

REBUTTAL TESTIMONY
Of
WALTER E. EDGE JR. MBA CPA PRESIDENT
B&E CONSULTING LLC

FOR
INTERSTATE NAVIGATION COMPANY
POST OFFICE BOX 482
NEW LONDON, CONNECTICUT 06320

DOCKET No. 3762

NOVEMBER 2006

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

3 A. Yes I am.
4

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

6 A. I will provide additional information that was not available to me when I prepared
7 my direct testimony in this docket which I believe will assist the Division and the
8 Commission in evaluating this filing. I will also respond to the direct testimony of the
9 Division and discuss Interstate's position regarding the "Position Memorandum of the
10 Town of New Shoreham" filed in this docket.
11

12 **Q. Mr. Edge you filed testimony for Interstate Navigation requesting a rate**
13 **increase of \$2,438,522 or about 27.4%. The Division recommends a rate increase of**
14 **\$873,587 or about 10.84% and the Town recommends (if I have calculated their**
15 **adjustments correctly) virtually no rate increase, although I must point out that**
16 **their "memorandum" does not calculate the proposed rate increase they are**
17 **recommending. Why are the recommendations so drastically different?**

18 A. The difference between the Division's and Interstate's positions is the result of a few
19 very large issues. One issue, the inclusion of fuel costs in base rates, has virtually no
20 impact on Interstate because if the fuel costs are not collected in base rates they can be
21 collected through the fuel surcharge. This issue results in the same revenue for Interstate
22 using either Interstate's original position (adjusted for current fuel prices) or the
23 Division's proposed position. Therefore it is not really an issue and we will agree to the
24 Division's position.
25

26 A second major issue is the use of the profit from Interstate's fast ferry operations. In
27 my prefiled testimony I did not calculate fast ferry profits in the rate year because there
28 was no public evidence that there were going to be fast ferry profits in the rate year
29 because at that time Interstate had no fast ferry vessel or fast ferry vessel lease for the rate
30 year.

1 Although I was aware of confidential negotiations that could have resulted in Interstate's
2 running a fast ferry in the rate year, I was not in a position to use that information in my
3 prefiled testimony. The Division however was aware after I filed financing testimony at
4 the Division (subsequent to my prefiled direct testimony in this docket) that Interstate
5 would be purchasing IHSF's RI operations and that, if the closing is successful, Interstate
6 will be running a fast ferry operation in the rate year. The Division has proposed using
7 their projected profit for the fast ferry operations in the rate year as a reduction to the
8 revenue requirement. Interstate supports using rate year fast ferry profits to subsidize the
9 life line rates but I will address what I believe are weaknesses in the Division's
10 calculation.

11
12 These two adjustments alone represent \$694,556 or about 44% of the difference between
13 the Division position and Interstate's position in its prefiled testimony. Neither of these
14 two issues adversely impacts Interstate, if implemented correctly.

15
16 As for the other differences, I believe that the Division has taken unfair, unreasonable
17 positions on some of the other large issues that, if accepted by the Commission, will
18 probably result in a significant decrease in the level of service provided by Interstate to
19 its ratepayers. A few of their positions range from unrealistic to impossible.

20
21 The Town on the other hand has filed a "memorandum" by its lawyer (not supported by
22 expert testimony) that expresses what appears to be its lawyer's opinion on a number of
23 perceived issues (many of which are the exact same as the Division, but the Division's
24 presentations of the issues are much more understandable). The Town's lawyer has also
25 proposed a fully allocated cost analysis for charging indirect costs to the fast ferry
26 operation (an approach not supported by the prefiled testimony of the Division or
27 Interstate) that is replete with error and is sophomoric in nature, (which is somewhat
28 understandable because it is not expert testimony). It is difficult to believe that an expert
29 in the preparation of cost allocation studies for regulated utilities was involved in any
30 way in the preparation of the Town's so-called fully allocated cost of service analysis.

1 Until the Town presents an expert witness to support its memorandum and this cost
 2 allocation model, and because I have been advised by Interstate legal counsel that this
 3 memorandum of a lawyer cannot be considered by the Commission as evidence, I believe
 4 that it is not worth my time or ratepayer money to address all of the errors that I have
 5 noticed in the Town's model.

