Expense of $196,083 (Schedule DJE-3, Page 3), which is $199,873 less than the expense proposed by the Company. To the extent the Company accrues a balance in the reserve account from May 31, 2006 until the rates in this case go into effect, that balance should be addressed in the Company's next rate case.

g. Local Transfer

Q. What is local transfer expense?

A. Local transfer expense is the cost of delivering UPS packages sent to the Island on Interstate's boats to their final destinations. Interstate pays Lamb's Package Services ("LPS") to make these deliveries. Interstate is reimbursed by UPS for its payments to LPS (response to DIV 1-20), with the reimbursements being included in revenue.

Q. How did Interstate calculate the rate year local transfer expense?

A. Interstate calculated that the average annual increase in this expense over the last five years was 21.1%. The Company then applied this annual rate of increase to project the local transfer expense to the rate year. This method resulted in an increase of $38,452 to the test year local transfer expense.

Q. Is this adjustment appropriate?

A. No. As noted above, Interstate is reimbursed by UPS for the local transfer expense. If the local transfer expense increases, so will the reimbursement received from UPS. Thus, any increase in this expense will not result in a decrease to the income earned by Interstate. Therefore I have eliminated the Company's proposed adjustment to local transfer expense. This elimination reduces rate year expenses by $38,452 (Schedule DJE-3, Page 1).

h. Professional Services

Q. What rate year professional services expense is Interstate proposing to include in its revenue requirement?

A. The Company is proposing to include professional services expense of $363,399 in its revenue requirement.

Q. How did Interstate determine its proposed rate year level of professional services expense?

A. The rate year professional services expense proposed by the Company represents the average of the expense over the last three fiscal years plus the test year. The projected rate year expense is $21,140 greater than the actual test year expense.

Q. Is the Company's reliance on the actual professional services expense in recent years for the purpose of determining the likely level of prospective expense appropriate?

A. No. In recent years, including the test year, Interstate has incurred substantial legal fees and other professional service fees related to Island Hi-Speed Ferry ("IHSF") matters and to obtaining a certificate of public convenience and necessity ("CPCN") to provide its own high speed ferry service. For example, in the test year the Company incurred legal fees of $47,010 related to IHSF matters and $74,760 related to CPCN matters (response to DIV 2-12). With Interstate's acquisition of the assets and operations of IHSF in 2006, these expenses should not be incurred prospectively.

Q. How do you propose to determine the rate year professional services expense?

A. The Company has not established that the actual test year expense, other than fees incurred for professional services related to IHSF and CPCN matters, is unrepresentative of the normal expense that will be incurred prospectively. Therefore, I recommend that the actual test year professional services expense, adjusted to eliminate professional fees related to IHSF and CPCN matters, be included in the rate year cost of service. The actual test year professional services expense was $342,259. Of that amount, $121,770 was for legal fees related to IHSF and CPCN matters. Based on the response to COM 1-30, the ratio of fees for other regulatory and accounting services (excluding bookkeeping) to legal service fees is approximately 1 to 3. Accordingly, I estimate that that the other professional services related to IHSF and CPCN matters was $40,590. Therefore, the adjusted test year professional services expense, exclusive of the professional fees related to IHSF and CPCN issues, was $179,899 (Schedule DJE-3, Page 3). This amount is $183,500 less then the rate year professional services expense proposed by the Company. I recommend that the projected rate year professional services expense be adjusted accordingly.

i. Other Professional Fees

Q. Are you proposing an adjustment to other professional fees?

A. Yes. Lobbying expenses of $24,500 are included in other professional fees. As a matter of public policy, expenditures to influence legislation, such as lobbying, should not be included in the cost of service of a public utility company. Therefore, I have eliminated this $24,500 of lobbying expense from the Company's revenue requirement (Schedule DJE-3, Page 1).

j. Credit Card Administration

Q. What amount of credit card administration fees does the Company include in its rate year cost of service?

A. The Company has projected rate year credit card administration fees of $159,340 and included this amount in its rate year cost of service.

Q. What do the credit card administration fees represent?

A. These fees are costs incurred related to the purchase of ferry tickets by credit card. For the most part, the administration fees are approximately 2%-3.75% of the purchase price of the tickets. The costs include fees related to advance vehicle reservations made by telephone and prepaid by credit card. It should be noted that some of these vehicle reservations are made months in advance of when the tickets are actually used.

Q. Should the entire credit card administration fee be included in the Company's revenue requirement?

A. No. The credit card administration fees should, at least in part, pay for themselves. That is, to the extent that the fees relate to advance purchases of tickets by credit card, the Company is provided with a source of funds from its customers. The earnings on such customer supplied funds are available to offset the fees incurred by the Company. The expense included in the Company's revenue requirement should be offset by the benefit to the Company from receiving payment in advance.

