STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DIVISION OF PUBLIC UTILITIES AND CARRIERS

In Re: Rhode Island Fast Ferry, Inc.) Docket No. D-13-51

REBUTTAL TESTIMONY OF LAWRENCE R. KUNKEL

1. Q. Mr. Kunkel have you had the opportunity to review the testimony of Messrs. Mazze and Edge, as well as Interstate's responses to RIFF's Data Requests?

A. Yes.

2. Q. Do you have an opinion as to the soundness of the methodology of the Interstate survey relied upon so heavily by Mazze and Edge?

A. Yes.

3. Q. What is that opinion?

A. In my opinion it was fundamentally flawed because it was self -administered, leaving substantial opportunity for bias to affect the results. First, there was no apparent attempt to control for the bias of the Interstate employees who administered the survey. In fact, one of the Interstate employees who administered the survey and recorded responses made negative public statements in the press regarding RIFF's proposed service. Additionally, although the survey has been touted as a marketing exercise, it challenges credulity and common sense to believe that the Interstate employees administering it did not know its true purpose, particularly the permanent employees and management level personnel involved (one of whom made the negative press comments regarding RIFF's plan and presumably is an authorized company spokesperson).

4. Q. Do you have any other opinions regarding the survey?

A. Yes. Assuming for argument's sake that the methodology was sound and the sample was representative, the survey results themselves are evidence of public need for a Quonset fast ferry that is currently unsatisfied. In its Order In Docket D-05-06 granting Interstate's application for its own high speed CPCN, the Division found that IHSF's survey data showing that 57% of its ridership would cross the dock to use an Interstate fast ferry was an "admission that Interstate's proposed high-speed service to Old Harbor would accommodate existing and future customers" and further found that this was evidence of public convenience and necessity. That same logic applies here and the Division should make a similar finding regarding Interstate's survey data.

5. Q. Do you have an opinion regarding Mr. Edge's testimony that since Interstate has excess capacity there is no need for RIFF's proposed service?

A. Yes. First, if Mr. Edge's testimony is taken to its logical conclusion, since the Division allowed Interstate to enter the high speed market in 2006 regardless of the existing excess capacity of other carriers, then it should allow RIFF to do so also regardless of this factor. In Mr. Edge's own analysis, choice is more important than market or participant efficiency – and if that is the gold standard for public convenience, then if one potential unsatisfied customer exists for a Quonset service, theoretically public convenience requires the service. With that said, when all of the evidence here is weighed, including Interstate's own survey, a Quonset fast ferry would satisfy the needs of a significant segment of the public, regardless of how Interstate tries to minimize that need. Moreover, as Mr. Edge points out, the risk of failure of RIFF's plan falls entirely on the shoulders of its shareholders and therefore RIFF should be allowed to take that risk.

6. Q. How do you reconcile that opinion with your opinion in Docket D-05-06 that it would be irrational for a business to enter a market characterized by excess capacity which requires a capital intensive investment?

A. Very simply, it became apparent in the ensuing years that demand for Block Island high speed ferry service was more elastic than predicted in 2006. Otherwise why would Interstate have been able to sustain increases in its Point Judith high speed prices from $26.00 to $35.85, particularly during a severe recession. One would have to assume that if demand for its Point Judith service was not elastic, Interstate would have lost ridership with its high speed price increases. But that does not explain why Interstate introduced high speed offerings from Newport and Fall River since 2006. The most logical and rational answer to that conundrum is that Interstate must have perceived that there was unsatisfied demand from other departure points. Interstate's argument that it was only trying to preserve its Newport route, does not pass good business-judgment muster, particularly since it involved the purchase and rehabilitation of a used fast ferry at not insignificant cost. Interstate's argument that it agreed to operate the Fall River route simply to have a place to overnight the Newport ferry is equally unconvincing. While announcing its new Fall River service, Interstate's Sales Manager was quoted in the press as saying: "We are trying to extend our ferry service," she said. "**We are thinking it will be easier for Massachusetts residents, especially people from Boston. It is much easier for them to get to Fall River than to drive to Galilee or Newport**." (Emphasis supplied). Clearly, Interstate understands that its Galilee location is inconvenient for some, particularly those living in Massachusetts, and it has attempted to meet that unsatisfied demand despite its own excess capacity.

7. Q. What do you make of Interstate's contention that Interstate's fast ferry market

overlaps RIFF's and negates RIFF's position that there is unsatisfied public need?

A. First, Interstate has conceded in its Data Responses that Mr. Edge is not an expert in the fields of economics or marketing. But from a substantive viewpoint, this simplistic argument ignores generally accepted economic principles. There are significant factors differentiating RIFF's proposed service and Interstate's, such as departure point and time over water, meaning that RIFF and Interstate will not be direct competitors and will serve different markets, by definition. Moreover, Mr. Edge's argument ignores Interstate's own arguments in Docket D-05-06, where Interstate posited that its request to provide high speed service over two conjoined "routes", i.e., Point Judith and Block Island and Newport and Block Island, was necessary "to serve three separate and distinct ferry markets". [1] If Newport to Block Island is a separate and distinct market from Point Judith to Block Island – a point I agree with – then clearly Quonset to Block Island is separate and distinct from the Point Judith to Block Island market.