6

7 **Q. Mr. Edge, will you provide a list of the larger issues in the Docket?**

8 A. Certainly, the issues between the Division and Interstate and the approximate impacts
 9 are as follows:

10

#	Issue	Amount	Comment
		\$2,438,522	Interstate Position (prefiled)
1	Payroll	(101,790)	Interstate 5%/ Division 3.1% Increase.
2	Payroll Taxes	(11,873)	A function of item 1 above.
3	Employee Insurance	(86,457)	Co-pay, enrollment, % increase.
4	Crew Expense	(5,171)	Same approach as item 1 above.
5	Wharfage	(39,124)	Div. eliminated Point Judith Increase.
6	Homeland Security	(199,873)	Div. eliminated equipment, capital etc
7	Local Transfer	(38,452)	Revenue off-set.
8	Professional Services	(183,500)	Div. eliminated CPCN and IHSF cost.
9	Other Professional	(24,500)	Div. eliminated lobbying cost.
10	Credit Card Fees	(39,835)	Off-set by value of pre-payments.
11	Fuel	(472,629)	Lower cost - less rolled into base rate.
12	Rate Case Expense	(60,000)	3 vs. 2 years and eliminate prior years.
13	Gross Receipts Tax	(29,152)	Function of adjustments above.
14	Depreciation	(7,744)	Div. increased amortization period.

15	FIT	46,831	Div. increased to correct WEE error.
16	Return on Rate Base	(89,261)	Accumulated Deferred Income Tax and ROR on equity 12% vs. 10.75%.
17	Fast Ferry Income	(221,927)	Division Calculation vs. Interstate \$0
		<u>\$874,065</u>	Division' position

1 **Q. Mr. Edge do you agree with or accept any of the Division's adjustments listed**
2 **above?**

3 A. Yes I do. After reading the Division's testimony I called the Division to get further
4 clarification and reasons for the Division's proposed adjustments. This call was in lieu
5 of sending written data requests and was needed in order to get my rebuttal testimony
6 filed as soon as possible. During a conference call with the Division's accounting
7 department and their expert witness I obtained significant reasons and logic that has
8 allowed me to accept the following Division adjustments:

9

3	Employee Insurance	(86,457)	Co-pay, enrolment, % increase.
4	Crew Expense	(5,171)	Same approach as item 1 above.
7	Local Transfer	(38,452)	Revenue off-set.
9	Other Professional	(24,500)	Eliminate lobbying cost.
10	Credit Card Fees	(39,835)	Off-set by value of pre-payments.
11	Fuel	(472,629)	Lower cost - less rolled into base rate.
15	FIT	46,831	Increase to correct WEE error.

10

11 In addition to the above, I can also agree with the calculation methodology (but not the
12 amounts) used by the Division for items 2 (Payroll Taxes) and 13 (Gross Receipts Tax)
13 above. My agreement to these items results in a significant reduction in the remaining
14 issues that need Commission consideration.

15

16 **Q. What would you like to discuss first?**

17 A. The two largest remaining items are Homeland Security and professional fees. I
18 would like to discuss professional fees first.

19

1 In the past dockets (prior to the last docket) the Division and Interstate had always used
2 the average of prior years' professional fees to estimate professional fee costs for the rate
3 year. This averaging approach was used by Interstate in this docket. The Division has
4 used the test year professional fees less significant professional fees paid by Interstate for
5 CPCN matters and activities with IHSF, resulting in a substantial proposed reduction.

6
7 Given that professional fees have averaged about \$300,000 for the past seven years, the
8 Division's proposal to back out specific items from the test year and allow only \$179,899
9 is unreasonable and unfair. Each year, Interstate, which has no in-house counsel or in-
10 house utility accountant, is faced with professional fees in excess of \$300,000. The
11 Division's proposal of \$179,899 is woefully short of what Interstate needs to operate and
12 Interstate's averaging request is only 6% greater than the test year actual expenditure
13 level for professional services.

