

Massaro, Luly (PUC)

From: Michael McElroy <michael@mcelroydonaldson.com>
Sent: Wednesday, September 13, 2023 9:26 AM
To: WilsonFrias, Cynthia (PUC)
Cc: Leah Donaldson; Nault, Alan (PUC); Bell, John (DPUC); Gregory Schultz; dbebyn@gmail.com; Massaro, Luly (PUC)
Subject: Re: Dkt. 4373 and Annual Report - Interstate Delinquent Reports
Attachments: Cover letter for ROE 2022.docx; 000---roe schdules.pdf

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Report Suspicious

Cindy:

Attached is Interstate Navigation's Return on Equity earnings report for FY22.

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Our firm's web and email addresses changed on June 19, 2023. Please update your records with my new email address (Michael@McElroyDonaldson.com). Thank you.

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On Tue, Aug 15, 2023 at 4:04 PM WilsonFrias, Cynthia (PUC) <Cynthia.WilsonFrias@puc.ri.gov> wrote:

Good Afternoon, Leah and Mike,

Attached please find a letter on the above-referenced matter.

Thanks, Cindy

Cynthia G. Wilson-Frias

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September 13, 2023

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

Subject: Interstate Navigation Company FYE May 31, 2022 Earnings Report to the Public Utilities Commission (PUC).

Dear Mike,

This letter is the Interstate Navigation Company FYE May 31st 2022 “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 2022 ROE Calculations and Schedules

In preparing this filing for FY 2022 ROE report, I have utilized the same format as the FY 2021 ROE report to calculate earned ROE and any earning above the earnings cap. The FY 2022 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. In Addition, the schedule includes extraordinary income, normally excluded, generated from an Employment Retention Credit(ERC) Grant and the forgiveness of the Paycheck Protection Program(PPP) loan as the result of a settlement agreement with the Division. 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, 2022. 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, 2022. Schedule DGB-ROE-2.
3. A “Ratepayers Portion of Accumulated Earnings Above 12% ROE Ceiling” schedule for FYE May 31, 2022. 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, 2021. 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, 2021 Annual Report.

Results

My calculations on Schedule DGB-ROE-1 resulted in a return on equity of 34.0% 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 \$335,188. 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 \$1,404,566 (75% of \$1,872,755) for FY 2021 should be used to benefit ratepayers. 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. Furthermore, there was a credit for FY 2021 tax expense for tax depreciation on assets purchased by the Capital Reserve. The tax depreciation on this asset was \$532,724 for the FY 2021 return. I calculate a credit of \$111,872 using this tax depreciation balance and the 21% rate. The total excess earnings for FY 2021, including the tax savings, was \$1,559,318 and should be used to benefit ratepayers.

Schedule DGB-ROE-1 shows that adjusted pre-tax operating income on total operations was \$2,598,322. This amount removing the one time extraordinary one time revenues from the ERC Grant and forgiveness of the PPP loan would have resulted in a pre-tax operating income on total operations of \$1,472,263. The adjusted pre-tax operating income on Fast Ferry operations, which is included in the calculation for ROE, was \$2,146,502. Therefore, about 146% 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, 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.

Schedule DGB-ROE-3 presents the balance of the excess earnings as of the end of FY 2022. This results in a total accumulated balance of excess earnings to be shared with ratepayers of \$406,143 at the end of FY 2021.

Regarding the request for \$1,559,318 of the 2022 ROE to replenish the Fuel Reserve, I am making this recommendation since the fuel reserve account from the 2021 ROE has been reduced by nearly two-third as of the filing of this ROE report. Fuel prices continue to be over 150% of the fuel floor used in the fuel surcharge calculation. This balance could also be used to generate a fuel surcharge credit like was done with the results of the 2021 ROE.

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, 2022
 Interstate Navigation Company

Schedule DGB-ROE-1

		<u>Total</u>
Calculation of Net Income available for Common Equity		
Revenues	Annual Report-page 6	\$ 17,946,136
Operation and Maintenance Expenses *	Annual Report-page 6a	14,831,267
Total Depreciation Expense	Annual Report-page 6a	<u>1,063,302</u>
Pre-Tax Operating Income		2,051,567
Adjustments:		
Fast Ferry Depreciation & Amortization	\$168,000 + \$94,166 annually	262,166
Fast Ferry Principal	Annual Report-FF Schedule	(180,241)
Fast Ferry Interest	Annual Report-FF Schedule	(125,493)
Excess HL Expenses over settlement of \$315K	Annual Report-HL Schedule	136,244
Income due to use of Fuel Reserve funded by PY ROE Excess (1)		(824,512)
Misc income due to PPP Loan Forgiveness		1,035,348
Misc income due to ERC Grant		90,711
Depreciation of Assets purchase from Capital Reserve	Annual Report-page 11	<u>304,414</u>
Total Adjustments		698,637
Adjusted Pre-Tax Operating Income		2,750,204
Interest on Debt Supporting Rate Base	Rate Base** X Wtd Debt Cost***	<u>151,882</u>
Adjusted Pre-Tax Income		2,598,322
Income Taxes (rate 21%)		<u>545,648</u>
Net Income available for Common Equity		<u>\$ 2,052,675</u>

Calculation of Common Equity Applicable to Rate Base

Common Equity Supporting Rate Base	Equity Ratio**** X Rate base	<u>\$ 1,499,331</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	136.9%
ROE Ceiling from Settlement		<u>12.0%</u>
Percentage of Earnings Above 12%	Return on CE - ROE Ceiling	124.9%

Calculation of Earnings in Excess of ROE Ceiling

Earnings	Net Income available for CE	\$ 2,052,675
Earnings at ROE Ceiling from Settlement	CE supp RB X 12%	<u>179,920</u>
Earnings in Excess of 12%		<u>\$ 1,872,755</u>

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

Customer Share	75% of Earnings in Excess of 12%	\$ 1,404,566
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>111,872</u>
		<u>1,559,318</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 5,731,386 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 earning and increased fuel reserve liability when the funds are used the liability is reduced and a surcharge revenue is recognized. Since this revenue is recognized in essence a double time it is being adjusted out similar to how the depreciation from assets purchased from capital fund is removed.