Q. What do you propose?

A. I propose to reduce the credit card administration fees included in the Company's revenue requirement by 25%. This offset assumes that one-half of the fees relate to advance payments and the return on the advance payments is, on average, adequate to offset one-half of the amount of the fee. Reduction of credit card administration fees by 25% results in a decrease of $39,835 to rate year operation and maintenance expenses (Schedule DJE-3, Page 1).

k. Fuel Expense

Q. What rate year fuel expense is the Company projecting?

A. The Company is projecting rate year fuel expense of $1,499,173. This is the second largest item of operation and maintenance expense, exceeded only by payroll. It is also one of the most difficult to predict.

Q. How did Interstate project its rate year fuel expense?

A. The Company calculated the annual percentage increase in fuel oil prices from November 2004 to November 2005, 21.094%, and assumed that percentage rate of increase would take place in the approximate two year period from the test year to the rate year. The actual test year fuel oil expense of $1,054,361 was thus increased by 42.188% (2*21.094%) to derive a projected price of $2.92 per gallon and a rate year expense of $1,499,173. The Company's proposed base rate revenue requirement also includes the effect of rolling into base rates the fuel surcharge in effect during the test year.

Q. Is the Company's method of forecasting the rate year fuel expense reasonable?

A. No. There is absolutely no reason whatsoever to believe that the increase in fuel oil prices from November 2004 to November 2005 is representative of the rate of change in the price of fuel oil from the test year to the rate year. The increase projected by the Company is entirely speculative. Indeed, the speculative nature of the Company's projection can be verified by reference to the decline in the price of fuel oil in recent months. For example, the price paid for fuel oil actually declined from September 2005 to September 2006 (comparing Schedule DGB-5B, Page 3 and the response to DIV 3-5). It would make as much sense to forecast the rate year fuel expense by projecting the price decrease in fuel oil for the twelve months ended September 2006 into the rate year. The Company's projection of 21% annual increases in the price of fuel oil is clearly unreasonable.

Q. Do you agree that the full amount of the projected rate year fuel expense should be rolled into base rates?

A. I agree with Mr. Edge that it is beneficial to include the actual fuel costs in base rates rather than to collect a portion of the fuel costs through the surcharge mechanism, in order to avoid the unreasonable cross subsidies and other anomalies inherent in the surcharge mechanism. However, avoidance of the undesirable features of the surcharge mechanism must be weighed against another significant consideration, namely that the surcharge mechanism works in only one direction. That is, if the price of fuel increases above the price assumed in establishing base rates, the Company can put the surcharge into effect to recover the difference and be made whole. On the other hand, if the price of fuel decreases below the price assumed in establishing base rates, there is no mechanism to protect customers and to prevent a potentially substantial windfall to the Company. In effect, the Company would get to recover the actual price of fuel oil or the price assumed in establishing base rates, whichever is higher.

Q. Can you illustrate how the application of the surcharge mechanism could result in a windfall to the Company?

A. Yes. Assume that the price of oil is established at $2.00 per gallon in this case. Further assume that the actual price of oil is $1.90 per gallon in July 2007 and $2.10 per gallon in August 2007, with the usage 180,000 gallons in each month. The actual average price for the two month period would be $2.00 per gallon, exactly matching the price assumed in the rate case, and the total cost of fuel oil in the two month period would be $720,000. In July, the Company would recover $360,000 of fuel oil expense in base rates. In August, the Company would also recover $360,000 of fuel oil expense in base rates and would ultimately recover $18,000 through the surcharge mechanism for the $0.10 per gallon by which the actual price exceeded the price assumed in the rate case. The Company would recover $738,000 in its total rates for actual fuel expense of $720,000, resulting in a windfall of $18,000.

Q. Do you have a proposal to address the asymmetry in the surcharge mechanism while also attaining the benefits of recovering fuel oil expense in base rates?

A. Yes. In any month when the actual price of fuel is lower than the price assumed in the rate case, the Company should be required to accrue the difference to a reserve account. In the above example, $18,000 (180,000*(2.10-2.00)) would be accrued to the reserve account in July 2007. The amount accrued to the reserve account could then be used to offset the effect of fuel prices in excess of the base price in subsequent months. Again, in the above example, the $18,000 in the reserve account at the end of July would be used to offset the effect of the excess fuel price in August. If there is a balance in the reserve account at the time of the Company's next rate case, such balance could be used to offset the forecasted rate year fuel expense at that time. With such a mechanism in place, it would be appropriate to set the fuel price in this case at the price that is deemed to be most likely in the rate year. Absent such a mechanism, the fuel price should be set at the very bottom of the range of reasonably likely prices in the rate year, or even at $1.20 per gallon, the minimum price at which the surcharge can take effect. The latter option would avoid the problem of creating windfalls to the Company, but it would also continue the anomalies in the recovery of fuel expense through the surcharge mechanism.