14
15 **Q. Has the Division taken this same position relating to professional fees in**
16 **previous dockets?**

17 A. Yes they have. In the last Interstate rate docket the Division's witness stated the
18 following:

19 *"Interstate has been heavily involved in several proceedings over the past five*
20 *years that are now resolved, the most notable of which were the proceedings*
21 *involving IHSF." "This litigation is essentially complete."*

22
23 *"Interstate was also involved in several disputes with the Town of Narragansett*
24 *relating to tax and landing fees."*

25
26 *"Extensive legal work on the point Judith project was also provided to*
27 *Interstate."*

28
29 *"Legal advise was also provided during the past few years on issues regarding*
30 *the death of certain shareholders and on issues involving the captain of the MV*
31 *Nelseco, which hopefully will not reoccur in the immediate future."*

32
33 *"I understand that many of the PUC/DPUC legal matters shown in Schedule 13*
34 *of Mr. Edge's testimony have now been resolved."*

1 *“The Company has also now resolved significant litigation that was filed in*
2 *United States District Court regarding its overtime practices.”*

3
4 *“In summary, while the Company’s legal expenses were unusually high during*
5 *the past five years, there is no indication that this level of legal expense will*
6 *continue in the Rate Year.”*

7
8 The Division was clearly wrong in the last filing and I believe that the Division, using the
9 same logic, is wrong again.

10
11 **Q. Are professional services difficult to project?**

12 A. No. they are really not difficult to project at all. Professional fees run \$300,000 per
13 year, every year, and have done so for the past seven years. However, the Division is
14 concerned by the nature of professional fees incurred each year which often relate to
15 items that are non-recurring from year to year (see quotes from the Division testimony in
16 the last docket above). Each year, although the total professional fees expense amounts
17 are relatively consistent, different professional services matters are addressed. For
18 example, if passenger “X” files a suit against Interstate in one year and that suit is
19 resolved, then one would hope that the same passenger “X” would not file a suit in the
20 next year. However a different passenger “Y” may file a suit in the next year and so on
21 and so on. Unfortunately, Interstate is subject to suits from passengers just as any
22 company that carries the public from place to place.

23
24 It is important that professional fees are somewhat higher because Interstate made a
25 financial decision a few years ago, which was approved by the Commission, to reduce
26 insurance expense with a high deductible. This means that for “run of the mill” slip and
27 fall cases or property damage claims Interstate will often handle these suits directly rather
28 than pay high insurance premiums to have these suits fully covered by insurance and
29 fully handled by an insurance company. This decision has resulted in significant savings
30 for the ratepayers in insurance costs but slightly higher legal fees.

1 **Q. The second large item is Homeland Security. Would you like to address the**
2 **issues that you have with the Division's adjustments to Homeland Security expense?**

3 A. Yes. The Division wants to throw out the Homeland Security restricted account
4 concept established by the Commission and roll the costs of Homeland Security into
5 Interstate's normal cost of service. Further, the Division has proposed the elimination of
6 the purchase of capital items, including equipment contracts, through "pay-as-you-go"
7 Homeland Security funding. I believe that neither of these two Division approaches
8 provides the flexibility that is needed for Interstate to react on a timely basis to security
9 mandates. Interstate currently has that needed flexibility under the current Commission
10 approved Homeland Security restricted account.

11
12 Interstate is under Federal mandate to operate under its Homeland Security plan and the
13 regular pronouncements of the Federal Department of Homeland Security and the U. S.
14 Coast Guard. To do so, Interstate needs to have flexibility and adequate funding. The
15 Division has ignored the fact that Interstate, over the past two years, has had to spend
16 almost all of the funds made available through the Homeland Security allowance
17 approved by the Commission. And further, Interstate has projected that more than the
18 allowance being sought will be spent in the rate year. The relatively minor balance
19 (about \$83,000) currently left in the Homeland Security account at the end of the test year
20 is being intentionally held by Interstate's Company Security Officer as a reserve to
21 address any immediate cash needs that will be driven by any emergency change in the
22 security preparedness level (MARSEC level).

