

REDACTED
REBUTTAL TESTIMONY OF
LAWRENCE R. KUNKEL
President and Chief Economist
Kunkel Strategic Services, IBC

For
ISLAND HI-SPEED FERRY, LLC

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Regarding
INTERSTATE NAVIGATION COMPANY
DOCKET NO. D-05-06

JUNE 29, 2005

RI DIVISION OF	
PUBLIC UTILITIES & CARRIERS	
DOCKET NO.	<u>D-05-06</u>
SPONSOR	<u>IHSF</u>
EXHIBIT NO.	<u>15</u>
IDENT. (DATE)	<u>7/11/05</u>
FULL (DATE)	<u>7/11/05</u>
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- 1 **Q. Mr. Kunkel what is your background in the design, implementation**
2 **and interpretation of opinion surveys?**
- 3 A. I have designed, implemented and interpreted dozens of surveys, for
4 corporate, cultural, institutional and religious entities, for the purpose of
5 satisfying, a variety of informational objectives.
- 6 **Q. Who designed the conceptual framework for the IHSF survey?**
- 7 A. I did and I reviewed the questions, which were drafted by IHSF's counsel,
8 Mark J. Hagopian, before the survey was taken, for bias. I found none.
- 9 **Q. Who administered the survey?**
- 10 A. IHSF's senior personnel.
- 11 **Q. How was it administered?**
- 12 A. It was administered every day, on every run to and from the island,
13 without having been pre-announced, over a two week period between May
14 27th and June June 9, 2005. No incentives were offered for participation.
15 All passengers were offered the opportunity to participate. The survey
16 instrument was distributed by deckhands, under the supervision of a senior
17 deckhand, who received his instructions from the captain.
- 18 **Q. Please explain what was done to ensure that the sample of passengers**
19 **would be random?**
- 20 A. Randomness was inherent in the fact that the survey was not pre-
21 announced and IHSF had no way of knowing who would be riding its
22 vessel on any particular date or at any particular time.
- 23

- 1 **Q. Please explain what was done to ensure that the same passengers**
2 **were not surveyed more than once?**
- 3 A. The survey instruments were numbered. Only a certain number were
4 handed out each time and all surveys were returned by the senior
5 deckhand to the captain, who confirmed that all surveys distributed were
6 returned.
- 7 **Q. Did the survey inform passengers taking it of the differences between**
8 **IHSF's existing schedule and Interstate's proposed fast ferry**
9 **schedule?**
- 10 A. No. I believed the varying schedules to be irrelevant, because Interstate
11 will be running a continuous schedule of traditional and fast ferry trips to
12 Old Harbor, if the CPCN is granted.
- 13 **Q. What were the most significant results of the survey?**
- 14 A. Only 13% of the respondents reported that the ability to disembark in New
15 Harbor was an important factor for using IHSF's service, while at the
16 same time nearly 87% of the respondents reported that speed was the most
17 important factor in their choice of IHSF. Over 57% responded that they
18 would essentially cross the dock and use Interstate's fast ferry instead of
19 IHSF's service, because arriving and departing from Old Harbor would be
20 more convenient. However, nearly 80% reported that they would continue
21 to use IHSF (because they prefer its service), if both Interstate and IHSF
22 offered high speed service to Old Harbor at the same price.

- 1 **Q. What then do these results mean for purposes of the issues in this**
2 **case?**
- 3 A. First, they debunk the myth that people use IHSF's service *because* it
4 travels to and from New Harbor. Second, people use IHSF's service
5 despite the fact that the overwhelming majority of them would prefer to go
6 to Old Harbor. Third, the survey results show that the majority of
7 respondents are loyal to IHSF, but that their loyalty would be
8 overwhelmed by the option of traveling to Old Harbor on another fast
9 ferry.
- 10 **Q. What would the result of a loss of 57% of IHSF's ridership be?**
- 11 A. It would result in the financial collapse of IHSF and a reconstitution of
12 Interstate's monopoly on ferry transportation from mainland Rhode Island
13 to Block Island. It would also maintain Interstate's sub-market
14 monopolies in the areas of freight and motor vehicle transportation.
- 15 **Q. Would that result contravene the regulatory intent of the Division**
16 **manifest in its order granting IHSF's CPCN?**
- 17 A. Absolutely, because the underlying intent of that order was to break
18 Interstate's monopoly stranglehold on ferry transportation from
19 mainland Rhode Island to Block Island.
- 20 **Q. Do you know what IHSF's normalized net income is for the fiscal year**
21 **ending June 30, 2005?**
- 22 A. Yes. Subject to minor year-end adjustments, IHSF suffered a loss of
23 ██████████