Q. What do you recommend?

A. Based on the response to DIV 3-5, the average price of the most recent marine diesel deliveries at the time of the preparation of this testimony was approximately $2.00 per gallon (including applicable taxes). Given the impossibility of forecasting the future price of fuel oil, I believe that this is as good an estimate as any of the probable average price of fuel oil in the rate year. Therefore, I recommend that a price of $2.00 per gallon be used to determine the rate year fuel oil expense. Doing so results in a rate year fuel oil expense of $1,026,544, which is $472,629 less than the fuel oil expense projected by the Company (Schedule DJE-3, Page 3).

Consistent with this recommendation, when the price of fuel is less than $2.00 per gallon, Interstate should be required to accrue the difference to a reserve account, with the accrual calculated as the price differential times the volume of fuel oil purchased. The balance in the reserve account should then be used to offset subsequent purchases of fuel oil in excess of \$2.00 per gallon. If there are purchases of oil in excess of \$2.00 per gallon when the reserve account is zero, the excess should be recovered by implementing the surcharge.

l. Rate Case Expense

Q. What level of rate case expense is Interstate seeking to include in its revenue requirement?

A. Interstate is seeking to include \$120,000 of rate case expense in its rate year revenue requirement. This consists of estimated rate case costs of \$180,000 in this case amortized over two years, plus \$30,000 annual amortization of rate case costs that was allowed in the Company's prior rate case.

Q. Should the rate case expense included in the Company's revenue requirement be adjusted?

A. Yes. There should be two adjustments to the pro forma rate case expense. First, based on the Company's actual experience in recent years, an amortization of three years is more appropriate than two years, as the Company has averaged more than three years between rate cases. Second, the rate case expense related to the prior rate case should be eliminated. If the period from one rate case to the next is greater than estimated at the time of the first case, the utility company never refunds any over-recovery of rate case expense. Similarly, if the period from one rate case to the next is less than estimated at the time of the first case, the utility company should not be able to recover prospectively for any retroactive under-recovery.

The effect of amortizing the cost of the present rate case over three years rather than two years is to reduce the annual expense included in the cost of service by $30,000. Elimination of the amortization from the prior rate case reduces the pro forma rate case expense by an additional $30,000. Thus, the rate case expense included in the Company's revenue requirement should be reduced by $60,000 (Schedule DJE-3, Page 3).

m. Gross Receipts Tax

Q. Should the gross receipts tax included by the Company in its cost of service be modified?

A. Yes. The Company has used a rate of 1.50% to calculate the gross receipts tax. It is my understanding that the gross receipts tax applicable to ferry operations is 1.25%. In addition, the Company has reflected the gross receipts tax based on its own calculation of the rate year revenue requirement. To the extent that other elements of the cost of service are modified, the pro forma gross receipts tax expense will also have to be adjusted. I have adjusted the Company's gross receipts tax based on my proposed adjustments to the Company's revenue requirements, as shown on my Schedule DJE-3, Page 1.

2. Depreciation Expense

Q. Are you proposing any adjustments to the Company's pro forma depreciation expense?

A. Yes. In calculating its pro forma depreciation expense, the Company has included depreciation on plant additions from the test year to the rate year. Included in these plant additions are certain general additions to vessel improvements in 2006 and 2007. The Company's calculations assume that these general additions are depreciated over three years. Based on the Company's depreciation schedules, it appears that a depreciation life of ten years would be more appropriate. I have calculated that depreciating the general additions to vessel improvements over ten years rather than three years reduces pro forma depreciation expense by $17,500 (Schedule DJE-3, Page 3). I have also adjusted the rate year depreciation expense to reflect deprecation on capital additions related to Homeland Security.

3. Income Tax Expense

Q. Have you calculated the pro forma income tax expense to be included in the Company's revenue requirement?

A. Yes. I have calculated the pro forma income tax expense on my Schedule DJE-4. I have used what is commonly referred to as the return method of calculating pro forma income tax expense. This method begins by calculating the taxable income base (that is, the net income after income tax expense) by applying the weighted return on equity to the rate base. To determine the taxable income, the net income must then be grossed up by the complement of the income tax rate (which step was erroneously omitted on Schedule WEE-13), as the income tax expense itself is not deductible for federal income taxes. Finally, I applied the income tax rate of 34% (the rate for taxable income in excess of $335,000 but less than $10,000,000) to the taxable income to calculate the pro forma income tax expense to be included in the Company's revenue requirement.

