



State of Rhode Island and Providence Plantations

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Peter F. Kilmartin, Attorney General

February 24, 2016

Ms. Luly Massaro
Commission Clerk
Public Utilities Commission
89 Jefferson Blvd.
Warwick, RI 02889

Re: A & R Marine Corp. General Rate Filing
RIPUC Docket No. 4586

Dear Luly,

Enclosed for filing, please find an original and nine (9) copies of the Division of Public Utilities and Carriers' Direct Testimony from consultant David J. Efron in connection the A & R Marine Corp., d/b/a Prudence & Bay Islands Transport, General Rate Filing, RIPUC Docket No. 4586. Please note that an electronic copy of this document has been sent to the service list.

Thank you for your attention to this matter. If you have any questions, please feel free to contact me.

Sincerely,

Christy Hetherington, Esq.
Special Assistant Attorney General
Regulatory Unit
Extension 2425

Enclosure

cc: Service List (via electronic mail only)

**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**

**TESTIMONY AND EXHIBITS
OF DAVID J. EFFRON**

ON BEHALF OF THE

**DIVISION OF
PUBLIC UTILITIES AND CARRIERS**

FEBRUARY 24, 2016

RIPUC DOCKET NO. 4586
DIRECT TESTIMONY
OF DAVID J. EFFRON

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1 **I. STATEMENT OF QUALIFICATIONS**

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

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

5

6 **Q. What is your present occupation?**

7 A. I am a consultant specializing in utility regulation.

8

9 **Q. Please summarize your professional experience.**

10 A. My professional career includes over thirty years as a regulatory consultant, two years
11 as a supervisor of capital investment analysis and controls at Gulf & Western Industries
12 and two years at Touche Ross & Co. as a consultant and staff auditor. I am a Certified
13 Public Accountant and I have served as an instructor in the business program at
14 Western Connecticut State College.

15

16 **Q. What experience do you have in the area of utility rate setting proceedings?**

17 A. I have analyzed numerous electric, gas, telephone, and water filings in different
18 jurisdictions. Pursuant to those analyses I have prepared testimony, assisted attorneys
19 in case preparation, and provided assistance during settlement negotiations with various
20 utility companies.

21 I have testified in over three hundred cases before regulatory commissions in
22 Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky,
23 Maine, Maryland, Massachusetts, Missouri, Nevada, New Jersey, New York, North

1 Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Virginia,
2 and Washington.

3

4 **Q. Please describe your other work experience.**

5 A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was
6 responsible for reports and analyses concerning capital spending programs, including
7 project analysis, formulation of capital budgets, establishment of accounting
8 procedures, monitoring capital spending and administration of the leasing program. At
9 Touche Ross & Co., I was an associate consultant in management services for one year
10 and a staff auditor for one year.

11

12 **Q. Have you earned any distinctions as a Certified Public Accountant?**

13 A. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest
14 scores in the May 1974 certified public accounting examination in New York State.

15

16 **Q. Please describe your educational background.**

17 A. I have a Bachelor's degree in Economics (with distinction) from Dartmouth College
18 and a Masters of Business Administration Degree from Columbia University

19

20 **II. PURPOSE AND SUMMARY OF TESTIMONY**

21 **Q. On whose behalf are you testifying?**

22 A. I am testifying on behalf of the Rhode Island Division of Public Utilities and Carriers
23 ("the Division").

1

2 **Q. What is the purpose of your testimony?**

3 A. I am addressing the revenue requirement of A&R Marine Corp., d/b/a Prudence & Bay
4 Islands Transport (“A&R” or “the Company”) based on its proposed test year
5 consisting of the twelve months ended September 30, 2015 and its proposed rate year
6 consisting of the twelve months ending June 30, 2017. I also address the design of
7 rates necessary to produce the Company’s required revenues.

8

9 **Q. Please summarize your testimony.**

10 A. I have calculated a net revenue requirement of \$1,016,632 for services provided
11 pursuant to rates established by the Rhode Island Public Utilities Commission
12 (“Commission”). This net revenue requirement represents the total cost of service less
13 miscellaneous revenues.

14

15 **III. REVENUE REQUIREMENT**

16 **A. SUMMARY**

17 **Q. Have you prepared a summary of A&R’s net revenue requirement?**

18 A. Yes, I prepared a summary on my Schedule DJE-1. On this schedule, I compare the
19 Company’s presentation of its revenue deficiency to the Division’s recommendation. I
20 have begun with A&R’s total cost of service. The cost of service includes all elements
21 of the Company’s revenue requirement, including the return on rate base. I then
22 subtract the miscellaneous revenues earned by the Company. The miscellaneous
23 revenues include charter revenue, postal contract revenue, and miscellaneous other.

