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December 11, 2006

**BY FEDERAL EXPRESS PRIORITY OVERNIGHT AND EMAIL**

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

Re: Opposition of the Town of New Shoreham to Portions of the December 7, 2006 Settlement Agreement Between Interstate Navigation Company and the Division of Public Utilities and Carriers with attached Modifications to Settlement Agreement Based Upon the Town of New Shoreham's Opposition to Portions of the Settlement Agreement as Filed on December 7, 2006

Dear Luly:

Enclosed please find for filing in the above matter an original and nine (9) copies of the Opposition of the Town of New Shoreham to Portions of the December 7, 2006 Settlement Agreement Between Interstate Navigation Company and the Division of Public Utilities and Carriers with attached Modifications to Settlement Agreement Based Upon the Town of New Shoreham's Opposition to Portions of the Settlement Agreement as Filed on December 7, 2006. A copy of this filing is being emailed to you and to the Service List.

Thank you for your assistance in this matter.

Very truly yours,

A handwritten signature in blue ink that reads "Alan Mandl" with a small "(jcm)" in parentheses to the right.

Alan D. Mandl, Bar No. 6590

Enclosures  
cc: Service List

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
PUBLIC UTILITIES COMMISSION**

**In Re: Interstate Navigation Company-     )**  
**General Rate Filing-                 )**                 **Docket No. 3762**  
**Traditional Service Rates            )**

**OPPOSITION OF THE TOWN OF NEW SHOREHAM TO PORTIONS OF THE  
DECEMBER 7, 2006 SETTLEMENT AGREEMENT BETWEEN INTERSTATE  
NAVIGATION COMPANY AND THE DIVISION OF PUBLIC UTILITIES AND  
CARRIERS**

**I.     INTRODUCTION**

Pursuant to Section 1.27(b) of the Commission’s procedural regulations, the Town of New Shoreham (“Town”) files this Opposition to Portions of the December 7, 2006 Settlement Agreement filed by Interstate Navigation Company (“Interstate”) and the Division of Public Utilities and Carriers (“Division”).

The Town requests that the Commission determine that the Settlement Agreement is contested in part and afford the Town the opportunity granted under Section 1.27(b)(3) “to fully present...evidence and legal arguments and cross-examine all pertinent witnesses of other parties, for the purpose of presenting and litigating the contested issues.” The Commission also should establish procedures for the purpose of receiving additional evidence regarding the Rate Plan portions of the settlement Agreement. The Town further requests an opportunity to present legal argument through a brief, after an opportunity to review the hearing record on contested issues.

In order to aid the Commission's review of contested issues, the Town has attached a redlined copy of the Settlement Agreement, which was first provided to the Town late in the day on December 6, 2006 (without the accompanying schedules), reviewed by the Town Council at its evening public meeting on December 6, 2006, and discussed again (with accompanying schedules) at a special session convened on December 11, 2006.<sup>1</sup>

## **II. UNCONTESTED SETTLEMENT PROVISIONS**

The Town does not contest the annual revenue requirement of approximately \$1.1 million or the proposed rate design under Section II of the Settlement Agreement. These provisions are consistent with the Town's Position Statement. In addition, the Town does not contest the Section IV(B) treatment of Interstate's fuel costs. The Town accepts provisions requiring a 3 year amortization of rate case expenses , establishment of a deferred tax reserve and 3 year amortization of one-time profits realized from the 2006 fast ferry operations (Sections IV(D)(1), IV(D)(2) and IV(A)(2), respectively).

These uncontested provisions ought to be severable from the contested portions of the Settlement Agreement. They allow for the establishment of new base rates effective as soon as January 1, 2007, independent of Commission resolution of the contested issues, which likely will require additional time to decide.

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<sup>1</sup> The Town's mark-up also includes clarifying revisions designed to improve upon the precision of terms and remove potential ambiguities in the Settlement Agreement. These smaller points are not discussed in this Opposition, but the Town reserves the right to question the settling parties on these settlement language issues. In addition, the Town reserves the right to raise any additional issues that may arise as a result of the Commission's questioning the settling parties.

### **III. CONTESTED SETTLEMENT AGREEMENT ISSUES**

#### **A. THE PROPOSED 5 YEAR RATE PLAN MUST BE REJECTED AS FILED AND TAINTS THE ENTIRE SETTLEMENT**

The Town has serious reservations about the implementation of the 5 year Rate Plan included in the Settlement Agreement. The Rate Plan is flawed in so many respects that it cannot be approved by the Commission as filed. Because the Rate Plan would govern Interstate's traditional ferry rates for 5 years, the material flaws in the Rate Plan, even when balanced with uncontested portions of the Settlement Agreement, cannot be approved as filed. Overall, the settlement is unjust, unreasonable, unfair, contrary to the public interest and otherwise not in accord with regulatory policy.

##### **1. The Rate Plan Shifts Fast Ferry and Investor Risks to Traditional Service Customers**

The operation of the proposed Rate Plan is linked to the financial results for fast ferry operations, causing potential increases in traditional service base rates due to risks associated with fast ferry operations. As described below, elements of the Rate Plan would enable Interstate to charge exogenous event costs associated with fast ferry operations to traditional service ratepayers. The Town is under the impression after discussions with the settling parties that the Settlement Agreement Rate Plan is intended to allow Exogenous Event impacts on fast ferry operations (e.g., a sunk or damaged fast ferry vessel) to be recovered through adjustments to traditional service base rates. Such a result is patently unreasonable and not in accord with law and regulatory policy.