4. Return on Rate Base

Q. How is the return on rate base included in the total revenue requirement calculated?

A. The return on rate base is calculated by multiplying the rate of return by the rate base. The rate base is the net investment in facilities necessary to provide utility service. I am proposing adjustments to both the rate of return and rate base proposed by the Company.

a. Rate Base

Q. What adjustment to the Company's rate base are you proposing?

A. The Company's rate base should be adjusted to reflect accumulated deferred income taxes ("ADIT") related to accelerated tax depreciation in excess of straight line book depreciation. The balance of ADIT should be deducted from plant in service in the determination of the Company's rate base.

Q. Why is an adjustment to recognize ADIT necessary?

A. The Company deducts accelerated tax depreciation from gross revenues for the purpose of calculating its taxable income and actual federal income taxes payable. The use of accelerated depreciation reduces the Company's actual income tax liability below the income tax expense included in the cost of service for ratemaking purposes. The difference between the income tax expense recovered by the Company as part of its revenue requirement and the actual income taxes paid by the Company provides the Company with a source of customer supplied funds. The cumulative excess of taxes recovered in the Company's revenue requirement over income taxes actually paid represents the balance of customer supplied funds that should be deducted from rate base. However, the Company's presentation of its rate base does not deduct any ADIT from plant in service in the determination of its rate base. In effect, the Company disregards its use of accelerated depreciation for income tax purposes.

Q. How have you determined the balance of ADIT to be deducted from plant in service in the determination of the Company's rate base?

A. In response to DIV 1-11, Interstate provided the income tax basis of its fixed assets as of May 31, 2005. The tax basis of the assets incorporates the effect of tax accelerated depreciation used by the Company on its income tax returns over the years. The difference between the book basis of the fixed assets and the tax basis of the fixed assets reflects the cumulative difference between the book depreciation and tax depreciation on the fixed assets. Generally accepted accounting principles require that deferred taxes be recorded on the difference between the book basis and tax basis of the fixed assets. The appropriate balance of ADIT can be determined by applying the income tax rate to the difference between the book basis and tax basis of the fixed assets.

As of May 31, 2005, the book basis of the Company's fixed assets was \$13,066,800, and the tax basis was \$10,758,293. Applying the income tax rate of 34% to the difference of \$2,307,877, the result is a balance of ADIT of \$784,678.

From this balance of ADIT, I have deducted a deferred tax debit balance of $93,315 related to operating loss carryforwards, as the existence of the loss carryforwards imply that the Company was not able to take able to take full advantage of available tax accelerated depreciation in all years.

On my Schedule DJE-5, I have calculated a net balance of ADIT of $691,363 as of May 31, 2005. I have assumed that this balance is representative of the balance of ADIT that will exist during the rate year, and I have deducted this balance of ADIT from plant in service in the determination of the Company's rate base.

Q. The Company does not explicitly reflect any deferred income tax expense in its revenue requirement. Is this failure to explicitly reflect deferred income tax expense of any relevance?

A. No. The excess of tax accelerated depreciation over book depreciation is not flowed through in the calculation of the income tax expense. This is the mathematical equivalent of reducing current income tax expense to reflect the excess tax depreciation and then recognizing a deferred income tax expense on that same excess tax depreciation. Not flowing through the effect of the excess tax depreciation means that normalization accounting is employed to determine the income tax expense included in the cost of service.

Q. The Company's balance sheet does not include a balance of ADIT related to accelerated depreciation. Is this of any relevance to the determination of the Company's rate base?

A. No. First, it should be noted that the balance sheet *should* recognize the existence of ADIT related to accelerated depreciation. If the tax basis of the Company's fixed assets is different from the book basis of those assets, generally accepted accounting principles require that ADIT be recognized on the difference. Second, and more importantly, the failure of the Company to reflect the appropriate balance of ADIT related to tax accelerated depreciation does not change the fact that the use of accelerated depreciation has reduced the actual taxes paid below the income taxes recovered by the Company as part of its revenue requirement and has provided the Company with a source of customer supplied funds.

Q. Are you proposing any other adjustments to the projected rate year rate base?

A. Yes. In my testimony on operating expenses, I recommended that capital additions related to Homeland Security be charged to appropriate plant accounts. I have adjusted the rate year rate base to include capital additions related to Homeland Security.

b. Rate of Return

Q. How is the rate of return calculated?

A. The rate of return is the sum of the weighted average cost of debt and the weighted return on equity.

Q. What is the Company's presently authorized return on equity?

A. The Company's presently authorized return on equity is 10.75%.

Q. What return on equity has the Company reflected in determining its weighted average rate of return?

A. The Company has reflected a return on equity of 12.00%

Q. What return on equity have you reflected in determining its weighted average rate of return?

A. The Company has not presented any convincing reason why its authorized return on equity should be increased from 10.75% to 12.00%. Therefore, I have reflected a return on equity of 10.75% in my calculation of the weighted average rate of return. Combined with the Company's weighted cost of debt, the result is a weighted average rate of return of 7.72% (Schedule DJE-6).