1 The cost of service net of miscellaneous revenues is the revenue requirement from
2 services that are provided pursuant to the Company's approved tariffs. The difference
3 between the net revenue requirement and the test year revenues earned from tariff
4 service is the Company's revenue deficiency.

5 A&R has calculated a revenue deficiency of \$564,409. I have calculated a
6 revenue deficiency of \$464,304.

7

8 **B. COST OF SERVICE**

9 **Q. What are the elements of the cost of service?**

10 A. The elements of the rate year cost of service are cash operating expenses, depreciation,
11 and return on rate base. These elements of the total cost of service are summarized on
12 my Schedule DJE-2.

13

14 **Q. Are you proposing adjustments to the rate year cost of service calculated by the**
15 **Company?**

16 A. Yes. The Company has calculated a pro forma cost of service, based on its rate year, of
17 \$1,149,285. Based on the adjustments to the Company's position that I have identified,
18 I am proposing a total cost of service of \$1,049,180. I address the individual
19 adjustments to the Company's cost of service in the following testimony.

20

21 **1. Fuel Expense**

22 **Q. What rate year fuel expense is the Company projecting?**

1 A. The Company is projecting rate year fuel expense of \$84,675. This is the second
2 largest component of pro forma rate year operation and maintenance expenses, after
3 payroll expense.

4

5 **Q. How did A&R project its rate year fuel expense?**

6 A. The Company multiplied the test year fuel consumption of 42,337 gallons by a
7 proposed fuel floor price of \$2.00, resulting in pro forma rate year fuel expense of
8 \$84,675. The Company used the price of \$2.00 per gallon based on the approximate
9 price of fuel at the time of its filing.

10

11 **Q. Are you proposing to modify the Company's calculation of pro forma rate year**
12 **fuel expense?**

13 A. Yes. The present price of fuel is less than \$1.50 per gallon. For the purpose of
14 calculating the Company's base rate revenue requirement, I am recommending that
15 the pro forma rate year fuel expense be based on a fuel price of \$1.50 per gallon.
16 This results in a rate year fuel oil expense of \$63,506, which is \$21,170 less than the
17 fuel oil expense projected by the Company (Schedule DJE-3, Page 1)

18

19 **2. Depreciation Expense**

20 **Q. Are you proposing any adjustments to the Company's pro forma depreciation**
21 **expense?**

22 A. Yes. The Company has included depreciation expense of \$223,323 in pro forma rate
23 year expenses. The support for this pro forma depreciation expense is shown in the

1 response to Division Data Request 1-6. I am proposing to modify the assumed asset
2 lives used in the calculation of depreciation expense.

3

4 **Q. Please explain your proposed modifications.**

5 A. First, with regard to vessels, the Company uses a fifteen year depreciation life. Based
6 on the 2014 A&R Annual Report, the service life of vessels is estimated at 15-30
7 years. Given this range, I believe that it is more reasonable to use a depreciation life
8 of at least twenty years, rather than using the service life at the very bottom of the
9 range. Consistent with the use of a depreciation life of twenty years for vessels, I am
10 also proposing to use a depreciation life of twenty years for vessel improvements.

11 Second, the Company is depreciating the Prudence Dock over twenty years.
12 Based on the 2014 A&R Annual Report, the service life of docks is estimated at 20-
13 30 years. Given this range, I believe that it is more reasonable to use a depreciation
14 life of 25 years, which is the midpoint of the range, rather than the twenty year
15 depreciation life used by the Company.

16

17 **Q. What is the effect of your proposed modifications to the Company's calculation**
18 **of rate year depreciation expense?**

19 A. The effect is to reduce the pro forma rate year depreciation expense by \$44,022
20 (Schedule DJE-3, Page 2).

21

1 **3. Return on Rate Base**

2 **Q. How is the return on rate base included in the total revenue requirement**
3 **calculated?**

4 A. The return on rate base is calculated by multiplying the rate of return by the rate base.
5 The rate base is the net investment in facilities necessary to provide utility service. I
6 am proposing adjustments to the rate of return used by the Company in calculating
7 the return component of the revenue requirement.

8

9 **Q. How is the rate of return calculated?**

10 A. The rate of return is the sum of the weighted average cost of debt and the weighted
11 return on equity.

12

13 **Q. What adjustments are you proposing to the rate of return calculated by the**
14 **Company?**

15 A. I am proposing to adjust the capital structure and the return on equity.

16

17 **Q. Please describe the capital structure used by the Company in its calculation of**
18 **the requested rate of return.**

19 A. As can be seen on Schedule DGB-12, the Company's capital structure consists of
20 37.66% debt and 62.34% equity.

21

22 **Q. Why are you proposing to adjust this capital structure?**

1 A. The capital structure presented by the Company is too heavily weighted toward
2 equity, which is the most expensive source of capital. A capital structure consisting
3 of 62.34% equity is not appropriate for determining the authorized rate of return for a
4 regulated utility. I have utilized a hypothetical capital structure consisting of 50%
5 equity and 50% debt for the purpose of calculating the Company's cost of capital. I
6 believe that a capital structure with 50% equity and 50% debt is more reasonable for
7 ratemaking purpose than is the Company's capital structure with a 62.24% equity
8 ratio.

