

# McElroy & Donaldson

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August 11, 2021

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

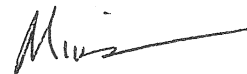
Re: Interstate Navigation Company – Docket No. 4373 – Earnings Report

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, 2020.

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

Very truly yours,

  
Michael R. McElroy

MRMc:tmg

cc: Susan E. Linda  
David Bebyn  
Service list

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

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<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> ;	
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August 8, 2021

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

Subject: Interstate Navigation Company FYE May 31, 2020 Earnings Report to the Public Utilities Commission (PUC).

Dear Mike,

This letter is the Interstate Navigation Company FYE May 31<sup>st</sup> 2020 “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 2020 ROE Calculations and Schedules**

In preparing this filing for FY 2020 ROE report, I have utilized the same format as the FY 2019 ROE report to calculate earned ROE and any earning above the earnings cap. The FY 2020 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 the percentage required for the benefit of the ratepayers. In prior ROE reports the percentage required for the benefit of the ratepayers was 50% as required by page 5 of the “Settlement Agreement” in Section III.D.2, however, percentage sharing changes to 25% owners and 75% for the benefit of the ratepayers in accordance with the terms of the July 9, 2018 settlement agreement effective July 1, 2019. Schedule DGB-ROE-1 is calculated with the ratepayers share of earnings in excess of the ROE ceiling using the earnings in excess of the ROE ceiling from calculation 5 above and multiplying it by 75% as mentioned above. The excess earnings are included on the report in the balance of excess earnings.

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, 2020. 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, 2020. Schedule DGB-ROE-2.
3. A “Ratepayers Portion of Accumulated Earnings Above 12% ROE Ceiling” schedule for FYE May 31, 2020. 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, 2020. 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, 2020 Annual Report.

## Results

My calculations on Schedule DGB-ROE-1 resulted in a return on equity of 68.5% 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 \$874,106. Section III.D.2., of the "Settlement Agreement" states that "Earnings in excess of 12% will be shared 25% for the stockholders and 75% for the ratepayers." Thus, this provision in the settlement states that excess earnings of \$655,579 (75% of \$874,106) for FY 2020 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 for a total of \$698,459. There was no credit for FY 2020 for tax expense for tax depreciation on assets purchased by the Capital Reserve since the asset was capitalized on 5/30/20 which resulted in no tax depreciation for the end of FY 2020. The credit for the tax expense will start with the FY 2021 report. The total excess earnings for FY 2020, including the tax savings, was \$698,459 and should be used to benefit ratepayers.

Schedule DGB-ROE-1 shows that adjusted pre-tax operating income on total operations was \$1,341,319. The adjusted pre-tax operating income on Fast Ferry operations, which is included in the calculation for ROE, was \$1,303,377. Therefore, about 97% 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. It should also be noted that non-commuter passenger rates were reduced as part of the FY 2018 ROE settlement effective January 2020. If the reduced rates had been in effect for the entire fiscal year, the ROE would have been approximately \$500,000 less, resulting in a return on equity of only 36.2%, and all profits would have been generated from the Fast Ferry operations.

As a result of the FY 2014 ROE filing, Interstate agreed to maintain a record of excess earnings. In addition, the balance includes the monthly calculation of accrued interest in conformity with the FY 2019 ROE report settlement agreement. The interest rate used for the calculation was calculated using the year end interest income earned by Interstate.

Additionally, Interstate utilized \$3,044,142 of the reserve to fund the repowering of the MV Anna C. Interstate is requesting that the FY 2020 excess earnings of \$698,459 less \$300,000 to replenish the fuel reserve, be transferred to the capital reserve which is what was done with the balance for the FY 2019 ROE report settlement agreement. Schedule DGB-ROE-3 presents the balance of the excess earnings as of the end of FY 2020. This results in a total accumulated balance of excess earnings to be shared with ratepayers of \$211,984 at the end of FY 2020.

