

# McElroy & Donaldson

Michael R. McElroy  
Leah J. Donaldson  
Barnaby E. McLaughlin

Practicing in Rhode Island  
and Massachusetts

Attorneys at Law

21 Dryden Lane  
Post Office Box 6721  
Providence, RI 02940-6721

Michael@McElroyLawOffice.com  
Leah@McElroyLawOffice.com  
Barnaby@McElroyLawOffice.com

(401) 351-4100  
fax (401) 421-5696

September 11, 2020

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

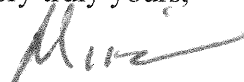
Re: Interstate Navigation Company – Docket No. 4373 – Earnings Report

Dear Luly:

As you know, this office represents Interstate Navigation Company. Enclosed please find an original and nine copies of Interstate Navigation Company's Earnings Report for the period ending May 31, 2019.

If you have any questions, please feel free to call.

Very truly yours,

  
Michael R. McElroy

MRMc:tmg

cc: Susan E. Linda  
David Bebyn

**Docket No. 4373 – Interstate Navigation Co. – Limited Rate Change Application  
Service List as of 6/25/2020**

<b>Name</b>	<b>E-mail</b>	<b>Phone</b>
Michael McElroy, Esq. Schacht & McElroy PO Box 6721 Providence RI 02940-6721	<a href="mailto:Michael@McElroyLawOffice.com">Michael@McElroyLawOffice.com</a> ;	401-351-4100
	<a href="mailto:Leah@McElroyLawOffice.com">Leah@McElroyLawOffice.com</a> ;	
Christy Hetherington, Esq. Dept. of Attorney General 150 South Main St. Providence RI 02903	<a href="mailto:Chetherington@riag.ri.gov">Chetherington@riag.ri.gov</a> ;	401-222-2424
	<a href="mailto:john.bell@dpuc.ri.gov">john.bell@dpuc.ri.gov</a> ;	
	<a href="mailto:john.spirito@dpuc.ri.gov">john.spirito@dpuc.ri.gov</a> ; <a href="mailto:dmacrae@riag.ri.gov">dmacrae@riag.ri.gov</a> ;	
David Bebyn B&E Consulting 21 Dryden Lane Providence RI 02904	<a href="mailto:dbebyn@beconsulting.biz">dbebyn@beconsulting.biz</a> ;	401-785-0800
Katherine A. Merolla, Esq., Merolla & Accetturo 469 Centerville Road Suite 206 Warwick, RI 02886	<a href="mailto:KAMLAW2344@aol.com">KAMLAW2344@aol.com</a> ;	401-739-2900
James Kern, Town Manager Town of New Shoreham PO Drawer 220 Block Island, RI 02807	<a href="mailto:Jkern@new-shoreham.com">Jkern@new-shoreham.com</a> ;	401-466-3219
David Effron Berkshire Consulting 12 Pond Path North Hampton, NH 03862-2243	<a href="mailto:Djeffron@aol.com">Djeffron@aol.com</a> ;	603-964-6526
Richard La Capra 5 Carmine St New York, NY 10014	<a href="mailto:Rlacapra@lacapra.com">Rlacapra@lacapra.com</a> ;	212-675-8123
<b>File an original &amp; nine (9) copies w/:</b> Luly E. Massaro, Commission Clerk Public Utilities Commission 89 Jefferson Blvd. Warwick RI 02888	<a href="mailto:Luly.massaro@puc.ri.gov">Luly.massaro@puc.ri.gov</a> ;	401-780-2107
	<a href="mailto:Cynthia.WilsonFrias@puc.ri.gov">Cynthia.WilsonFrias@puc.ri.gov</a> ;	
	<a href="mailto:Alan.nault@puc.ri.gov">Alan.nault@puc.ri.gov</a> ;	

# ***B&E Consulting, LLC***

*Certified Public Accountants*

(401) 785-0800  
Fax (401) 421-5696

21 Dryden Lane  
Providence, RI 02904

*dbebyn@beconsulting.biz*  
*wedge@beconsulting.biz*

September 11, 2020

Michael R. McElroy, Esq.  
Attorney for Interstate Navigation Company  
21 Dryden Lane  
Providence R.I. 02904

Subject: Interstate Navigation Company FYE May 31, 2018 Earnings Report to the Public Utilities Commission (PUC).