The earnings below floor and earnings sharing provisions also create the potential for fast ferry operations dragging down overall earnings and causing traditional service

rate increases. The Town understands that no such provision exists in other rate plans approved by the Commission.

The proposed \$208,000 fast ferry revenue credit has not been shown to make traditional ratepayers whole. The Rate Plan allows Interstate to effectively subsidize high speed operations by more than the \$208,000 fast ferry revenue credit by allowing the traditional service to bear virtually all joint and common costs as part of the rate-setting process (for example, non-vessel plant investment, management salaries and benefits, wharfage).<sup>2</sup> Traditional service rates are based on embedded accounting costs, while Interstate intends to record only incremental costs for its fast ferry operations.<sup>3</sup> The settling parties have failed to demonstrate the fairness of this approach. Moreover, the significant financial risks that the Rate Plan shifts from fast ferry passengers and Interstate investors are not safeguarded by the annual \$208,000 revenue credit.

## **2. The Absence of Annual Earnings Sharing is Unreasonable**

The lack of an annual earnings sharing requirement deprives ratepayers of the benefits of any earnings sharing on a timely basis.<sup>4</sup>

## **3. Allowing Interstate to Keep the Entire Equity Return Between 11%-12.5% is Unreasonable**

The earnings sharing requirement is further deficient because it does not apply to all earnings over the allowed rate of return on equity and permits Interstate to retain significant excess profits.<sup>5</sup>

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<sup>2</sup> Schedules WEE-1S and WEE-1RY to Mr. Edge's rebuttal testimony raises many questions about fast ferry related costs that have not been charged or projected to be charged to fast ferry operations.

<sup>3</sup> Existing fast ferry rates have never been based on Interstate's costs, incremental or fully allocated. Mr. Edge's schedules show that the fast ferry is being treated as basically a breakeven operation, before including charter revenues, and without any allocation of joint and common costs to the fast ferry operation.

<sup>4</sup> In *New England Gas*, Docket No. 3401 (2003) at 64, the Commission noted its favoring the calculation of earnings sharing on an annual basis.

The Town has consistently taken the position that Interstate's entry into the fast ferry business should not cause rate increases for traditional ferry services. Yet, the Settlement Agreement allows that to happen. The exogenous event, earnings below floor and earning sharing provisions of the Settlement Agreement all shift fast ferry financial risks to traditional service ratepayers.

**4. The Earnings Below Floor Provision is Unreasonable Because it Effectively Guarantees Interstate an 11 Percent Return on Equity on its Total Operations at the Expense of Traditional Service Ratepayers**

As detailed below, the earnings floor provision of the Rate Plan is unreasonable and contrary to regulatory policy because it allows for increases in traditional ferry rates to cover pre-tax earnings on fast ferry operations below 11%.

Further, this provision effectively guarantees rate increases to Interstate without any requirement that it demonstrate the prudence of its expenses.<sup>6</sup>

**5. No Productivity Factor or Service Quality Plan is Included**

The Rate Plan clearly cannot be considered an incentive rate plan because it imposes no service-related requirements upon Interstate. The Commission has previously expressed its hesitancy to approve rate plans without service quality plans.<sup>7</sup> The Settlement Agreement does not even require that Interstate maintain existing levels of service and imposes no rate reductions for service quality slippage.

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<sup>5</sup> Earnings sharing starts at 11.25% for New England Gas and increases to a 75/25 split in favor of ratepayers at 12.25%. *Id.* at 64.

<sup>6</sup> The Town is concerned that if the Commission approves this provision, this provision will operate automatically and the typical review of rate increases under R.I.G.L. §§39-3-10 and 39-3-11 will be circumvented. For this reason, the Town has recommended that this provision be modified to expressly provide that substantive review of the rate filing under the earnings floor provision is not foreclosed.

<sup>7</sup> *New England Gas*, Docket 3401 (2003) at 64.

For these reasons, the Commission should reject entirely the Rate Plan portion of the Settlement Agreement.<sup>8</sup> Because it is an integral part of the Settlement Agreement, the Rate Plan taints the entire Settlement Agreement, which must be rejected as filed.

**B. ALTERNATIVELY, THE 5 YEAR RATE PLAN MUST BE MODIFIED**

The Rate Plan must be modified in order for the Commission to approve any Settlement Agreement and salvage its good provisions. The modifications suggested by the Town are needed to protect traditional ferry service ratepayers from financial risks associated with fast ferry operations that should instead be covered by fast ferry passenger rates and Interstate's shareholders.

**1. Exogenous Event Rate Increases Should be Based Solely Upon Impacts on Traditional Ferry Service**

Section III(A) of the Settlement Agreement must be modified to assure that Exogenous Event impacts resulting in changes in traditional service base rates relate only to traditional service operations. The Town understands, based on its effort to obtain clarification from the settling parties, that costs associated with the fast ferry operation due to a catastrophe, such as the sinking of the fast ferry vessel, could be recouped from traditional service ratepayers under this provision. Fast ferry costs should not be rolled into the Rate Plan, as fast ferry rates are separately determined by the Commission. Exogenous Event impacts on high speed ferry operations-positive or negative-should not be included in this portion of the Rate Plan. The Town has proposed modifications to eliminate this problem.

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<sup>8</sup> The December 26, 2006 "deadline" for Commission action is an artificial and more time is permitted for Commission action under the suspension period –until the end of February 2007. Prompt rejection of the Settlement Agreement would allow this case to move forward and also afford time for all parties to attempt a reasonable settlement.

In the event that the Town's understanding is found to be incorrect after a hearing record on this issue is developed, it believes that modifications to the Settlement Agreement should be made to avoid any possibility that exogenous event adjustments to traditional service rates would be based on fast ferry-related cost impacts.