Q. What return on rate base have you calculated?

A. I have calculated a return on rate base of $804,006 (Schedule DJE-5) and included this return component in the Company's total revenue requirement.

C. MISCELLANEOUS REVENUES

Q. What are miscellaneous revenues?

A. Miscellaneous revenues are the revenues earned from services other than the traditional ferry services provided pursuant to Commission approved tariffs. Examples include bar revenues and mail revenues. In my presentation, I have deducted the miscellaneous revenues from the total cost of service to determine the revenues that must be produced by the services subject to Commission approved tariffs.

Q. Are you proposing any adjustments to the test year miscellaneous revenues?

A. Yes. Interstate is acquiring the assets and operations of Island Hi-Speed Ferry and will be providing high speed ferry service in the rate year. The high speed ferry service will be provided by a separate division of Interstate, with its own books and records. However, Interstate has agreed that the profits from high speed ferry operations can be used as a contribution to the revenue requirements of traditional ferry service. Accordingly, the miscellaneous revenues in the test year should be adjusted to incorporate the expected profits to be generated by the high speed ferry service in the test year.

Q. How have you calculated the high speed ferry profits to be included in pro forma miscellaneous revenues?

A. In Division Docket No. D-06-53, Interstate presented a projection of revenues and expenses related to the provision of high speed ferry service. I have used that projection as the basis of my calculation of high speed ferry profits to be included in pro forma miscellaneous revenues in this case. However, I have made certain modifications to the Company's presentation.

First, the Company treated repayment of principal on the loan to finance the acquisition as an expense. Repayment of principal is not an expense, so I eliminated this item from the calculation of the profit. On the other hand, the Company's presentation did not include any depreciation expense on the assets being acquired. I adjusted the projected expenses to include depreciation expense on the high speed ferry that will be used to provide service.

Second, certain of the $5.6 million being borrowed to acquire the high speed operations finances what I would describe as non-operating assets. In particular, of the total acquisition price, $500,000 is related to a non-compete agreement from the prior owners and $200,000 is goodwill, which is a premium over the fair value of the assets being acquired. The interest on the debt to finance the non-compete agreement and the goodwill should be eliminated for the purpose of calculating the profits from high speed ferry operations to be included in Interstate's rate year miscellaneous revenues.

Q. With your proposed modifications, what profit from high speed ferry operations are you proposing to include in miscellaneous rate year revenues?

A. I am proposing to include high speed ferry profits of $221,927 in miscellaneous rate year revenues (Schedule DJE-7). My proposed adjustment reflects the expected profit from operating the high speed ferry in 2007. Interstate also operated the high speed ferry in 2006. However, the actual profits from the 2006 operation were not available at the time of the preparation of this testimony. The Company has represented that the profits from the operation of the high speed ferry in 2006 would inure to the benefit of the customers of traditional service. If the 2006 profits become available during the course of this case, those profits should be amortized to miscellaneous revenues over three years, consistent with my proposed period for amortizing rate case expense. If the profits do not become available during the course of this case, then the profits should be maintained in reserve to be addressed in the Company's next rate case.

IV. RATES

Q. The Company is proposing to increase all rates subject to Commission approval by an equal percentage (referred to by Interstate as an "across the board" increase) in order to produce the required revenues. Is the Division proposing any modifications to the Company's proposed rate design?

A. Yes. It should be noted that the Company was not able to produce a schedule of rate year billing determinants or a proof of revenues. Therefore, anything other than an "across the board" rate increase requires certain assumptions and estimates. That being said, the Division believes that an across the board rate increase does not result in equitable adjustments to the rates for all rate classes.

First, rates for freight should not be increased at this time. The whole Island relies on Interstate's freight deliveries for substantially all aspects of its economy. Therefore, an increase in freight rates would negatively affect the Island's economy. In addition, because the base rate change includes a roll-in of the fuel surcharge and because there is no fuel surcharge on freight, an across the board increase would result in a relatively larger total increase in rates (base plus fuel surcharge) for freight.

Second, the revenues produced by commuter passengers and commuter vehicles are only about 6% of total passenger and vehicle revenue. Therefore, relatively little additional revenue is produced by subjecting the commuter passenger and commuter vehicle rates to the same rate increases being imposed on other rate classes. On the other hand, large increases to the commuter passenger and commuter vehicle rates can impose significant additional costs on the customers who use those services regularly. The Division recommends that the rates for commuter passengers and commuter vehicles be increased no more than 5% at this time.