Dear Mike,

This letter is the Interstate Navigation Company FYE May 31<sup>st</sup> 2019 “Earnings Report”. This report provides the earned “Return on Equity” (ROE) informational calculation required to be filed with the Division of Public Utilities and Carrier (DPUC) and the Public Utilities Commission (PUC). This filing requirement is part of the “Settlement Agreement” which is attached as “Appendix A” to the PUC’s Order in Docket No. 4373.

## **The Parameters on How to Calculate Earned ROE**

The method for calculating the earned ROE is described in Section III.D.1.a. of the “Settlement Agreement” as follows:

**“This annual earnings report will calculate the earned ROE from the Company’s financial statements on the basis of Generally Accepted Accounting Principles (GAAP).”** See page 4.

The description of how the ROE is calculated is shown on page 5 of the “Settlement Agreement” in Section III.D.1.b. and is as follows:

**“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.”**  
See page 5.

While rate base is calculated each year by using Interstate’s average rate base, the common equity ratio is set based on the capital structure approved in Docket No. 4373 which is shown on pages 4 and 5 of the “Settlement Agreement” in Section III.D.1.b, as follows:

**“...Interstate shall use the capital structure and associated costs of capital approved by the Commission in this Docket No. 4373.” See page 4.**

**“...there will be no adjustments to actual results to recognize or annualize prospective known and measurable changes.” See page 5.**

Further descriptions of items included in the earnings for the ROE calculation are shown on pages 6, 8 and 9 of the “Settlement Agreement” in Section IV., and are as follows:

Section IV.A.

**“All earnings reports required by Section III, above, will include pre-tax profits earned by Interstate’s Fast Ferry Athena. The actual pre-tax profit earned by the Fast Ferry Division will be calculated employing the debt service method, as shown on the “Analysis of Revenues and Expenses – Interstate Fast Ferry” in the 2012 Annual Report of Water Carriers filed with the Commission. 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.” See page 6.**

Section IV.D.1.

**“For the purpose of all earning reports required by Section III, above, Interstate will amortize the actual cost of this rate case over three years. The amortization will be complete on May 31, 2016, and no amortization will be recognized as an expense subsequent to that date.” See page 8.**

Section IV.D.3.

**Sale of MV Nelseco. “The net proceeds from the sale of the MV Nelseco will be amortized on the Company’s books of account over five years. The amortization will be included in earnings reports required by Section III, above, and the unamortized balance of the proceeds will be deducted from the Company’s rate base in said earnings reports.” See page 9.**

Lastly, there is a need to include a calculation of the earnings over 12%. The settlement agreement caps the return on equity at 11% and details the procedure to share these earnings with customers as described in Section III.D.2., and is as follows:

**“Earnings in excess of 12% will be shared 50% for the stockholders and 50% for the ratepayers. Prior to proposing a method of crediting earnings above the 12.00% threshold applicable to the ratepayers, 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 directly with Commission subsequent to**

**consulting with the Division and the Commission will make the ultimate determination.”** See page 5.

### **FY 2019 ROE Calculations and Schedules**

In preparing this filing for FY 2019 ROE report, I have utilized the same format as the FY 2018 ROE report to calculate earned ROE and any earnings above the earnings cap. The FY 2019 schedules conform with all the requirements mentioned above, which include maintaining the capital structure and associated cost of capital approved by the Commission in Docket No. 4373. These requirements break down into six essential calculations as follows:

1. A calculation of the average rate base as required by page 5 of the “Settlement Agreement” in Section III.D.1.b. Schedule DGB-ROE-2.
2. A calculation of the net income available for common equity as required by page 5 of the “Settlement Agreement” in Section III.D.1.b. This calculation will be adjusted for items to be included in the earnings for the ROE calculation which are shown on pages 6, 8 and 9 of the “Settlement Agreement” in Section IV. Interest calculated based on debt supporting rate base will be used instead of actual interest to maintain the requirement of keeping the capital structure of Docket 4373 as required by pages 4 and 5 of the “Settlement Agreement” in Section III.D.1.b. Lastly since the return on common equity is after-tax, a tax with a rate of 21%. is also applied. The tax rate is what was agreed upon by the Company and the Division as part of a settlement agreement after the finalizing of the FY 2018 ROE report. Schedule DGB-ROE-1.
3. A calculation of common equity applicable to rate base as required by page 5 of the “Settlement Agreement” in Section III.D.1.b. The equity ratio used in the calculation maintains the equity ratio used in the capital structure of Docket 4373 as required by pages 4 and 5 of the “Settlement Agreement” in Section III.D.1.b. Schedule DGB-ROE-1.
4. A calculation of return on common equity as required by page 5 of the “Settlement Agreement” in Section III.D.1.b. This calculation uses the net income available for common equity from calculation 2 above and the common equity applicable to rate base from calculation 3 above. Since calculations 2 and 3 above maintain the capital structure of Docket 4373, this calculation meets the requirement of pages 4 and 5 of the “Settlement Agreement” in Section III.D.1.b. Schedule DGB-ROE-1.
5. A calculation of the earnings in excess of the ROE ceiling is presented using the net income available for common equity from calculation 2 and earnings at the ROE ceiling. The ROE ceiling is calculated using the common equity applicable to rate base from calculation 3 above and multiplying it by 12% as required by page 5 of the “Settlement Agreement” in Section III.D.2. This complies with page 9 of the “Settlement Agreement” in Section IV.D.3. Since calculation 3 above maintains the capital structure

of Docket 4373, this calculation meets the requirement of pages 4 and 5 of the “Settlement Agreement” in Section III.D.1.b. Schedule DGB-ROE-1.

6. Lastly, a calculation of ratepayers share of earnings in excess of the ROE ceiling is presented using the earnings in excess of the ROE ceiling from calculation 5 above and multiplying it by 50% as required by page 5 of the “Settlement Agreement” in Section III.D.2. Schedule DGB-ROE-1. The excess earnings are included on the report in the balance of excess earnings. Schedule DGB-ROE-3. It should be noted that for FYE May 31, 2020, beginning on July 1, 2019, the percentage sharing will change to 25% owners and 75% for the benefit of the ratepayers in accordance with the terms of the July 9, 2018 settlement agreement.

I have completed three compliance schedules and two attachments as follows:

1. An “Earnings Report – Based on Capital Structure-Docket 4373” schedule for FYE May 31, 2019. This schedule includes the tax savings on the ROE below the ceiling in the amount of \$42,880 and a credit for tax expense for tax depreciation on assets purchased by the Capital Reserve in conformity with the FY 2017 ROE report settlement agreement. Schedule DGB-ROE-1.
2. An “Average Rate Base” schedule for FYE May 31, 2019. Schedule DGB-ROE-2.
3. A “Ratepayers Portion of Accumulated Earnings Above 12% ROE Ceiling” schedule for FYE May 31, 2019. This schedule includes the monthly calculation of accrued interest in conformity with the FY 2017 ROE report settlement agreement. Schedule DGB-ROE-3.
4. Attachment-1 “Deferred Regulatory Revenue-Nelseco Sale” showing the Unamortized Balance of the Sale of MV Nelseco for FYE May 31, 2019. This report complies with page 9 of the “Settlement Agreement” in Section IV.D.3.
5. Attachment-2 “Analysis of Revenue and Expenses – Interstate Fast Ferry”. This complies with page 6 of the “Settlement Agreement” in Section III.D.1.b and was filed with Interstate’s May 31, 2019 Annual Report.