**2.. The Settlement Agreement Exogenous Event Provisions Should be Modified to Provide for Offsets in the Case of Insurance Payments or Recoveries From Third Parties**

The Town requests that Section III(A)(1)(b) be revised to provide that any Exogenous Event rate increases due to "catastrophic events" are offset by any insurance proceeds or recoveries from third parties. It is unreasonable to require ratepayers to pay for costs that have been covered by third parties, including insurers. The Town has provided proposed revisions in its attached mark-up.<sup>9</sup>

**3. Local Property Tax Changes Should Not be Considered a "State or Federal Initiated Cost Change**

Section III(A)(1)(a)(1) should be revised to remove the reference to property taxes. This revision is needed in order to make the definition of "State or Federal Initiated Cost Change" internally consistent with its elsewhere stating that local property tax changes are excluded from the definition.

**4. The Commission Should Consider Requiring a Productivity Offset and Service Quality Standards After Taking Additional Evidence**

The Rate Plan allows for CPI-based rate increases during years 2008-2011. However, the Rate Plan provides for no productivity offset from these CPI-based rate increases. In addition, it does not require Interstate to maintain a satisfactory level of

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<sup>9</sup> The Commission should take evidence on the effect of the proposed Settlement Agreement on existing obligations of Interstate under past Commission orders. One example is the treatment of any gain on the sale of the *Manisses*. Other examples involve reporting requirements and service commitments.



service during the 5 year period or require rate reductions for below par performance, as many performance-based rate plans require.<sup>10</sup>

These deficiencies are not present in at least some rate plans approved by the Commission. Given the lifeline nature of traditional ferry service, it is critical that Interstate be required to have the same cost-cutting incentives and service quality obligations demanded of other utilities.<sup>11</sup>

As no evidence has been presented by the settling parties on these typical incentive rate plan provisions, the Commission should direct them to provide additional evidence regarding appropriate productivity offsets and service quality provisions.

**5. The Commission Should Not Permit Guaranteed Earnings on Total Interstate Operations, Including Fast Ferry Operations, During the Post Rate Freeze Period in This Traditional Service Rate Filing**

The earnings below floor provision, Section III (B) (3), effectively guarantees Interstate an 11% return on equity, thereby further eliminating the incentive for increased productivity. This type of earnings guarantee is not in accord with regulatory policy. This type of provision is not contained in other incentive rate plans approved by the Commission, according to the Town's discussion with the Division. The Town submits that this provision (Section III-B-3) should be removed.<sup>12</sup>

If permitted, the earnings below floor provision also would effectively guarantee Interstate an 11% return on equity on its combined traditional and fast ferry operations, even though fast ferry operations are not subject to rate-setting in this case and no matter whether Interstate has acted imprudently or engaged in unreasonable affiliate

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<sup>10</sup> See, e.g., *New England Gas*, Docket No. 3401 (2003).

<sup>11</sup> *Id.*

<sup>12</sup> The Town's marked up draft has not removed this provision in order that it could provide modifications to this provision if it is allowed to remain.

transactions. Sub-par earnings on the fast ferry operation should not be allowed to cause traditional service rate increases. In order to cure this problem, the Town has recommended that the assumed floor on fast ferry profits for purposes of this provision be raised from zero to 5.5%. It has provided language to achieve that result (Section III(B)(3)).

The Town also has provided Settlement Agreement modifications in Section III(B)(3) to expressly provide for the substantive review of any earnings below floor filings in the event that they are permitted. This language would cure another shortcoming or ambiguity in the Settlement Agreement.

**6. Post Rate Freeze Inflation Adjustments**

The Town recommends that Section IV(B)(2) be modified so that the computation of inflation adjustments is not based, in part, upon the fuel cost component of base rates. Changes in fuel costs are covered by a separate statutory fuel charge mechanism and the inflation provision, as drafted, would effectively allow for double counting fuel costs.

**7. Rate Filings After the Rate Plan**

The Town recommends that Section IV(C) of the Settlement Agreement be clarified to provide that after expiration of the Rate Plan (if allowed), there will be no special adjustments for not only Exogenous Events, but also CPI-based inflation factors and earnings below floor provisions of the Settlement Agreement (if allowed).

**8. The Earnings Sharing Plan is Unreasonable**

As discussed above, earning sharing should occur annually and not await the end of the 5 year Rate Plan(if allowed).

In addition, any earnings sharing should begin once the 11% allowed return on common equity is reached. Under the proposed Settlement agreement, no earnings sharing occurs unless Interstate has earned more than 12.50% of equity.

In order to protect conventional service ratepayers from sub-par fast ferry operations, the Commission should impute to fast ferry operations an 11% return on equity floor. Otherwise, traditional service ratepayers would be forced to assume risks that should be placed on fast ferry passengers or Interstate shareholders.<sup>13</sup>

An earnings sharing mechanism as so modified would still provide Interstate with every incentive to maximize its profits from overall operations while at the same time, avoid traditional service ratepayers having to assume financial risks associated with Interstate's fast ferry operations. The Town's proposed modifications properly balance shareholder and ratepayer interests without subjecting traditional service ratepayers to fast ferry business risks.<sup>14</sup>

**9. The Commission Should Reject Section III(E) Because it Relates to Fast Ferry Rate-Setting, Falls Outside the Scope of Issues in This Case and Undermines the Operation of Any Approved Rate Plan**

The Town requests that the Commission reject Section III(E) of the Settlement Agreement. The Commission should not permit Interstate and the Division to dilute the Division's exercise of its statutory duties regarding fast ferry rate filings over a 5 year period. The right of the Division to seek a suspension and substantive investigation of fast ferry rate filings would be limited to undefined "extraordinary circumstances." This

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<sup>13</sup> A potential scenario is the traditional cost of service bearing all common and allocable costs and the fast ferry operation not achieving a high level of profitability. Under this circumstance, overall earnings would suffer as the fast ferry takes passenger business away from the traditional operation but does not operate profitably enough to produce overall earning over 11% on equity. Traditional service ratepayers should not be forced to assume this risk.

