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August 2, 2019

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, 2018.

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 8/2/19**

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August 2, 2019

Michael R. McElroy, Esq.
Attorney for Interstate Navigation Company
21 Dryden Lane
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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 31st 2018 "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 2018 ROE Calculations and Schedules

In preparing this filing for FY 2018 ROE report, I have utilized the same format as the FY 2017 ROE report to calculate earned ROE and any earning above the earnings cap. The FY 2018 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 2017 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.

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

1. A “Earnings Report – Based on Capital Structure-Docket 4373” schedule for FYE May 31, 2018. This schedule has been updated from the FY 2017 ROE report to now include 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, 2018. Schedule DGB-ROE-2.
3. A “Ratepayers Portion of Accumulated Earnings Above 12% ROE Ceiling” schedule for FYE May 31, 2018. This schedule has been updated from the FY 2017 ROE report to now include 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, 2018. 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 will be filed with Interstate’s May 31, 2018 Annual Report.

Results

My calculations on Schedule DGB-ROE-1 resulted in a return on equity of 124.6% 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 \$1,531,901. 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 \$765,950 (50% of \$1,531,901) for FY 2018 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 report settlement agreement. The total is \$808,830.

There was no credit for FY 2018 for tax expense for tax depreciation on assets purchased by the Capital Reserve since no assets have been purchased from the reserve by the end of FY 2018.

Schedule DGB-ROE-1 shows that adjusted pre-tax operating income on total operations was \$2,145,713. The adjusted pre-tax operating income on Fast Ferry operations, which is included in the calculation for ROE, was \$1,119,846. Therefore, about 52% 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 2017 ROE report settlement agreement, Interstate agreed that the balance would be transferred to a capital reserve less \$300,000 which would be transferred to the fuel reserve account. The balance includes the monthly calculation of accrued interest in conformity with the FY 2017 ROE report settlement agreement. The interest rate used for the calculation was calculated using the year end interest income earned by Interstate.

Interstate is therefore requesting that the FY 2018 excess earning of \$808,830 be transferred \$300,000 to the fuel reserve as we did last year and \$508,830 to the capital reserve as what was done with the balance for the FY 2017 ROE report settlement agreement. Schedule DGB-ROE-3 presents the balance of the excess earning as of the end of FY 2018. This results in a total accumulated balance of excess earnings to be shared with ratepayers of \$2,035,078 at the end of FY 2018.

We hope that the Division and Commission agree that the above proposed funding of the fuel and capital reserves with the FY 2018 excess earnings as set forth above is the appropriate arrangement. 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, 2018
 Interstate Navigation Company

Schedule DGB-ROE-1

<u>Calculation of Net Income available for Common Equity</u>		<u>Total</u>
Revenues	Annual Report	\$ 15,056,484
Operation and Maintenance Expenses *	Annual Report	12,079,818
Total Depreciation Expense	Annual Report	<u>836,422</u>
Pre-Tax Operating Income		2,140,244
Adjustments:		
Fast Ferry Depreciation & Amortization	\$168,000 + \$94,166 annually	262,166
Fast Ferry Principal	Annual Report-FF Schedule	(157,226)
Fast Ferry Interest	Annual Report-FF Schedule	(149,024)
Excess HL Expenses over settlement of \$315K	Annual Report-HL Schedule	13,580
Amortization of Gain on Nelseco	See Attachment-1	<u>173,752</u>
Total Adjustments		143,248
Adjusted Pre-Tax Operating Income		2,283,492
Interest on Debt Supporting Rate Base	Rate Base** X Wtd Debt Cost***	<u>137,779</u>
Adjusted Pre-Tax Income		2,145,713
Income Taxes (rate 21%)		<u>450,600</u>
Net Income available for Common Equity		<u>\$ 1,695,114</u>

<u>Calculation of Common Equity Applicable to Rate Base</u>		
Common Equity Supporting Rate Base	Equity Ratio**** X Rate base	<u>\$ 1,360,108</u>

<u>Calculation of the return on Common Equity and Percentage above ROE Ceiling</u>		
Return on Common Equity	Net Income / CE supp RB	124.6%
ROE Ceiling from Settlement		<u>12.0%</u>
Percentage of Earnings Above 12%	Return on CE - ROE Ceiling	112.6%

<u>Calculation of Earnings in Excess of ROE Ceiling</u>		
Earnings	Net Income available for CE	\$ 1,695,114
Earnings at ROE Ceiling from Settlement	CE supp RB X 12%	<u>163,213</u>
Earnings in Excess of 12%		<u>\$ 1,531,901</u>