Finally, spreading the remaining revenue deficiency evenly across the remaining rate classes, the result is a rate increase of approximately 12.35% to each of those classes. I show the revenues under present and proposed rates on my Schedule DJE-8.

V. RATE PLAN

Q. Mr. Effron, do you believe that a properly structured incentive based rate plan can align the interests of the Company and its customers by establishing appropriate incentives to operate efficiently, thereby creating benefits for both the Company and its customers?

A. Yes. Both Narragansett Electric Company and New England Gas Company have been operating pursuant to incentive based rate plans in recent years. I believe the record is clear that these plans have produced demonstrable benefits for both the utility companies and their customers, especially in the case of Narragansett. Therefore, if the Company consents, I believe that the Commission should also consider implementation of an incentive based rate plan for Interstate.

Q. What goals should an appropriate incentive based rate plan contain?

A. The rate plan should contain incentives to management to create efficiencies in operations and should also ensure that the benefits resulting from any such efficiencies are shared with customers. In addition, the rate plan should promote rate stability and should, if possible, alleviate administrative costs associated with the establishment of appropriate rates.

Q. Have you put together an outline of a rate plan that you believe would accomplish these objectives?

A. Yes. I believe an incentive based rate plan with the following elements would have the potential to produce benefits for both Interstate and its customers:

- The rate plan should be in effect for five years, those being calendar years 2007 - 2011.
- All rates should be frozen for calendar years 2007 and 2008. To provide the Company with a degree of rate flexibility and to alleviate the administrative costs associated with rate applications, while protecting the customers who rely most heavily on the ferry service, Interstate should be authorized to increase rates as of January 1, 2009, 2010, and 2011, other than the rates for freight, commuter passengers, and commuter vehicles, by the change in the consumer price index (CPI). The change in the CPI would be measured as the average CPI for the twelve months ended September 30 preceding the rate change over the average CPI for the previous twelve month period. The rates for freight, commuter passengers, and commuter vehicles would be frozen for the term of the rate plan.

- To enable sharing of any efficiencies in operations achieved during the course of the Rate Plan, an earnings sharing mechanism ("ESM") should be established. In particular, by May 1, 2012, Interstate should file an earnings report with the Commission, calculating the five year average return on equity for the period January 1, 2007 through December 31, 2011. Any accumulated earnings up to 150 basis points (1.50%) over the allowed return on equity may be retained by the Company. Any earnings more than 150 basis points above the authorized return should be shared equally, with 50% going to customers and 50% going to the Company. Prior to proposing a method of crediting customers for the customers' share of earnings above the earnings thresholds, Interstate should consult with the parties to this proceeding to propose a mutually acceptable method. The agreed on method should then be filed with the Commission for review and approval.

Such a rate plan would share many of the elements of the rate plans under which Narragansett and New England Gas have operated in recent years. As those rate plans have worked well for Narragansett and New England Gas and for their customers, I believe that it would be reasonable to implement a similar rate plan for Interstate.

Q. Does this conclude your direct testimony?

A. Yes.

INTERSTATE NAVIGATION COMPANY
RATE YEAR REVENUE REQUIREMENT

		Company Position	Adjustments	Division Position
Cost of Service	(A)	11,333,579	(1,343,009)	9,990,570
Miscellaneous Revenues	(B)	837,249	221,927	1,059,176
Net Revenue Requirement		10,496,330	(1,564,936)	8,931,394
Tariff Revenues, Present Rates	(C)	8,057,807	-	8,057,807
Revenue Deficiency		2,438,523	(1,564,936)	873,587
Percentage Rate Increase		30.26%		10.84%

Notes:

(A)	DJE-2	
(B)	WEE-15	554511+30553+61527+27200+158990+4468
	DJE-7	Adjustment
(C)	WEE-14	

Schedule DJE-2

INTERSTATE NAVIGATION COMPANY
COST OF SERVICE

	(A) Company Position	Adjustments		Division Position
Cash Operating Expenses	9,071,585	(1,292,356)	(B)	7,779,229
Depreciation	1,233,220	(7,744)	(C)	1,225,477
Income Taxes	129,325	46,831	(D)	176,156
Return on Rate Base	899,449	(89,740)	(E)	809,709
Total Cost of Service	11,333,579	(1,343,009)		9,990,570

Notes
- (A) WEE-1, WEE-3
- (B) DJE-3, Page 1
- (C) DJE-3, Page 3
- (D) DJE-4
- (E) DJE-5