<sup>14</sup> Further evidence should be taken as to whether any portion of the fixed \$208,000 fast ferry annual earnings credit should be taken into account in connection with annual earning sharing calculations.

provision is not in accord with law and regulatory policy because the Division should not be permitted to waive its statutory obligations in this manner.

Moreover, because of the nexus between fast ferry rates, net profits and traditional ferry rate-setting, the Division would be effectively tying its hands as to matters that also affect traditional ferry service rates.

The Commission and the rate-paying public rely upon the Division to carry out its duties in all circumstances, not just undefined “extraordinary circumstances.” One can only imagine the future problems that would arise if the Division and Interstate disagreed whether “extraordinary circumstances” were present.

The Town is further troubled by this provision because of Interstate’s stated intent to oppose Town intervention in future fast ferry rate filings, despite the clear nexus between traditional ferry rates and fast ferry rates under the terms of the Settlement Agreement. While the Town believes that its intervention in fast ferry rate proceedings would be proper<sup>15</sup>, it cannot be assured how the Commission would rule on that issue in a future proceeding. For this reason, if the Division were permitted to waive its statutory role, there is a prospect that there would be no parties to offer the Commission evidence and argument regarding proposed fast ferry rate changes.<sup>16</sup>

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<sup>15</sup> The fast ferry can no longer be viewed as a discretionary service, now that it is operated by Interstate in tandem with traditional operations-in effect, no different than just another boat in the fleet that travels somewhat faster than other vessels and doesn’t carry freight or vehicles. Interstate’s and the Division’s commingling of fast ferry operating results with the setting of traditional service rates also gives the Town a direct, specific and substantial interest in assuring that fast ferry rates are set at reasonable levels and that fast ferry schedules and routes are prudently adopted.

<sup>16</sup> R.I.G.L. §39-1-11 expressly provides that the Commission render its decisions “based upon the law and upon the evidence presented before it by the division and the parties in interest.” It would be contrary to law and regulatory policy to undercut this statutory scheme.

**10. Homeland Security Capital Expenditures Should be Capitalized in Accordance with Generally Applicable Accounting Principles**

Section IV(C)(2) of the Settlement Agreement should be modified to require Interstate to capitalize Homeland Security expenditures to the same extent that they would be required to be capitalized under generally accepted accounting principles. No justification has been provided for the Commission's authorizing the expensing of all capital expenditures less than or equal to \$50,000 and the charging of such capital expenditures against the Homeland Security expense reserve account.

**IV. CONCLUSION**

For the reasons above, the Commission should reject the Settlement Agreement in its entirety or modify its terms in accordance with the recommendations of the Town.

Respectfully submitted,

TOWN OF NEW SHOREHAM

By its attorneys,

 (per)

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Alan D. Mandl, Bar No. 6590  
Smith & Duggan LLP  
55 Old Bedford Road  
Lincoln, MA 01773  
(617) 228-4464

Dated: December 11, 2006

**MODIFICATIONS TO SETTLEMENT AGREEMENT BASED UPON THE TOWN OF  
NEW SHOREHAM'S OPPOSITION TO PORTIONS OF THE SETTLEMENT  
AGREEMENT AS FILED ON DECEMBER 7, 2006 [NOTE-THE TOWN HAS  
MODIFIED THE DECEMBER 6, 2006 DOCUMENT PROVIDED BY THE DIVISION  
BASED ON THE REPRESENTATION OF THE SETTLING PARTIES THAT THE  
FILED SETTLEMENT DOCUMENT IS THE SAME]**

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS**

**RHODE ISLAND PUBLIC UTILITIES COMMISSION**

**IN RE: INTERSTATE NAVIGATION COMPANY – )  
GENERAL RATE FILING – ) DOCKET NO. 3762  
TRADITIONAL SERVICE RATES )**

**SETTLEMENT AGREEMENT**

**I. INTRODUCTION**

**A. Summary**

The Interstate Navigation Company (“Interstate” or the “Company”) enters into this settlement agreement (the “Settlement Agreement” or “Settlement”) with the Division of Public Utilities and Carriers (the “Division”) (together, the “Settling Parties”), to resolve all issues arising in this docket, R.I.P.U.C. Docket No. 3762.

The Settling Parties are seeking approval of the Settlement Agreement by the Commission by December 26, 2006, so that the rates established in this Agreement may become effective as of January 1, 2007. Elements of the Settlement include, among other provisions, a two year rate freeze on rates for traditional ferry service after an increase in base rates to produce

\$1,100,694 in additional annual revenues effective January 1, 2007, restrictions on rate increases for traditional ferry service in 2009, 2010, and 2011, a performance-based rate plan which includes an earnings sharing mechanism, and procedures to credit customers for decreases in fuel prices for traditional ferry services below a \$2.00 per gallon floor (including taxes) during the term of the Rate Plan established by the Settlement.