23
24 **Q. What are you proposing for the Homeland Security allowance in the rate year?**

25 A. I recommend a continuance of the current Homeland Security allowance and that all
26 funds collected for Homeland Security continue to be deposited in a restricted account to
27 be used exclusively for Homeland Security. Further, the Commission should allow
28 Interstate to continue to purchase capital items with the Homeland Security funds.
29 Please note that it is more expensive and inappropriate for Interstate to purchase
30 Homeland Security capital items (such as cameras, fences, etc., that have to be
31 consistently replaced) with long term financing.

1 If the Department of Homeland Security mandates that Interstate spend \$20,000 for a
2 security item, then Interstate needs to have the flexibility to do so. Per my discussions
3 with Mr. McCombe, I am aware that he has identified over \$500,000 of items he needs to
4 purchase over the next five years for security reasons. When he is done he will have to
5 replace the items that he purchased two year ago due to reduced useful life because of
6 exposure to salt air and harsh sea conditions. Please see Bill McCombe's rebuttal
7 testimony for greater details relating to the need for Homeland Security funding.

8
9 **Q. What is Interstate's position on the on the Homeland Security issue?**

10 A. Interstate understands the Division's position relating to the purchase of significant
11 capital items with "pay as you go" Homeland Security funds. Interstate has reviewed its
12 Homeland Security needs for the next few years and believes that it can purchase all of
13 the appropriate equipment items and cover all annual operating expenses relating to
14 Homeland Security if the allowance is reduced to \$300,000 a year, a savings of \$95,956
15 dollars in the revenue requirement. Of course, Interstate would still maintain the
16 restricted account (to protect the ratepayers) and submit an annual report to the Division
17 and the Commission of all Homeland Security expenditures.

18
19 **Q. Lets return to items 1 - payroll and 2 - payroll taxes on your schedule of**
20 **Division adjustments. Why has the Division adjusted your payroll allowance for**
21 **the rate year?**

22 A. The Division believed that all of the Homeland Security salaries and wages were new
23 employees, so they backed out all of the Homeland Security salary dollars from their
24 average payroll percentage increase calculation. The Division was only half right. Bill
25 McCombe was not a full time employee in the base year, therefore part of his salary
26 should be eliminated from the calculation (about \$70,000). Also, two employees were
27 changed from part time (six months per year) to full time (twelve months a year) and
28 therefore about \$20,000 should be backed out for them.

1 Since the original amount backed out by the Division was \$193,710 and the correct
2 adjustment should have been about \$90,000, it would be reasonable to use a percentage
3 that is close to the middle of the range between Interstate (5%) and the Division (3.2%).
4 I have calculated that the payroll percentage increase should be 4.2% instead of the
5 Division's calculated 3.2%. The payroll taxes would then be calculated using the new
6 payroll amount in the manner used by the Division on DJE-3 page 2.

7
8 **Q. Do you have any comments regarding the wharfage allowance recommended by**
9 **the Division relating to Point Judith?**

10 A. Yes, I do. The Division eliminated all of the anticipated increase for Point Judith
11 wharfage because, at the time we filed, the State was unable to provide Interstate with
12 any documentation to support the 100% increase that the State's lawyer told Interstate's
13 lawyer to be prepared for concerning the State's 1/1/07 increase to Interstate. The State
14 is now in the process of appraising all of Interstate's Point Judith (Galilee) properties and
15 has already appraised a number of nearby Galilee properties. Interstate expects to get a
16 major increase from the State, in part because of all the work the Interstate has done to
17 improve its service and security in Point Judith. Subsequent to the Division filing its
18 testimony, Interstate received an e-mail from the State explaining that, based on recent
19 appraisals from nearby properties, the lease increases in Point Judith to date have
20 averaged between 75% and 100% and that Interstate should expect a similar (if not
21 larger) increase. This supports Interstate's original calculation. Interstate can not agree
22 to the Division's adjustment in this area.

23
24 **Q. After wharfage on your schedule of Division adjustments is Homeland Security.**
25 **Do you have anything to add to your previous comments regarding Homeland**
26 **security?**

27 A. No. I should point out that I have also already addressed items 7 Local Transfer, 8
28 Professional Services, 9 Other Professional Services, 10 Credit Card Fees, and 11 Fuel,
29 which brings us to rate case expense on my schedule.