Average Rate Base
For Fiscal Year Ended May 31, 2022
 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

		5/31/2021	5/31/2022	Average
Net Plant	Annual report page 5	\$ 10,247,401	\$ 9,435,918	\$ 9,841,660
<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	2,441,040	2,609,040	2,525,040
Net Plant - Athena		1,758,960	1,590,960	1,674,960
<u>Assest Purchased with Capital Reserve</u>				
Plant In Service	Annual report page 11	3,044,142	3,044,142	3,044,142
Accumulated Depreciation	Annual report page 11	456,621	761,036	608,829
Net Plant - Athena		2,587,521	2,283,106	2,435,314
Net Plant Excluding Athena & Assest Purchased with Capital Reserve		5,900,920	5,561,852	5,731,386
Accumulated Deferred Income Taxes	AR page 5a	-	-	-
Deferred Gain on Nelseco	See Attachment-1	-	-	-
Rate Base		\$ 5,900,920	\$ 5,561,852	\$ 5,731,386

Settlement Capital Structure per Docket 4373

	Percent of Total	Cost Rate	Weighted Cost
Long Term Debt	73.85%	3.59%	2.65%
Common Equity	26.16%	11.00%	2.88%
Total Capital	100.01%		5.53%

Ratepayers Portion of
Accumulated Earnings Above 12% ROE Ceiling
For Fiscal Year Ended May 31, 2022
Interstate Navigation Company

Schedule DGB-ROE-3

Excess Earnings held in Capital Reserve

		<u>Total</u>
FY 2014-21 Results	Agreed to with Division in 2021 Settlement	\$ -
Capital Reserve funds used during FY 2022		-
Interest Accrued during FY 2022		-
FY 2022 Results		<u>1,543,395</u>
Balance at May 31, 2022		<u>\$ 1,543,395</u>
Recommended transfer to Fuel reserve to reduce need for fuel surcharge		<u>\$ (1,543,395)</u>
Recommended Balance at May 31, 2022		<u>\$ (0)</u>

	<u>Balance</u>	APY Interest Rate	Accrued Interest	Ending Balance
Jun-21	-	0.43%	-	-
Jul-21	-	0.43%	-	-
Jul-21	-	0.43%	-	-
Aug-21	-	0.43%	-	-
Sep-21	-	0.43%	-	-
Oct-21	-	0.43%	-	-
Nov-21	-	0.43%	-	-
Dec-21	-	0.43%	-	-
Jan-22	-	0.43%	-	-
Feb-22	-	0.43%	-	-
Mar-22	-	0.43%	-	-
Apr-22	-	0.43%	-	-
			<u>-</u>	-

Deferred Regulatory Revenue-Nelseco Sale
Interstate Navigation Company
5/31/22

Attachment-1
2022-ROE

G/L # 1990

Balance per General Ledger at 5/31/22	-
Balance per detailed analysis at 5/31/22	<u>-</u>
Variance	<u><u>-</u></u>

Analysis of Deferred Nelseco Sale Rev:

Balance at 5/31/21	-
	-
Additions	-
	-
Yearly Amortization	-
	-
Balance per detailed analysis at 5/31/22	<u><u>-</u></u>

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 5/31/21</u>	<u>Actual</u> <u>FYE 5/31/22</u>
Revenues:		
Passenger Revenue	\$ 2,438,978	\$ 3,451,524
Other Revenues (Bar, bike, etc)	80,259	167,454
Charter Revenue		
Total Revenue	<u>2,519,237</u>	<u>3,618,978</u>
Expenses:		
Salaries and wages	255,402	291,666
Payroll taxes	19,117	21,906
Fuel	140,904	353,224
Maintenance:		
Vessel Maintenance-Athena	67,532	68,373
Lube Oil	15,405	9,415
Other Vessel Expenses	7,282	6,099
Insurance	34,601	40,897
Advertising	248,254	239,892
Bar expense	34,412	49,992
General and Administrative Expense	-	335
Legal and accounting	-	-
General office supplies	325	325
Gross Receipts Taxes	32,135	44,571
Boat Charter	39,625	39,625
Fees (coast guard, banking, etc)	-	423
<u>Debt service on \$5,600,000:</u>		
Principal	174,189	180,241
Interest	131,680	125,493
Total Expense	<u>1,200,864</u>	<u>1,472,476</u>
Net Income Before Taxes	<u>1,318,373</u>	<u>2,146,502</u>
Federal Income Tax	<u>250,561</u>	<u>437,480</u>
Net Income	<u><u>\$ 1,067,812</u></u>	<u><u>\$ 1,709,023</u></u>