**B. Procedural History**

On July 31, 2006, the Company filed a request for a traditional ferry service rate increase totaling \$2,438,522. During the period August 1 through November 30, 2006, the Company responded to numerous data requests issued by the Division, Commission, and the Town of New Shoreham (“the Town”). On October 27, 2007, the Division filed the direct testimony of David J. Effron, and the Town filed its Position Memorandum through its legal counsel. On November 13 and November 14, 2006, the Company submitted its rebuttal testimony.

**C. Parties’ Statement**

This Settlement Agreement is based on extensive discovery and negotiations among the Settling Parties concerning all issues involved in establishing new base rates for traditional ferry service to become effective January 1, 2007. After due consideration of the testimony, exhibits and other documentation included in the filings by Interstate, the Division, and the Town, the Settling Parties now have agreed to a comprehensive settlement in the rate case which resolves all issues relating to the Company’s traditional service revenue requirement, rate base, rate of return and rate design. The Settling Parties agree that the Settlement Agreement is just and reasonable, and represents a fair and equitable overall resolution of all of their concerns.

The Settlement Agreement is as set out below.

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**Deleted:** , and certain service related issues including the incorporation of the Company’s new high speed ferry service into its business plan.

## II. RATE INCREASE AND RATE DESIGN

For traditional ferry service on and after January 1, 2007, Interstate Navigation Company shall implement a base rate increase from the rates currently in effect, designed to produce \$1,100,694 of additional revenues per year, calculated as shown on Exhibit 1, measured using a rate year of calendar year 2007. The tariffs included in Exhibit 2 shall be approved and implemented effective January 1, 2007, for calendar years 2007 and 2008 (“the Rate Freeze Period”). The tariffs for traditional ferry service in Exhibit 2 include a 0% increase for freight, a 5% increase for commuter passengers and commuter vehicles, and a 15.72% increase for all other tariff services from the base rates presently in effect. Interstate will concurrently adjust its fuel surcharge level to reflect a base price for fuel of \$2.00 per gallon (including taxes), effective January 1, 2007, and will implement the fuel surcharges prospectively pursuant to the procedures specified in Section IV.B, below.

Only the holders of a current Rhode Island driver’s license with solely a Block Island address on the license are eligible for passenger commuter rates, except that for students attending the Block Island School who are too old to qualify for the child rate and too young to obtain a Rhode Island license, a current Block Island School picture identification card may be used to establish eligibility for the commuter passenger rate. To be eligible for the commuter car, SUV, van and pick-up truck rates, the vehicle (1) must be driven by a driver with solely a Block Island address on the current Rhode Island license, and (2) must have solely a Block Island address on the vehicle registration. The eligibility criteria will be included in the Company’s tariff and on the Company’s website.



### III. RATE PLAN

The Rate Plan for traditional ferry service will be in effect from January 1, 2007, through December 31, 2011. This Rate Plan will consist of a Rate Freeze Period consisting of the calendar years 2007 and 2008 and a Post Rate Freeze Period consisting of the calendar years 2009, 2010, and 2011.

#### A. Rate Freeze Period

Interstate's base rates reflected in Exhibit 2 shall be frozen for the Rate Freeze Period, subject only to 1) statutory fuel surcharges if the price of fuel oil, including taxes, exceeds \$2.00 per gallon, subject to the procedures defined in subsection IV.B below, and 2) the exogenous events, defined in subsection 1 below, that occur during the Rate Freeze Period ("Exogenous Events") with regard to traditional ferry service. During the Rate Freeze Period the Company will adjust rates of traditional ferry service resulting from any of these Exogenous Events according to the procedures set forth in subsection 2, below.

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#### 1. Exogenous Events

a. State or Federal Initiated Cost Change: Interstate shall adjust its rates (upward or downward) if the occurrence of a "State or Federal Initiated Cost Change," as defined below, causes (in the aggregate) a change in Interstate's traditional ferry service annual revenue requirement by more than \$100,000. For purposes of this Settlement, the term "State or Federal Initiated Cost Change" shall mean:

(1) the enactment or promulgation of any new or amended Federal, state, or local, laws or regulations, or of any decision issued by a court of competent jurisdiction, governing income, revenue, sales, franchise, gross receipts taxes, or any new or

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amended Federal, state or locally imposed fees (but excluding the effects of annual changes in local property tax rates and revaluations);

(2) the elimination of any existing Federal, state or local tax or fee obligations;

(3) any Federal, state or local legislative or regulatory mandates which impose new or amended obligations, duties or undertakings, or remove existing obligations, duties, or undertakings, which decrease or increase Interstate's costs, revenue, or revenue requirement; and,

(4) any externally imposed changes in the Federal state or local tax rates, laws or regulations or of any decision issued by a court of competent jurisdiction, governing income, revenue, or sales or gross receipts taxes, or any changes in Federal, state or local imposed fees.

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(5) In no case shall the impacts of any State or Federal Initiated Cost Change upon fast ferry operations be recoverable through this provision.

b. Catastrophic Events: Events beyond the reasonable control of Interstate's management, such as (but not limited to) 1) injuries or death(s) to persons in connection with traditional service operations (employees, contractors, passengers, or others); 2) and damage to traditional service vessels or Interstate-owned wharfs or other facilities used to provide traditional service caused by acts of god, acts of war, terrorism, criminal acts, natural disasters, storms such as (but not limited to) hurricanes, fires, flooding, collisions, allisions, or other similar events, and which cumulatively decrease or increase Interstate's costs, revenue, or revenue requirement by more than \$100,000. To the extent that the consequences of a catastrophic event are compensable, through insurance coverage or through actions against a third party.