### Results

My calculations on Schedule DGB-ROE-1 resulted in a return on equity of 116.3% which is higher than the 12% on page 5 of the “Settlement Agreement”, Section III.D.2. My calculations resulted in earnings in excess of the 12% ceiling in the amount of \$1,519,533. Section III.D.2., of the “Settlement Agreement” states that “Earnings in excess of 12% will be shared 50% for the stockholders and 50% for the ratepayers.” Thus, this provision in the settlement states that excess earnings of \$759,767 (50% of \$1,519,533) for FY 2019 should be used to benefit ratepayers. Furthermore, the tax savings on the ROE below the ceiling in the amount of \$42,880 is added to the calculated excess earnings in conformity with the FY 2017 ROE settlement agreement. There was no credit for FY 2019 for tax expense for tax depreciation on assets

purchased by the Capital Reserve since no assets had been purchased from the reserve by the end of FY 2019. The total excess earnings for FY 2019 including the tax savings was \$802,647 for FY 2019 that should be used to benefit ratepayers.

Schedule DGB-ROE-1 shows that adjusted pre-tax operating income on total operations was \$2,144,824. The adjusted pre-tax operating income on Fast Ferry operations, which is included in the calculation for ROE, was \$1,314,561. Therefore, about 61% of the adjusted pre-tax operating income was generated from the Fast Ferry operations. The settlement agreement set the profit subsidy to the Traditional Service at \$481,981.

As a result of the FY 2014 ROE filing, Interstate agreed to maintain a record of excess earnings. In addition, as a result of with the FY 2018 ROE settlement agreement, Interstate agreed that the balance would be transferred to the capital reserve, less \$300,000 which would be transferred to the fuel reserve account. These transfers have been made.

Please note that The \$802,647 balance includes the monthly calculation of accrued interest in conformity with the FY 2018 ROE settlement agreement. The interest rate used for the calculation was calculated using the year end interest income earned by Interstate.

Interstate is requesting that the FY 2019 excess earning of \$802,647 be transferred to the capital reserve, as the Division and Commission approved for the FY 2018 ROE. excess earnings. See Commission Order No. 23850 in Docket No. 4373, issued on June 25, 2020. Schedule DGB-ROE-3 presents the \$2,035,078 balance of the excess earning as of the end of FY 2018. Adding the \$802,647 for FY 2019 results in a total accumulated balance of excess earnings to be shared with ratepayers of \$2,846,493 at the end of FY 2019.

We hope that the Division and Commission once again agree to continue funding the Capital Reserve with the FY 2019 excess earnings. I expect that the entire \$2,846,493 accumulated capital reserve will be utilized by Interstate in FY 2020 because of the complete overhaul of the M/V *Anna C* which was just completed at a cost of about \$3.5 million. Moreover, Interstate expects to repower the M/V *Athena* in the near future.

The FY 2020 excess earnings should be lower than FY 2019 because the August 2, 2019 settlement agreement for the FY 2018 ROE report required a 10% reduction in Interstate's non-commuter passenger rates effective for rates starting February 21, 2020. Also, I expect that ridership and associated revenues for 2020 have been negatively impacted by the COVID-19 travel restrictions.

If I can be of any additional assistance, please do not hesitate to contact me directly.