1 **Q. What are the issues with rate case expense?**

2 A. There are two issues. The first issue (\$30,000) is the amortization period (Division
3 proposed 3 years and Interstate 2 years) and the second issue (\$30,000) is the Division's
4 proposal to eliminate the amortization of prior docket rate case expense that has not been
5 fully amortized. Interstate can accept the 3 year amortization period for the rate case
6 expense in this docket but must vehemently disagree with the Division's elimination of
7 the unamortized portion of the previous rate case expense. In the last docket Interstate
8 asked for a 3 year amortization period and the Division recommended five years, which
9 was adopted. As it turned out, Interstate was right and 3 years was the correct
10 amortization period. The Division was wrong but now wants to eliminate Interstate's
11 right to collect the remaining unamortized rate case expense. This is completely unfair.

12

13 **Q. That brings us down to the Division's depreciation adjustment. Do you wish to**
14 **comment on this adjustment?**

15 A. This adjustment will change if the Commission continues the Homeland Security
16 restricted account, even if some of the funding level is reduced. If the Commission
17 accepts the Division on Homeland Security this \$7,744 item is not worth fighting.

18

19 **Q. What are the issues with the return on rate base?**

20 A. There are two issues. The first issue is the calculation of the Accumulated Deferred
21 Federal Income Tax (ADFI) used by the Division to reduce rate base. I have reviewed
22 the Division's adjustment and determined that the Division's adjustment should be
23 reduced to reflect two items listed on Interstate's books that have not yet been included
24 on Interstate's tax return. These two items reduce the ADFI by \$110,860 which will
25 increase the return on rate base.

26

27 The second issue is the Division's proposed return on equity (10.75%). The Division
28 did not present any testimony on the issue other than to state that they don't agree with
29 the Interstate testimony. The Commission should accept the only return on equity
30 testimony filed in this case (by Interstate) and allow a 12% return on equity for the
31 reasons stated in my original prefiled testimony.

1 **Q. The next issue listed above is the use of Fast Ferry income. Do you have any**
2 **problems with the Division's approach on this item?**

3 A. Yes. Although I agree that the rate year fast ferry profit should be used to reduce the
4 conventional rates, I disagree with the Division's calculation of depreciation and interest.
5 Interstate has proposed that all of the profit can be used to reduce the conventional
6 service rates, but only after the fast ferry service pays the debt service on the \$5.6 million
7 loan to purchase the fast ferry business. The Division's approach would have
8 Interstate's owners paying the debt service on all of the intangible assets purchased from
9 IHSF (\$1.4 million), yet still providing all of the profit from the fast ferry operation to the
10 conventional service.

11
12 Apparently the Division didn't think its proposal all the way through. If Interstate gives
13 all of the profit from the fast ferry operation to reduce rates for the conventional service,
14 where would Interstate get the funds to pay the debt service on the \$1.4 million intangible
15 assets? The only source of funds left to Interstate that is not used for paying bills is the
16 return on equity that Interstate's owners may earn from the conventional service. It is
17 illogical and inconsistent for Interstate's owners to be required to use their authorized
18 profit from the conventional service to pay fast ferry bills, yet still turn over all of the
19 profit from the fast ferry to reduce the conventional rates.

20
21 I have updated my fast ferry WEE-1 schedules with current information from the summer
22 of 2006. In fact I have prepared two new WEE-1 schedules. The first is WEE-1S
23 which reflects the profit that Interstate earned from the summer of 2006 fast ferry
24 operations using the charter (lease) and WEE-1RY which shows my estimate of the profit
25 that will be earned by Interstate's fast ferry operation in the rate year in this docket, with
26 Interstate owning the vessel and paying debt service.

27
28 I recommend that the Commission use my new rate year Schedule WEE-1RY to identify
29 the profit available from the fast ferry operations in the rate year to subsidize the
30 conventional rates. Interstate believes that the profit on Schedule WEE-1RY is an
31 optimistic level of profit but agrees to allow this level of profit for this docket.