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**Inserted:** ble through insurance coverage or through actions against a third party. Interstate shall be obligated to seek compensation and credit such compensation or reimbursement against any claimed costs. In no case shall cost impacts from catastrophic events upon fast ferry operations be recoverable through this provision.

Interstate shall be obligated to seek compensation and credit such compensation or reimbursement against any claimed costs. In no case shall cost impacts from catastrophic events upon fast ferry operations be recoverable through this provision.

**2. Procedure for Adjusting Rates During the Rate Freeze Period.**

a. Procedure: If Interstate incurs any changes in costs, revenue, or revenue requirement in excess of the thresholds set forth in the prior section in connection with any of the Exogenous Events that have occurred during the Rate Freeze Period, Interstate shall file for rate adjustments no later than March 1<sup>st</sup> following the calendar year in which the amounts are incurred. If Interstate has not made a filing, the Division has the right to make a filing on its own to open a proceeding if the Division believes that an investigation is required in order to determine whether an Exogenous Event has occurred that should result in a traditional service base rate decrease. Any proposed rate adjustments shall be subject to review by the Commission, and after a public hearing and approval by the Commission, shall be implemented for service no sooner than June 1st following the calendar year in which the Exogenous Event and related impacts occurred, and shall be applied through a uniform percentage rate adjustment applicable to all tariffed services (i.e. across the board).. Absent extraordinary circumstances, any such filings are limited to once per calendar year, and any costs incurred or avoided from such Exogenous Events during a calendar year shall be deferred for consolidation in the single filing. In any proceeding under this subsection, the party claiming that there should be a rate modification resulting from the occurrence of an Exogenous Event shall carry the burden of proving the occurrence and the cost impact. The Company will file a certification with the Commission by March 1st of each calendar year during the Period of the Rate Plan, with copies to the Division and the Town, certifying that, to the best of the Company's knowledge and belief,

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**Deleted:** However, when accumulated deferred costs reach \$100,000 the total cost shall accrue interest at an annual rate of 5% from such time until recovered in rates. In instances where the total accrued costs are less than \$100,000 and the effective date of the adjustment is suspended beyond June 1st, the Company shall be entitled to accrue interest at the 5% annual rate for the accumulated deferred costs (even though less than \$100,000) from June 1st until cost recovery is allowed.

there have been no occurrences of Exogenous Events except as identified in the certification.

b. Earnings Limit: If and when the Company makes a filing seeking an adjustment that increases base rates under this section, if the average annual return on equity of the Company, calculated using the same methodology as set forth in Section D.1.b below, for any calendar year period ending December 31<sup>st</sup> 2008, 2009 or 2010 exceeds 11%, the Company will not be permitted to make a base rate adjustment until the average annual return for such a fiscal year has dropped below 11%. For purposes of this section, fast ferry operations will, if included in the earnings limit analysis, be treated as having had an 11% average annual return on equity. If and when the average annual return on equity drops below 11%, the Company may only recover costs on a prospective basis (i.e. from the date of a Commission order allowing such recovery).

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#### **B. Post Rate Freeze Period**

Interstate's base rates reflected in Exhibit 2 shall be subject only to the specific adjustments defined below during the Post Rate Freeze Period of the Rate Plan.

##### **1. Exogenous Events**

During the Post Rate Freeze Period, the Company will adjust rates resulting from any of the Exogenous Events, as set forth in subsection A.1, above.

##### **2. Inflation**

On or before November 15, 2008, 2009, and 2010, Interstate is authorized to file with the Commission a percentage change in base rates, exclusive of the fuel cost component, to be effective on the following January 1, equal to the percentage change in the average Consumer Price Index ("CPI-U Northeast") from the twelve months ended September 30 of the prior year to the twelve months ended September 30 of the current year. Notwithstanding the foregoing,

base rates applicable to commuters, commuter vehicles, and freight shall not be increased for any rate increases authorized pursuant to this paragraph.

**3. Earnings Below Floor [The Town favors removal of this provision, but has included a mark-up to show proposed modifications it it remains part of any approved, modified Settlement Agreement]**

On or before March 1, 2008, 2009, 2010 and 2011, Interstate will file a report with the Commission detailing the earned return on common equity ("ROE") for the twelve months ended as of the preceding December 31 ("the historic period"). Interstate shall calculate the ROE in each report using the same methodology as set forth in Section D.1.b, below. If the ROE calculated using the same methodology as set forth in Section D.1.b, below, is below 5.5%, and, after hearing, the Commission so approves, Interstate shall be authorized to increase its traditional ferry service rates across the board, effective the following June 1 (unless further suspended by the Commission), to collect over twelve months the revenue necessary to make up the difference between the ROE pursuant to Section D.1.b in the historic period and 5.5%. Any adjustment to rates pursuant to this subsection 3 is independent of any adjustment to rates pursuant to subsection 2 above. In any proceeding in which Interstate seeks a traditional service base rate adjustment under this provision, Interstate shall be required to provide an analysis of the causes of its earned return on common equity falling below the 5.5% level. In any such proceeding, issues concerning, but not limited to, the prudence of expenditures by Interstate, affiliate transactions, cost assignments to fast ferry operations, and impacts of fast ferry operations may be considered as part of the Commission's determination whether a proposed rate increase under this provision is just and reasonable.