INTERSTATE NAVIGATION COMPANY
CASH OPERATING EXPENSES

Payroll	DJE-3, Page 2		(101,790)
Payroll Taxes	DJE-3, Page 2		(11,873)
Employee Insurance	DJE-3, Page 2		(86,457)
Crew Expense	DJE-3, Page 2		(5,171)
Wharfage	WEE-7		(39,124)
Homeland Security	DJE-3, Page 3		(199,873)
Local Transfer	WEE-3		(38,452)
Professional Services	DJE-3, Page 3		(183,500)
Other Professional Fees	DIV 1-24, Lobbying		(24,500)
Credit Card Fees	WEE-3	159340*0.25	(39,835)
Fuel Expense	DJE-3, Page 3		(472,629)
Rate Case Expense	DJE-3, Page 3		(60,000)
Total Adjustments Excluding Gross Receipts Tax			(1,263,205)
Gross Receipts Tax	(A)		(29,152)
Total Adjustment to Cash Operating Expenses			(1,292,356)

Notes

(A)	Net Revenue Requirement Excluding Gross Receipts Tax		8,819,752
	Gross Receipts Tax Gross-up Rate	0.0125/(1-0.0125)	1.266%
	Pro Forma Gross Receipts Tax		111,642
	Company Pro Forma Gross Receipts Tax		140,794
	Adjustment to Company Expense		(29,152)

INTERSTATE NAVIGATION COMPANY
ADJUSTMENTS TO PAYROLL AND RELATED EXPENSES

Actual Test Year Payroll Expense		WEE-3		2,511,753
Annual Rate of Increase			(A)	3.21%
Rate Year Expense - 25 months after Test Year				2,682,582
Company Rate Year Expense		WEE-3		2,784,372
Adjustment to Company Expense				(101,790)
Payroll Taxes		11.66%	(B)	(11,873)
Health Insurance at Current Rates - through 1/31/07		WEE-5		367,370
Person not Employed by Interstate		DIV 2-6		(14,830)
Net Health Insurance at Current Rates				352,540
Employee Co Pay	15%	COM 1-9		(52,881)
Interstate Expense Based on Current Premiums				299,659
Escalation to Rate Year		10%	(C)	329,625
Rate Year Health Insurance per Company		WEE-5		416,082
Adjustment to Company Expense				(86,457)
Actual Test Year Crew Expense		WEE-3		127,604
Percentage Increase from Test year to Rate Year			(D)	6.80%
Rate Year Expense		WEE-3		136,283
Company Rate Year Expense				141,454
Adjustment to Company Expense				(5,171)

Notes:

(A) Edge Testimony, Page 13
(2511.8/2321.1)^(1/2.5)-1

(B) WEE-4
(204+3+7+79)/2512

(C) See Testimony

(D) Percentage Increase in Payroll Expense, Above

INTERSTATE NAVIGATION COMPANY
ADJUSTMENTS TO NON-PAYROLL RELATED EXPENSES

Homeland Security - Personnel	WEE-8		202,900
Homeland Security - Operations	WEE-8	Average FY05&06, Rounded	21,000
Amortization of Reserve, 5/31/06	WEE-8	(33450+50000)/3	(27,817)
Net Homeland Security Expense			196,083
Homeland Security Expense, per Company			395,956
Adjustment to Homeland Security Expense			(199,873)

Professional Services, Test Year		WEE-3	342,259
Legal Services: High Speed Ferry and CPCN		DIV 2-12	(121,770)
Other Professional Services: High Speed Ferry and CPCN	1/3	Testimony	(40,590)
Professional Services Excl. High Speed Ferry and CPCN			179,899
Rate Year Professional Services, per Company		WEE-3	363,399
Adjustment to Professional Services			(183,500)

Gallons of Fuel Oil	WEE-11	513,272
Price per Gallon	Testimony	$ 2.00
Rate Year Expense		1,026,544
Rate Year Fuel Expense, per Company	WEE-11	1,499,173
Adjustment to Fuel Oil Expense		(472,629)

Rate Case Costs	Edge Testimony, P. 26	180,000
Amortization Period in Years	Testimony	3
Annual Expense		60,000
Rate Year Rate Case Expense, per Company	WEE-3	120,000
Adjustment to Rate Case Expense		(60,000)

Adjustment to Depreciation Expense:

		Interim		FY 2007	
General Additions to Vessel Improvements		50,000		50,000	
FY 2007 Depreciation	DIV 1-9	5,000		-	5,000
FY 2008 Depreciation	DIV 1-9	5,000		5,000	10,000
Average - Rate Year Depreciation					7,500
Company Rate Year Depreciation	DIV 1-9				25,000
Adjustment to Rate Year Depreciation Expense					(17,500)
Homeland Security - Capital Additions	WEE-8	144,730	20		7,237
Homeland Security - Equipment	WEE-8	12,600	5		2,520
Net Adjustment to Depreciation Expense					(7,744)