Sincerely

David G. Bebyn CPA  
President

Earnings Report - Based on Capital Structure-Docket 4373  
For Fiscal Year Ended May 31, 2019  
 Interstate Navigation Company

*Schedule DGB-ROE-1*

		<u>Total</u>
<b><u>Calculation of Net Income available for Common Equity</u></b>		
Revenues	Annual Report	\$ 16,094,621
Operation and Maintenance Expenses *	Annual Report	12,799,224
Total Depreciation Expense	Annual Report	<u>970,090</u>
Pre-Tax Operating Income		2,325,307
Adjustments:		
Fast Ferry Depreciation & Amortization	\$168,000 + \$94,166 annually	262,166
Fast Ferry Principal	Annual Report-FF Schedule	(162,689)
Fast Ferry Interest	Annual Report-FF Schedule	(148,155)
Excess HL Expenses over settlement of \$315K	Annual Report-HL Schedule	15,821
Amortization of Gain on Nelseco	See Attachment-1	-
Total Adjustments		<u>(32,857)</u>
Adjusted Pre-Tax Operating Income		2,292,450
Interest on Debt Supporting Rate Base	Rate Base** X Wtd Debt Cost***	<u>147,626</u>
Adjusted Pre-Tax Income		2,144,824
Income Taxes (rate 21%)		<u>450,413</u>
Net Income available for Common Equity		<u>\$ 1,694,411</u>

**Calculation of Common Equity Applicable to Rate Base**

Common Equity Supporting Rate Base	Equity Ratio**** X Rate base	<u>\$ 1,457,316</u>
------------------------------------	------------------------------	---------------------

**Calculation of the return on Common Equity and Percentage above ROE Ceiling**

Return on Common Equity	Net Income / CE supp RB	116.3%
ROE Ceiling from Settlement		<u>12.0%</u>
Percentage of Earnings Above 12%	Return on CE - ROE Ceiling	104.3%

**Calculation of Earnings in Excess of ROE Ceiling**

Earnings	Net Income available for CE	\$ 1,694,411
Earnings at ROE Ceiling from Settlement	CE supp RB X 12%	<u>174,878</u>
Earnings in Excess of 12%		<u>\$ 1,519,533</u>

**Per Settlement Section III. D. 2. on page 5**

Customer Share	50% of Earnings in Excess of 12%	\$ 759,767
Tax Savings from tax on ROE below ceiling - Response to COMM1-1 in Docket # 4792		42,880
Credit for tax expense on Tax Depreciation for Asset purchased from Capital Reserve		-
		<u>802,647</u>

\* Operation and Maintenance Expenses above include amortization of Rate Case Expense in compliance with Settlement Section IV.D.1. on page 8

\*\* Rate Base 5,570,780 See Schedule DGB-ROE-2

\*\*\* Weighted Debt Cost 2.65% See Schedule DGB-ROE-2

\*\*\*\* Equity Ratio 26.16% See Schedule DGB-ROE-2



Average Rate Base  
For Fiscal Year Ended May 31, 2019  
 Interstate Navigation Company

*Schedule DGB-ROE-2*

**Average Rate Base Per Settlement Section III. D. 1. on page 5 & Section IV. D. 3. on page 9**

		<u>5/31/2018</u>	<u>5/31/2019</u>	<u>Average</u>
Net Plant	Annual report page 5	\$ 7,337,142	\$ 8,162,337	\$ 7,749,740
<u>Athena</u>				
Plant In Service	Annual report page 12	4,200,000	4,200,000	4,200,000
Accumulated Depreciation	Annual report page 12	1,937,040	2,105,040	2,021,040
Net Plant - Athena		<u>2,262,960</u>	<u>2,094,960</u>	<u>2,178,960</u>
Net Plant Excluding Athena		5,074,182	6,067,377	5,570,780
Accumulated Deferred Income Taxes	AR page 5a	-	-	-
Deferred Gain on Nelseco	See Attachment-1	-	-	-
Rate Base		<u>\$ 5,074,182</u>	<u>\$ 6,067,377</u>	<u>\$ 5,570,780</u>

Settlement Capital Structure per Docket 4373			
	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long Term Debt	73.85%	3.59%	2.65%
Common Equity	26.16%	11.00%	<u>2.88%</u>
Total Capital	<u>100.01%</u>		<u>5.53%</u>