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**C. Traditional Cost of Service Ratemaking After the Rate Plan**

After expiration of the Rate Plan, if not extended by agreement of the settling parties and approved, after public hearing, by the Commission, no special adjustments to rates for Exogenous Events, inflation or earnings below floor as described in this Section III Rate Plan, shall be permitted, and rate changes for traditional service may occur under traditional cost of service (“COS”) principles, consistent with Rhode Island law. As such, the Company is permitted to file a COS rate case to change rates effective January 2012 or later, if the Company believes it has or will have a revenue deficiency for the applicable rate year. The Division also has the right to file a complaint with the Commission requesting that the Commission require a COS review to reduce rates beginning in January 2012 if the Division believes that the Company has, or will have, a revenue excess.

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**D. Incentive-Based Savings Plan**

A properly structured incentive-based rate plan can align the interests of the Company and its customers by establishing appropriate incentives to maximize potential economies for the benefit of the Company and its customers. To that end, the Parties agree that economies achieved by the Company shall be shared between the Company and customers as described in this section.

**1. Earnings Reports**

a. The Company will be required to file annual earnings reports with the Commission by March 1 of each year during the Rate Plan Period, commencing March 1, 2008, for each calendar year during the Rate Plan period. Copies also will be filed with the Division and the Town. This annual earnings report will calculate the earned ROE from the Company’s financial statements on the basis of Generally Accepted Accounting Principles (GAAP).

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b. A determination of whether the Company has exceeded its allowed rate of return on equity will be made after the end of each calendar year of the Rate Plan Period. For purposes of calculating return and income taxes for this determination, Interstate shall use the capital structure and associated costs of capital approved by the Commission in this Docket No. 3762. For purposes of these earnings reports, the allowed return on equity shall be 11.0%, and annual earnings report results will be adjusted to reflect established Commission ratemaking principles. However, there will be no adjustments to actual results to recognize or annualize prospective known and measurable changes. The return on common equity will be calculated by dividing the net income available for common equity by the common equity applicable to rate base. The common equity applicable to rate base shall be calculated by multiplying the common equity ratio required by this subsection by Interstate's average rate base. Any earnings as calculated in the annual earnings report above the allowed return on equity of 11.0% shall be shared 50% for customers and 50% for the Company. The customers' share will be credited to customers through the procedure described in subsection 2 below.

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**Deleted:** in a Final Accumulated Earnings Report. Specifically, by June 1, 2012, Interstate shall file the Final Accumulated Earnings Report that determines the actual cumulative average return on equity for the entire Rate Plan Period from January 1, 2007, through December 31, 2011.  
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**2. Customers' Share of Accumulated Earnings**

Prior to proposing a method of crediting customers for the customers' share of annual earnings above the earnings thresholds, Interstate will consult with the Division to propose a mutually acceptable method. The agreed upon method will then be filed with the Commission for review and approval, after public hearing. If the parties cannot reach agreement, Interstate shall file its proposal directly with the Commission subsequent to consulting with the Division and the Commission will make the ultimate determination.

**Deleted:** E. Fast Ferry Rates and Terms and Conditions¶  
 . The Fast Ferry service is a purely discretionary service. Therefore, Interstate shall be authorized to apply to the Commission from time to time to change Fast Ferry Rates and Terms and Conditions and, with Commission approval, to implement such changes on thirty (30) days' notice. The Division except in extraordinary circumstances will not object to any such changes, will not recommend any suspension by the Commission beyond the thirty (30) days' notice, and will not request compliance with any traditional rate filing requirements other than the thirty (30) day notice. Also, the previously agreed methodology for the calculation of Fast Ferry fuel surcharges will not change.

#### IV. SPECIFIED ACCOUNTING REQUIREMENTS

##### A. Fast Ferry

##### 1. Prospective Earnings

All earnings reports required by Section III, above, will include pre-tax profits earned by Interstate's Fast Ferry Division. The actual pre-tax profit earned by the Fast Ferry Division will be calculated employing the debt service method, as shown on Schedule WEE-1RY in this Docket No. 3762. The debt service will include annual interest and principal repayments on all debt used by Interstate to acquire the operations of Island Hi-Speed Ferry in

2006. Additional plant acquired shall be depreciated and the debt service methods shall not apply to such plant additions. For the purpose of the reports required by Section III.D.1.a, above, the annual Fast Ferry pre-tax profit will be fixed at \$208,357. However for the purpose of the annual ROE earnings sharing calculations, in Section III.D.1.b above and for the purpose of calculating the Earnings Below Floor in Section III.B.3 above, the annual Fast Ferry pre-tax profit will be the actual pre-tax profit calculated employing the debt service method, as shown on Schedule WEE-1RY in this Docket, as to the assets acquired from Island High Speed Ferry, up to the amount for which Interstate obtained Division approval in Docket No. D-06-53. However the pre-tax profit used in calculating the Earnings Below Floor will not be less than 5.5% and will not be less than 11% for purposes of the annual ROE earnings sharing calculations in Section III.D.1.b above.

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##### 2. 2006 Earnings

All earnings reports required by Section III, above, will include profits earned by Fast Ferry operations in 2006, deemed to be \$365,750 on a pre-tax basis, amortized over a three year period (\$121,916 per year) commencing January 1, 2007. The amortization will be



complete on December 31, 2009, and no amortization will be included in the calculation of earnings subsequent to that date.

### 3. Revenues and Expenses

Interstate shall account for Fast Ferry revenues and expenses in a timely manner in accordance with the general filing deadlines established by the Division and shall maintain the books of account for its Fast Ferry Division in a manner such that expense categories shown on Schedule WEE-1RY in this Docket No. 3762 can be readily identified. In addition, for expense categories common to traditional and fast ferry operations (e.g., legal and accounting), Interstate shall be prepared demonstrate that it has made reasonably accurate direct assignments of expenses that would not be incurred but for the fast ferry operations.

