



State of Rhode Island and Providence Plantations

DEPARTMENT OF ATTORNEY GENERAL

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Peter F. Kilmartin, Attorney General

April 20, 2016

VIA HAND DELIVERY & ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, Rhode Island 02888

Re: Docket 4586 – A & R General Rate Filing

Dear Ms. Massaro:

Enclosed please find an original and nine (9) copies of the Surrebuttal Testimony of Division consultant David J. Effron for filing by the Division of Public Utilities and Carriers in the above-captioned proceeding. An electronic copy shall be served upon the service list.

Thank you for your attention in this matter and if you should have any questions kindly contact me at your convenience.

Very truly yours,

Christy Hetherington
Special Assistant Attorney General

Enclosure

cc: Service List

**A&R MARINE CORP.
D/B/A PRUDENCE & BAY ISLANDS TRANSPORT**

GENERAL RATE FILING

RIPUC DOCKET NO. 4586

**BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION**

**SURREBUTTAL TESTIMONY
OF DAVID J. EFFRON**

ON BEHALF OF THE

**DIVISION OF
PUBLIC UTILITIES AND CARRIERS**

APRIL 20, 2016

1 **Q. Please state your name and business address.**

2 A. My name is David J. Effron. My business address is 12 Pond Path, North Hampton,
3 New Hampshire, 03862.

4

5 **Q. Have you previously submitted testimony in this docket?**

6 A. Yes. I submitted direct testimony on February 24, 2016. My qualifications and
7 experience are included with my direct testimony.

8

9 **Q. What is the purpose of your surrebuttal testimony?**

10 A. In this surrebuttal testimony, I respond to the rebuttal testimony of Company Witness
11 Bebyn.

12

13 **Q. Does the Company agree with your proposed adjustments to its pro forma
14 depreciation expense?**

15 A. In part. Mr. Bebyn accepts the 25 service life for the dock for the purpose of
16 calculating the annual depreciation expense. With regard to the service lives for the
17 vessels and improvements, Mr. Bebyn notes that while vessels have an estimated
18 service life of 15-30 years, the service life of vessel improvements, as shown in the
19 PUC Annual Report, is only 5-10 years. He concludes from this that the 15 year
20 service life that he uses for both vessels and vessel improvements together is
21 reasonable, and, in fact, conservative.

22

1 **Q. Do you continue to believe that the 20 year service lives that you have**
2 **recommended for vessels and improvements are reasonable?**

3 A. Yes. As Mr. Bebyn acknowledges, the mid-point of the service life range for vessels is
4 22.5 years. My proposed 20 year life is slightly below that. All of the vessel
5 improvements pertain to the refitting of the Herbert Bonner. The cost of the
6 improvements is \$897,783 as compared to the \$551,250 cost of the vessel itself. Given
7 the cost of the improvements in relation to the cost of the vessel, the improvements are
8 clearly more than equipment or interim replacements with relatively shorter lives. In
9 these circumstances, it seems reasonable to assume that the life of the refitting should
10 be equal to the life of vessel. I have done so and used a 20 year life for the Hebert
11 Bonner improvements as well as the Hebert Bonner itself.

12
13 **Q. Does the Company agree with your proposed adjustments to the rate of return?**

14 A. No. Mr. Bebyn notes that I am proposing a hypothetical capital structure consisting of
15 50% equity and 50% debt. However, he does not contend that this capital structure is
16 unreasonable or inappropriate for ratemaking purposes.

17 Mr. Bebyn further appears to disagree with my proposed return on equity of
18 10.00%. He states that I “concede” that Interstate Navigation’s return on equity of
19 11.00% (which he had cited a basis for the return on equity that he proposes for
20 A&R) is tied into Interstate’s capital structure. I would characterize my testimony on
21 Interstate’s capital structure and return on equity as being more in the nature of an
22 observation than a concession. Regardless, in response to my testimony that the
23 11.00% return on equity authorized for Interstate was in conjunction with a capital

1 structure consisting of 26.2% equity and 73.8% debt, Mr. Bebyn seems to be saying
2 that there is no relationship between the cost of equity and the capital structure and
3 that the cost of equity should be determined without reference to the percentage of
4 equity in the capital structure. While I do not hold myself out as an expert on rate of
5 return, I believe that it is a well-established principle of finance that the lower the
6 equity ratio, the greater the financial leverage, the greater risk to equity investors, and
7 the higher the cost of attracting equity investment. Mr. Bebyn acknowledges that the
8 return on equity should take into account the financial risk of the entity. A lower
9 common equity ratio entails greater financial risk. Accordingly, if an 11.00% return
10 on equity is appropriate for an entity with a 26% common equity ratio, a lower return
11 on equity is appropriate for an entity with a 50% common equity ratio.

12

13 **Q. Does this conclude your surrebuttal testimony?**

14 A. Yes.

15