Regarding the request for \$300,000 of the 2020 ROE to replenish the fuel reserve, I am making this recommendation since the fuel reserve account has been steadily declining. Part of this decline was planned as the result of a Settlement between Interstate and the Division, signed on February 18, 2021. In that Settlement the parties proposed a "negative fuel surcharge" of \$1.00, which was later approved, to be credited to all

passengers and vehicle tickets until the Fuel Account balanced reached \$50,000. This balance was projected to last till the end of September 2021. However, the entire balance is expected to run out before the end of August due to increased fuel costs over projections. With the transfer of \$300,000 of the 2020 ROE, Interstate will be able to maintain the “negative fuel surcharge” of \$1.00 on the tickets until the end of September, as originally projected. Under that scenario, Interstate would automatically revert passenger and vehicle ticket prices back to the pre-credit rates on October 1, 2021.

We hope that the Division and Commission agree that continued funding of the Capital Reserve with the FY 2020 excess earnings is the appropriate arrangement. The FY 2021 ROE should be lower than FY 2020 because (1) the August 2, 2019 settlement agreement for the FY 2018 ROE report required a 10% reduction in Interstate’s non-commuter passenger rates, effective on Rates starting January 1, 2020, and (2) the COVID passenger limitations were in effect for the summer of 2020.

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, 2020  
Interstate Navigation Company

Schedule DGB-ROE-1

<u>Calculation of Net Income available for Common Equity</u>	Total
Revenues	Annual Report-page 6 \$ 14,898,204
Operation and Maintenance Expenses *	Annual Report-page 6a 12,305,771
Total Depreciation Expense	Annual Report-page 6a <u>1,003,400</u>
Pre-Tax Operating Income	1,589,033
Adjustments:	
Fast Ferry Depreciation & Amortization	\$168,000 + \$94,166 annually 262,166
Fast Ferry Principal	Annual Report-FF Schedule (168,340)
Fast Ferry Interest	Annual Report-FF Schedule (138,034)
Excess HL Expenses over settlement of \$315K	Annual Report-HL Schedule 16,711
Income due to use of Fuel Reserve funded by PY ROE Excess (1)	(215,801)
Depreciation of Assets purchase from Capital Reserve	Annual Report-page 11 <u>152,207</u>
Total Adjustments	<u>(91,091)</u>
Adjusted Pre-Tax Operating Income	1,497,942
Interest on Debt Supporting Rate Base	Rate Base** X Wtd Debt Cost*** 156,623
Adjusted Pre-Tax Income	<u>1,341,319</u>
Income Taxes (rate 21%)	<u>281,677</u>
Net Income available for Common Equity	<u><u>\$ 1,059,642</u></u>

Calculation of Common Equity Applicable to Rate Base

Common Equity Supporting Rate Base	Equity Ratio**** X Rate base <u>\$ 1,546,135</u>
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Calculation of the return on Common Equity and Percentage above ROE Ceiling

Return on Common Equity	Net Income / CE supp RB 68.5%
ROE Ceiling from Settlement	<u>12.0%</u>
Percentage of Earnings Above 12%	Return on CE - ROE Ceiling 56.5%

Calculation of Earnings in Excess of ROE Ceiling

Earnings	Net Income available for CE \$ 1,059,642
Earnings at ROE Ceiling from Settlement	CE supp RB X 12% 185,536
Earnings in Excess of 12%	<u><u>\$ 874,106</u></u>

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

Customer Share	75% of Earnings in Excess of 12% \$ 655,579
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><u>698,459</u></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 5,910,304 See Schedule DGB-ROE-2

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

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

(1) Prior Year funds transferred to Fuel reserve reduced retained earnings and increased fuel reserve liability. When the funds are used, the liability is reduced and a surcharge revenue is recognized. Since this revenue being recognized in essence a second time, it is being adjusted out similar to the way depreciation from assets purchased from the capital fund is removed.

Average Rate Base  
For Fiscal Year Ended May 31, 2020  
 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**

		5/31/2018	5/31/2019	Average
Net Plant	Annual report page 5	\$ 8,162,337	\$ 10,572,125	\$ 9,367,231
<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	2,105,040	2,273,040	2,189,040
Net Plant - Athena		2,094,960	1,926,960	2,010,960
<u>Assets Purchased with Capital Reserve</u>				
Plant In Service	Annual report page 11	-	3,044,142	1,522,071
Accumulated Depreciation	Annual report page 11	-	152,207	76,104
Net Plant - Athena		-	2,891,935	1,445,968
Net Plant Excluding Athena & Assets Purchased with Capital Reserve		6,067,377	5,753,230	5,910,304
Accumulated Deferred Income Taxes	AR page 5a	-	-	-
Deferred Gain on Nelseco	See Attachment-1	-	-	-
Rate Base		\$ 6,067,377	\$ 5,753,230	\$ 5,910,304