1 **Q. Mr. Edge, what are you recommending to the Commission regarding your**
2 **Schedule WEES profit?**

3 A. Interstate wants to provide the highest level of subsidization to its conventional
4 rates from the fast ferry operation but does not wish to put its overall operations in any
5 financial jeopardy. Therefore, Interstate believes that it has identified a perfect way to
6 protect both the ratepayers and the stockholders. The profit from the fast ferry
7 operations in the summer of 2006 is a one time revenue source, but can be used in the
8 future to moderate profit variances in the fast ferry operations. Interstate is
9 recommending that the profit from the fast ferry operations from the summer of 2006 be
10 put into a restricted cash account to be used as a balancing account for variances in the
11 actual profit from fast ferry operations and the amount used to set the conventional rates.

12
13 For example, if we agree to use \$200,000 fast ferry profit figure to reduce conventional
14 rates, and the actual fast ferry profit is \$150,000 in the rate year, then Interstate will take
15 \$50,000 out of the balancing account from the 2006 summer profits. If Interstate's fast
16 ferry operation makes \$250,000 of actual profit in the rate year, then Interstate will
17 deposit another \$50,000 into the balancing account. Each time Interstate files for a rate
18 increase, either conventional or fast ferry, this balancing account will be reviewed and
19 evaluated. If the account shrinks, then the subsidy would be reduced. If the account
20 grows, then the subsidy would be increased. This balancing account will protect
21 everyone.

22
23 **Q. Mr. Edge, is that the end of the Division's adjustments listed on your schedule?**

24 A. Yes. However, there is one last revenue requirement issue that I would like to
25 discuss, which is rate year revenue at current rates. The Division accepted my projected
26 rate year revenue at current rates, but since I filed my prefiled testimony I have additional
27 information that leads me to the conclusion that my original position was overly
28 optimistic.

1 **Q. Why?**

2 A. Interstate's passengers and vehicles carried during this the summer of 2006 were
3 both down significantly. This downturn from the test year was not expected.
4 From May to September of 2006 Interstate suffered an 8.8% reduction in passenger
5 traffic and a 5.7% reduction in vehicle traffic. I have calculated that Interstate revenue
6 was down in just these five months by more than \$300,000.

7

8 When I prepared my original prefiled testimony, I thought that the downturn in passenger
9 traffic had reached bottom and I did not expect any reduction in vehicle traffic. To
10 overstate rate year revenue at current rates will have a huge impact on Interstate's ability
11 to earn its authorized rate of return and continue to provide a high level of year round
12 lifeline service. This exact situation arose in Interstate's last rate case, and as a result
13 Interstate has not earned its authorized rate of return since the last rate case.

14

15 I do not know if the downturn will continue, but the percentage reduction was significant
16 and grew progressively worse from May to September. Interstate could be facing a
17 continued reduction of revenue as a result of continued high speed ferry competition from
18 New London and Quonset Point as well as continued competition for vacation dollars
19 throughout New England, such as Connecticut casinos. Interstate is requesting a
20 \$300,000 adjustment to rate year revenue at test year levels. Interstate does not want to
21 face the same problem it faced in the last docket which resulted in Interstate constantly
22 missing its authorized rate of return because of an inadequate rate year revenue
23 projection.

24

25 **Q. Does that complete your rebuttal of the Division's adjustments?**

26 A. Yes. However, I still have to address the Division's rate design suggestion. It is
27 impossible at this time for Interstate to address the possibility of a rate freeze. Once
28 Interstate has a better understanding of what rate relief it will receive in this docket
29 (possibly during negotiations with the Division) Interstate will be in a much better
30 position to consider the five year rate design proposal of the Division.

31

1 **Q. What is Interstate's current position relating to how the eventual rate increase**
2 **approved by the Commission should be spread over the customer classes?**

3 A. The Division has not completed a rate design cost of service analysis and therefore
4 the Division's suggestions relating to how the eventual increase should be spread are not
5 supported by credible testimony. Interstate believes that without a cost allocation study
6 the rates should be increased equally across the board.

7

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

9 A. Yes it does.