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

Customer Share	50% of Earnings in Excess of 12%	\$ 765,950
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>808,830</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 5,199,189 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, 2018
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>5/31/2017</u>	<u>5/31/2018</u>	<u>Average</u>
Net Plant	Annual report page 5	\$ 7,928,908	\$ 7,337,142	\$ 7,633,025
<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	1,769,040	1,937,040	1,853,040
Net Plant - Athena		<u>2,430,960</u>	<u>2,262,960</u>	<u>2,346,960</u>
Net Plant Excluding Athena		5,497,948	5,074,182	5,286,065
Accumulated Deferred Income Taxes	AR page 5a	-	-	-
Deferred Gain on Nelseco	See Attachment-1	(173,752)	-	(86,876)
Rate Base		<u>\$ 5,324,196</u>	<u>\$ 5,074,182</u>	<u>\$ 5,199,189</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%	2.88%
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, 2018
Interstate Navigation Company

Schedule DGB-ROE-3

Excess Earnings held in Capital Reserve

		<u>Total</u>
FY 2014-17 Results	Agreed to with Division in 2017 Settlement	\$ 1,819,700
Amount transferred to Fuel Reserve per 2017 Settlement		(300,000)
Capital Reserve funds used during FY 2018		-
Interest Accrued during FY 2018		6,548
FY 2018 Results		808,830
Amount requested from the FY 2018 to be transferred to Fuel Reserve		<u>(300,000)</u>
Balance at May 31, 2018		<u><u>\$ 2,035,078</u></u>

	Balance	APY Interest Rate	Accrued Interest	Ending Balance
Jun-17	1,519,700	0.43%	545	1,520,245
Jul-17	1,520,245	0.43%	545	1,520,789
Aug-17	1,520,789	0.43%	545	1,521,334
Sep-17	1,521,334	0.43%	545	1,521,879
Oct-17	1,521,879	0.43%	545	1,522,425
Nov-17	1,522,425	0.43%	546	1,522,970
Dec-17	1,522,970	0.43%	546	1,523,516
Jan-18	1,523,516	0.43%	546	1,524,062
Feb-18	1,524,062	0.43%	546	1,524,608
Mar-18	1,524,608	0.43%	546	1,525,154
Apr-18	1,525,154	0.43%	547	1,525,701
May-18	1,525,701	0.43%	<u>547</u>	1,526,248
			6,548	

Deferred Regulatory Revenue-Nelseco Sale
Interstate Navigation Company
5/31/18

G/L # 1990

Balance per General Ledger at 5/31/18	-
Balance per detailed analysis at 5/31/18	-
	<hr/>
Variance	-
	<hr/> <hr/>

Analysis of Deferred Nelseco Sale Rev:

Balance at 5/31/17	(173,752.00)
Additions	-
	-
Amortization for last year	173,752.00
	-
Balance per detailed analysis at 5/31/18	-
	<hr/> <hr/>

Analysis of Revenue and Expenses
Interstate Fast Ferry

	<u>Actual</u> <u>FYE 5/31/17</u>	<u>Actual</u> <u>FYE 5/31/18</u>
Revenues:		
Passenger Revenue	\$ 2,274,745	\$ 2,254,721
Other Revenues (Bar, bike, etc)	134,378	137,172
Charter Revenue	<u>30,400</u>	<u>40,850</u>
Total Revenue	2,439,522	2,432,743
Expenses:		
Salaries and wages	163,636	155,254
Payroll taxes	12,416	11,965
Fuel	205,485	240,301
Maintenance:		
Vessel Maintenance-Athena	233,106	297,021
Lube Oil	9,457	8,658
Other Vessel Expenses	37,280	14,497
Insurance	33,027	33,747
Advertising	148,258	127,945
Bar expense	45,293	45,205
General and Administrative Expense	903	111
Legal and accounting	375	-
General office supplies	19,326	-
Gross Receipts Taxes	31,641	32,318
Boat Charter	39,900	39,625
Fees (coast guard, banking, etc)	1,365	-
<u>Debt service on \$5,600,000:</u>		
Principal	157,060	157,226
Interest	<u>232,000</u>	<u>149,024</u>
Total Expense	1,370,527	1,312,897
Net Income Before Taxes	<u>1,068,996</u>	<u>1,119,846</u>
Federal Income Tax	<u>327,934</u>	<u>213,053</u>
Net Income	<u><u>\$ 741,062</u></u>	<u><u>\$ 906,793</u></u>