**Settlement Capital Structure per Docket 4373**

	Percent of Total	Cost Rate	Weighted Cost
Long Term Debt	73.85%	3.59%	2.65%
Common Equity	<u>26.16%</u>	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, 2020  
Interstate Navigation Company

*Schedule DGB-ROE-3*

**Excess Earnings held in Capital Reserve**

		<u>Total</u>
FY 2014-19 Results	Agreed to with Division in 2019 Settlement	\$ 2,846,493
Capital Reserve funds used during FY 2020		(3,044,142)
Interest Accrued during FY 2020		11,173
FY 2020 Results		<u>698,459</u>
Balance at May 31, 2020		<u>\$ 511,984</u>
Recommended transfer to Fuel reserve to keep \$1 Credit going for Summer		<u>\$ (300,000)</u>
Recommended Balance at May 31, 2020		<u>\$ 211,984</u>

	<u>Balance</u>	APY Interest Rate	Accrued Interest	Ending Balance
Jun-19	2,846,493	0.43%	1,020	2,847,513
Jul-19	2,847,513	0.43%	1,020	2,848,533
Aug-19	2,848,533	0.43%	1,021	2,849,554
Sep-19	2,849,554	0.43%	1,021	2,850,575
Oct-19	2,850,575	0.43%	1,021	2,851,597
Nov-19	2,851,597	0.43%	1,022	2,852,618
Dec-19	2,852,618	0.43%	1,022	2,853,641
Jan-20	2,853,641	0.43%	1,023	2,854,663
Feb-20	2,854,663	0.43%	1,023	2,855,686
Mar-20	2,855,686	0.43%	1,023	2,856,709
Apr-20	2,856,709	0.43%	1,024	2,857,733
May-20	(186,409)	0.43%	<u>(67)</u>	(186,476)
			11,173	

Deferred Regulatory Revenue-Nelseco Sale  
Interstate Navigation Company  
5/31/20

Attachment-1  
2020-ROE

G/L # 1990

Balance per General Ledger at 5/31/20	-
Balance per detailed analysis at 5/31/20	-
	<hr/>
Variance	-
	<hr/> <hr/>

*Analysis of Deferred Nelseco Sale Rev:*

Balance at 5/31/19	-
	-
Additions	-
	-
Yearly Amortization	-
	-
Balance per detailed analysis at 5/31/20	-
	<hr/>
	<hr/> <hr/>

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

Analysis of Revenue and Expenses  
Interstate Fast Ferry

	<u>Actual</u> <u>FYE 5/31/19</u>	<u>Actual</u> <u>FYE 5/31/20</u>
<b>Revenues:</b>		
Passenger Revenue	\$ 2,417,373	\$ 2,379,429
Other Revenues (Bar, bike, etc)	144,430	147,238
Charter Revenue	-	-
<b>Total Revenue</b>	<b>2,561,803</b>	<b>2,526,667</b>
<b>Expenses:</b>		
Salaries and wages	224,930	344,715
Payroll taxes	16,764	24,859
Fuel	313,727	260,090
Maintenance:		
Vessel Maintenance-Athena	122,456	84,854
Lube Oil	14,842	11,610
Other Vessel Expenses	6,045	6,842
Insurance	33,747	37,726
Advertising	86,932	34,176
Bar expense	44,045	38,777
General and Administrative Expense	-	-
Legal and accounting	-	-
General office supplies	695	-
Gross Receipts Taxes	32,589	33,642
Boat Charter	39,625	39,625
Fees (coast guard, banking, etc)	-	-
<u>Debt service on \$5,600,000:</u>		
Principal	162,689	168,340
Interest	148,155	138,034
<b>Total Expense</b>	<b>1,247,241</b>	<b>1,223,290</b>
<b>Net Income Before Taxes</b>	<b>1,314,561</b>	<b>1,303,377</b>
Federal Income Tax	252,513	251,352
<b>Net Income</b>	<b>\$ 1,062,048</b>	<b>\$ 1,052,026</b>