1 **Q.** **Mr. Kunkel given what you now know about the survey, IHSF's**
2 **financial circumstances, and the market characteristics to which you**
3 **have previously testified, do you have an opinion with a reasonable**
4 **degree of economic certainty as to whether Interstate's entry into the**
5 **Block Island fast ferry market would be predatory?**

6 **A.** Yes. Given what we now know, Interstate's plan to enter the high speed
7 ferry market to Block Island can only be characterized as one of two
8 things: either it is economically irrational, or it is predatory.

9 **Q.** **Please explain what you mean by economically irrational.**

10 **A.** No rational business person would enter a market characterized by
11 extraordinary excess capacity, intense competition, which requires a
12 capital intensive investment and which is highly regulated in the sense that
13 management does not have the ability to adjust prices on a discretionary
14 basis.

15 **Q.** **Do you believe the management of Interstate Navigation is**
16 **economically irrational?**

17 **A.** No.

18 **Q.** **What then do you believe is motivating its petition?**

19 **A.** It certainly is not the "well documented business decision" articulated by
20 Doctor Stutz; which, in my opinion, is a conclusion he arrived at with an
21 extraordinary lack of evidence. On the contrary, it is my opinion that
22 Interstate's motivation can only be predatory.

23

- 1 **Q. Please explain what you mean.**
- 2 A. By employing a game theoretic approach, I am convinced that the ultimate
3 economic payoff which Interstate seeks is the elimination of a market
4 participant, namely IHSF, and the reestablishment of its monopoly market
5 position.
- 6 **Q. What is game theory, as employed in the discipline of economics?**
- 7 A. I agree with Doctor Stutz's definition: "it's a mathematical discipline
8 which was developed to quantify different payoffs, or alternatively, to
9 express the relative attractiveness of different strategies that
10 participants in a transaction described as a game could play". It is a
11 dynamic and not a static theoretical framework, meaning that it examines
12 the payoff in a multi-round game and the strategies necessary to achieve
13 the maximum payoff.
- 14 **Q. What is the basis of your opinion that the ultimate goal of Interstate's
15 strategy is to eliminate IHSF and reestablish its monopoly?**
- 16 A. As a participant in the many rounds of competition in the administrative
17 arena between Interstate and IHSF since 1998, I have had the unique
18 opportunity to observe Interstate's behavior and game playing strategies.
19 Additionally, from a practical standpoint I have supplied the United
20 States Justice Department with over three hundred and fifty antitrust
21 opinions, none of which have been challenged. As a result of my practical
22 experience and observations of Interstate's strategic moves, I can only
23 conclude that Interstate's intent is not necessarily to serve a public need as

1 much as it is to prey upon a less powerful market rival, with the ultimate
2 payoff being the reconstitution of its monopoly.

3 **Q. Then do you disagree with Dr. Stuz's testimony that predatory entry**
4 **is "one possible reason" for Interstate's petition?**

5 A. Yes. It is the only *probable* reason.

6 **Q. Mr. Kunkel based upon your education, training and experience, do**
7 **you have an opinion with a reasonable degree of economic certainty as**
8 **to whether Interstate's business plan, if implemented, would violate**
9 **federal antitrust laws?**

10 A. Yes. In my opinion it would violate federal anti-trust laws.

11 **Q. Is there, in your opinion, a game theoretic strategy that maximizes**
12 **both social and economic welfare in this market?**

13 A. Yes, if a Nash Equilibrium could be attained.

14 **Q. What is a Nash Equilibrium and could it be attained here?**

15 A. A Nash Equilibrium is one where rivals for the same prize cooperate,
16 rather than compete. This would involve IHSF and Interstate entering into
17 a cooperative relationship to be more competitive with the unregulated
18 competitor BI Express.

19 **Q. What would be the most optimal form of cooperation?**

20 A. A merger.

21 **Q. Does that conclude your testimony?**

22 A. Yes.

23
24



Lawrence R. Kunkel

Subscribed and sworn to before me this ____ day of June, 2005.