INTERSTATE NAVIGATION COMPANY
INCOME TAX EXPENSE

Rate Base	DJE-5	$ 10,494,661
Weighted Return on Equity	DJE-6	3.26%
Taxable Income Base		341,950
Taxable Income	Taxable Income/(1-Tax Rate)	518,106
Income Tax Rate	(A)	34%
Income Tax Expense		176,156

Notes:
(A) Rate on taxable income > $335,000 and <$10,000,000

Schedule DJE-5

INTERSTATE NAVIGATION COMPANY
RETURN ON RATE BASE

		Company Position	Adjustments		Division Position
Rate Year Average Net Utility Plant	WEE-12	$ 11,112,116	73,787	(A)	$ 11,185,903
Accumulated Deferred Income Taxes		-	(691,242)	(B)	(691,242)
Net Rate Base		11,112,116	(617,455)		10,494,661
Rate of Return	DJE-6	8.09%	-0.38%		7.72%
Return on Rate Base		$ 899,449	$ (89,740)		$ 809,709

Sources

(A)	Homeland Security - Capital Additions		144,730	WEE-8
	Homeland Security - Equipment		12,600	WEE-8
	Depreciation		(9,757)	DJE-3, Page 3
	Net Plant		147,574	
	Average for Rate Year	1/2	73,787	
(B)	Book Value of Plant 5/31/2005		13,066,800	DGB-6
	Tax Basis of Plant 5/31/2005		10,759,279	DIV 1-11, Page 7
	Difference		2,307,521	
	Tax Rate		34%	DJE-4
	ADIT		784,557	
	Deferred Tax Debit Balance		93,315	DGB-6
	Net ADIT		691,242	

Schedule DJE-6

INTERSTATE NAVIGATION COMPANY
RATE OF RETURN

Company Position

	Percent of Total	Cost Rate	Weighted Cost
Long Term Debt	69.69%	6.40%	4.46%
Common Equity	30.31%	12.00%	3.64%
Total Capital	100.00%		8.09%

Division Position

	Percent of Total	Cost Rate	Weighted Cost
Long Term Debt	69.69%	6.40%	4.46%
Common Equity	30.31%	10.75%	3.26%
Total Capital	100.00%		7.72%

Source: WEE-13

INTERSTATE NAVIGATION COMPANY
FAST FERRY PROFIT

Fast Ferry Revenues - Year 1	(A)	1,667,777
Operation and Maintenance Expense	(A)	922,600
Earnings before Depreciation, Interest, and Income Taxes		745,177
Depreciation	(B)	168,000
Earnings before Interest and Income Taxes		577,177
Interest	(C)	355,250
Earnings before Income Taxes		221,927

Sources:

(A)	Schedule WEE-1, Docket No. 3764	
(B)	Cost of Vessel	4,200,000
	Estimated Life	25
	Annual Depreciation Expense	168,000
(C)	Schedule WEE-1, Docket No. 3764:	
	Total Loan	5,600,000
	Non-Compete	(500,000)
	Goodwill	(200,000)
	Loan Supporting Assets	4,900,000
	Interest Rate	7.25%
	Interest Expense	355,250

Schedule DJE-8

INTERSTATE NAVIGATION COMPANY
RATE YEAR REVENUE INCREASES

Service	FY 2005 Revenue		Test Year Revenue	Increase	Proposed Revenue
Passengers - Noncommuter	3,578,411	93.3934%	3,632,928	448,720	4,081,647
Passengers - Commuter	253,134	6.6066%	256,990	12,850	269,840
Total Passenger Revenue	3,831,545	100.0000%	3,889,918	461,569	4,351,487
Vehicles - Noncommuter	3,096,552	94.0420%	2,988,058	369,069	3,357,126
Vehicles - Commuter	196,180	5.9580%	189,306	9,465	198,772
Total Vehicle Revenue	3,292,732	100.0000%	3,177,364	378,534	3,555,898
Bikes & Mopeds			123,573	15,263	138,836
Freight			719,432	-	719,432
Charter			113,716	14,046	127,762
Tours			33,804	4,175	37,979
Total Tariff Revenue			8,057,807	873,587	8,931,394

Rate Increase to Freight	0%
Rate Increase to Commuter Passengers and Vehicles	5%
Remaining Revenue Deficiency	851,272
Revenue - Remaining Rate Classes	6,892,078
Percentage Increase to Remaining Rate Classes	12.35%

Sources: Response to DIV 1-2, WEE-14