Ratepayers Portion of  
Accumulated Earnings Above 12% ROE Ceiling  
For Fiscal Year Ended May 31, 2019  
Interstate Navigation Company

*Schedule DGB-ROE-3*

**Excess Earnings held in Capital Reserve**

		<u>Total</u>
FY 2014-18 Results	Agreed to with Division in 2018 Settlement	\$ 2,035,078 *
Capital Reserve funds used during FY 2019		-
Interest Accrued during FY 2019		8,768
FY 2019 Results		<u>802,647</u>
	Balance at May 31, 2019	<u><u>\$ 2,846,493</u></u>

	Balance	APY Interest Rate	Accrued Interest	Ending Balance
Jun-17	2,035,078	0.43%	729	2,035,807
Jul-17	2,035,807	0.43%	729	2,036,537
Aug-17	2,036,537	0.43%	730	2,037,266
Sep-17	2,037,266	0.43%	730	2,037,997
Oct-17	2,037,997	0.43%	730	2,038,727
Nov-17	2,038,727	0.43%	731	2,039,457
Dec-17	2,039,457	0.43%	731	2,040,188
Jan-18	2,040,188	0.43%	731	2,040,919
Feb-18	2,040,919	0.43%	731	2,041,651
Mar-18	2,041,651	0.43%	732	2,042,382
Apr-18	2,042,382	0.43%	732	2,043,114
May-18	2,043,114	0.43%	<u>732</u>	2,043,846
			8,768	

\* Net of transfer of \$300,000 to Fuel Reserve

Deferred Regulatory Revenue-Nelseco Sale  
Interstate Navigation Company  
5/31/19

Attachment-1  
2019-ROE

G/L # 1990

Balance per General Ledger at 5/31/19	-
Balance per detailed analysis at 5/31/19	<u>-</u>
Variance	<u><u>-</u></u>

*Analysis of Deferred Nelseco Sale Rev:*

Balance at 5/31/18	-
	-
Additions	-
	-
Yearly Amortization	-
	-
Balance per detailed analysis at 5/31/19	<u><u>-</u></u>

Fully amortized by the end of fiscal year ended May 31, 2018

**Attachment-2**  
**2019 ROE**

Analysis of Revenue and Expenses  
Interstate Fast Ferry

	<u>Actual</u> <u>FYE 5/31/18</u>	<u>Actual</u> <u>FYE 5/31/19</u>
<b>Revenues:</b>		
Passenger Revenue	\$ 2,254,721	\$ 2,417,373
Other Revenues (Bar, bike, etc)	137,172	144,430
Charter Revenue	<u>40,850</u>	<u>-</u>
Total Revenue	2,432,743	2,561,803
<b>Expenses:</b>		
Salaries and wages	155,254	224,930
Payroll taxes	11,965	16,764
Fuel	240,301	313,727
Maintenance:		
Vessel Maintenance-Athena	297,021	122,456
Lube Oil	8,658	14,842
Other Vessel Expenses	14,497	6,045
Insurance	33,747	33,747
Advertising	127,945	86,932
Bar expense	45,205	44,045
General and Administrative Expense	111	-
Legal and accounting	-	-
General office supplies	-	695
Gross Receipts Taxes	32,318	32,589
Boat Charter	39,625	39,625
Fees (coast guard, banking, etc)	-	-
<u>Debt service on \$5,600,000:</u>		
Principal	157,226	162,689
Interest	<u>149,024</u>	<u>148,155</u>
Total Expense	1,312,897	1,247,241
<b>Net Income Before Taxes</b>	<u><b>1,119,846</b></u>	<u><b>1,314,561</b></u>
Federal Income Tax	<u>213,053</u>	<u>252,513</u>
Net Income	<u><u>\$ 906,793</u></u>	<u><u>\$ 1,062,048</u></u>