8. Q. In this same vein, what is your opinion of Mr. Mazze's testimony that it would be in RIFF's best interest to try to capitalize on Interstate's 80 year business history?

A. This concern is overblown in my opinion. First, Interstate concedes that its name is not confusingly similar to RIFF's, which is the traditional test to determine whether one company is palming itself off as another. Also, I do not agree with

[1] R.I. Division of Public Utilities and Carriers, Report and Order, Docket D-05-06, 1/23/2006, pp. 55.

the implication that it would be in RIFF's best interest to suggest an affiliation with Interstate, given the relative inconvenience of fast ferry travel from Galilee versus Quonset for that segment of the public who are willing to spend more time over water to avoid the experience of South County's Summer traffic. Not only do I see no upside to RIFF in playing such a game, it would seem to me that its marketing dollars would be better spent on publicizing its differentiating factors, with such themes as "new", "more convenient" and "easier to access" in order to activate this market.

9. Q. What is your opinion regarding Mr. Edge's testimony in these proceedings that RIFF's application should be denied because it jeopardizes Interstate's fast ferry profits, which subsidize its traditional ferry rates?

A. There should be no linkage between the two from a regulatory standpoint, particularly when determining public convenience and necessity. This argument ignores the Divisions findings in Docket D-05-06 that the "economic benefit to Interstate's lifeline operation" from its proposed high speed service has "little if any" relevance to the public convenience and necessity, citing its previous determination that "fast" ferry services and "conventional" ferry services "are two distinctly different water carrier operations". The Division went on to find in Docket D-05-06 that the Rhode Island Supreme Court had "thoroughly vetted [this] issue and has agreed with the Division. **Therefore, the Division cannot accept Interstate's argument that the economic viability of the two services should be linked for licensing purposes...In short, the Division finds the argument**

illogical from a licensing perspective".[2] (Emphasis supplied). That same logic should apply to a proposed new fast ferry service, even if it is found to compete with Interstate's high speed service.

10. Q. Are there any other reasons this cross-subsidization argument should be rejected?

A. Yes. In Division Dockets D-06-51 and D-06-53, in which the Division approved Intestate's purchase of IHSF's assets, Interstate entered into a Stipulation approved by the Division in which they admitted and agreed that "the proposed transaction is not without its own risks, including, but not limited to, generation of adequate revenues by the high speed service to cover the costs of that service (including the interest and principal repayments on approximately $5.6 million of additional debt). Therefore to protect the year round traditional service to Block Island at reasonable rates for passengers, vehicles, and freight, **Interstate agrees that any losses incurred from operation of high speed service will not affect the year round service, or rates, to Block Island for passengers, vehicles, or freight, unless the Public Utilities Commission should direct otherwise**".[3] (Emphasis supplied). To my knowledge, the Commission has not directed otherwise and Interstate concedes this point. Therefore, Interstate should be required to hold up its end of the regulatory bargain made when it was granted permission to expand from its traditional service orientation into the high speed market.

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[2] R.I. Division of Public Utilities and Carriers, Report and Order, Docket D-05-06, 1/23/2006, pp. 55, 61-62.

[3] R.I. Division of Public Utilities and Carriers, Report and Order, Dockets D-06-51 and D-06-53, 10/3/2006, p. 20. This was consistent with Interstate's representation to the Division in Docket D-05-06 that if its fast ferry operation was not profitable either its shareholders would absorb the losses, it would lease its hi-speed vessel or sell it to protect the traditional ferry users. Report and Order, Docket D-05-06, 1/23/2006 at p. 8.

11. Q. Are there measures Interstate could take to make its Point Judith services more attractive to customers or to respond to market forces?

A. Yes. First and foremost, it has rate flexibility that Island Hi-Speed Ferry did not have. Interstate has management discretion to increase or decrease its Point Judith hi-speed rates upon 30 days notice. The Division Advocacy Section has agreed not to object or recommend suspension of any such changes except in extraordinary circumstances and has also agreed that any such increases or decreases are subject to change by the Commission only if they are improper or unreasonable. Similarly, Interstate has the management discretion to increase certain traditional ferry rates upon 60 days notice to a level not 10% higher or 20% lower than the rates approved in its last rate case in 2012, in order "to respond more efficiently to market forces impacting the more discretionary portions of its business, namely, the non-lifeline portions of the business". One of the primary reasons that IHSF was forced to sell its assets to Interstate was that Block Island Express underpriced it by $1.00, causing massive ridership losses in short order. Interstate apparently learned that lesson and has wisely protected itself from such market forces. Furthermore, Interstate's own survey shows that the significant probable price point differential between RIFF's proposed service and its own services will be a buffering factor.

12. Q. Does that conclude your rebuttal testimony?

A. Yes.

4/16/15
Date

LAWRENCE R. KUNKEL