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#### B. Fuel

##### 1. Base Price

The base price of fuel oil included in the determination of the Company's revenue requirement for traditional ferry service in this Docket No. 3762 ("Base Price") is \$2.00 per gallon, which includes all applicable taxes.

##### 2. Fuel Price Less than Base Price

Commencing January 1, 2007, in any month in which the average price of fuel purchased for traditional ferry services, including all applicable taxes, is less than the Base Price, Interstate will accrue a reserve equal to the volume of fuel purchased in that month times the difference between the actual average price and the Base Price. The reserve balance will be maintained in a separate account on the Interstate balance sheet, or in a readily identifiable sub-account.

**3. Fuel Price in Excess of Base Price**

Commencing January 1, 2007, in any month in which the average price of fuel purchased for traditional ferry service, including all applicable taxes, is in excess of the Base Price, for the purpose of calculating the Fuel Factor component of its rates for the following month, the "Fuel Floor" used in the calculation of the fuel cost eligible for recovery ("Fuel Recovery") will be equal to the Base Price. The eligible Fuel Recovery will be charged against the credit balance, if any, existing in the reserve account established pursuant to subsection 2, above. Any eligible Fuel Recovery in excess of the credit balance in the reserve account will be used to calculate the Fuel Factor (surcharge) component of Interstate's traditional ferry service rates for the following month.

**4. Disposition of Balance in Reserve Account**

If a credit balance exists in the reserve account established pursuant to subsection 2, above, as of December 31, 2011, prior to proposing a method of crediting customers for that balance, Interstate will consult with the Division to propose a mutually acceptable method. The agreed upon method will then be filed with the Commission for review and approval. If the parties cannot reach agreement Interstate shall file its proposal with the Commission and the Commission will make the ultimate determination.

**C. Homeland Security**

**1. Reserve Account**

The balance in the Homeland Security reserve account as of May 31, 2006, is \$83,450. Interstate will continue the reserve method of accounting for Homeland Security expenditures as established in Docket No. 3573, subject to the modifications in subsection 2, below.

## 2. Annual Expense

The annual Homeland Security expense to be recorded by Interstate during the term of the Rate Plan will be \$250,000.

### D. Other

#### 1. Rate Case Expense

For the purpose of all earnings reports required by Section III, above, Interstate will amortize the cost of this rate case and the unamortized rate case cost of Docket No. 3573 over three years. The annual amortization expense is deemed to be \$83,333. The amortization will be complete on December 31, 2009, and no amortization will be included in the calculation of earnings subsequent to that date.

#### 2. Accumulated Deferred Income Taxes

Interstate will establish the appropriate balance of accumulated deferred Federal income taxes on its books of account as of May 31, 2007, including a) the difference between the book basis of its fixed assets and the tax basis of those fixed assets times the applicable Federal income tax rate, and b) deferred federal income taxes on other book-tax temporary differences as may be appropriate pursuant to GAAP. The balance of accumulated deferred income taxes will be maintained in conformity with GAAP. The balance of accumulated deferred income taxes will be deducted from plant in service to determine the rate base used in the earnings reports required in Section III, above.

#### 3. Depreciation Accrual Rates

Interstate will continue to use the depreciation accrual rates in effect during the twelve months ended November 30, 2005, for the term of the Rate Plan.

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## **V. EFFECT OF SETTLEMENT AGREEMENT**

This Settlement Agreement is the result of negotiations among the Settling Parties. The discussions that have produced this Agreement have been conducted on the explicit understanding that all offers of settlement and discussions relating hereto are and shall be privileged, shall be without prejudice to the position of any party or participant presenting such offer or participating in any such discussion, and are not to be used in any manner in connection with these or other proceedings involving any one or more of the parties to this Settlement or otherwise. The agreement by a party to the terms of this Settlement Agreement shall not be construed as an agreement as to any matter of fact or law for any other purpose. In the event that the Commission (i) rejects this Agreement, (ii) fails to accept this Agreement as filed, or (iii) accepts this Agreement subject to conditions unacceptable to any party hereto, then this Agreement shall be deemed withdrawn and shall be null and void in all respects.

IN WITNESS WHEREOF, the parties agree that this Settlement Agreement is reasonable and have caused this document to be executed by their respective representatives, each being fully authorized to do so. Dated at Providence this 7th day of December 2006.

Respectfully submitted,

**INTERSTATE NAVIGATION COMPANY**

**RHODE ISLAND DIVISION OF PUBLIC  
UTILITIES AND CARRIERS**

By its Attorney,

By its Attorney,

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Michael R. McElroy, Esq. (R.I. Bar No. 2627)  
Schacht & McElroy  
21 Dryden Lane  
P.O. Box 6721  
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William K. Lueker, Esq. (R.I. Bar No. 6334)  
Special Assistant Attorney General  
Department of Attorney General  
150 South Main Street  
Providence, RI 02903

CERTIFICATE OF SERVICE

I hereby certify that on this 11<sup>th</sup> day of December, 2006, I served a copy of the foregoing Opposition of the Town of New Shoreham to Portions of the December 7, 2006 Settlement Agreement Between Interstate Navigation Company and the Division of Public Utilities and Carriers with attached Modifications to Settlement Agreement Based Upon the Town of New Shoreham's Opposition to Portions of the Settlement Agreement as Filed on December 7, 2006 in Docket No. 3762 upon all parties by mailing a copy of said Opposition and Modifications to Settlement Agreement by Federal Express Priority Overnight, postage prepaid, and caused a copy of the same to be emailed to all parties.

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Alan D. Mandl, Bar No. 6590