9

10 **Q. What return on equity has the Company reflected in determining its weighted**
11 **average rate of return?**

12 A. The Company has reflected a return on equity of 11.00%. Mr. Bebyn cites the
13 11.00% allowed to Interstate Navigation Company in its last rate case, Docket No.
14 4373, as the basis for the 11.00% return on equity being requested by A&R in the
15 present case.

16

17 **Q. Is 11.00% an appropriate return on equity for A&R in the present case?**

18 A. No. Mr. Bebyn is correct that Interstate Navigation Company is a much larger utility
19 company. However, he neglected to mention that the 11.00% return on equity
20 authorized for Interstate was done so in conjunction with a capital structure with
21 26.2% equity and 73.8% debt. As a general matter, the lower the equity ratio is, the
22 greater the riskiness is, and the higher the cost of equity. Given the significantly

1 higher equity ratio for A&R, even with my proposed hypothetical capital structure,
2 the authorized return on equity should be lower than 11.00%.

3

4 **Q. What return on equity have you reflected in determining the weighted average**
5 **rate of return?**

6 A. I have reflected a return on equity of 10.00% in my calculation of the weighted
7 average rate of return. Combined with the Company's weighted cost of debt, the
8 result is a weighted average rate of return of 7.63% (Schedule DJE-5). By way of
9 comparison, I would note that Interstate Navigation's authorized return in Docket No.
10 4373 was 5.53%. Part of the difference is attributable to Interstate's lower cost of
11 debt. However, even if Interstate's cost of debt were the same as A&R's 5.25%, the
12 authorized rate of return for Interstate would still only be 6.75%, as compared to the
13 7.63% that I have calculated in the present case.

14

15 **Q. What return on rate base have you calculated?**

16 A. I have calculated a return on rate base of \$220,116 (Schedule DJE-4) and included
17 this return component in the Company's total revenue requirement.

18

19 **IV. RATES**

20 **Q. The Company is proposing to establish "commuter rates" for island residents**
21 **and their vehicles, with those rates set at the present one-way rates and to then**
22 **increase all other rates by an equal percentage in order to produce the required**

1 revenues. Is the Division proposing any modifications to the Company's
2 proposed rate design?

3 A. Yes. A&R proposes the new commuter rates on the grounds that the frequent user
4 rates do not provide an adequate discount for lifeline service. However, the
5 establishment of a commuter rate applicable only to Island residents would require
6 the Company to establish procedures to determine eligibility for the resident rates, set
7 up identification mechanisms, and verify the identity of passengers utilizing the
8 resident tickets. This would result in additional expenses that have not been included
9 in the cost of service. A better approach would be to increase the frequent user
10 discounts, especially for twenty-trip tickets.

11 On my Schedule DJE-6, I show an alternative schedule of rates. The twenty-
12 trip ticket is \$56.00, or \$2.80 per trip, with a sixty-day expiration date. This per-trip
13 rate actually slightly less than the \$2.85 per trip proposed by the Company as the one-
14 way rate for Island residents. The ten-trip discount is also greater than the discount
15 proposed by the Company, although the spread between the ten-trip and twenty-trip
16 tickets is greater. These rates assume that the residents mainly use twenty-trip tickets,
17 and would thus benefit most from the greater discount. I am not proposing to modify
18 the either the thirty-day expiration date for the ten-trip booklet or the sixty-day
19 expiration date for the twenty-trip booklet.

20 My proposed increase for six-trip car tickets is less than the overall increase,
21 although the new rate would be somewhat higher than resident rate for cars proposed
22 by the Company. I have also included a six-trip SUV, Van, and Pickup rate that is the
23 same as the six-trip car rate. This rate is lower than the resident SUV, Van, and

1 Pickup rate proposed by the Company. For the purpose of calculating the revenues
2 that this new rate would produce, I have assumed that the ratio of the six-trip SUV,
3 Van, and Pickup tickets to single-trip tickets would be the same as the ratio of six-trip
4 car tickets to single-trip car tickets.

5 The increases for the adult one-way and child one-way tickets are
6 approximately 90%. The increase for larger trucks, other vehicles, and freight is
7 100%.

8

9 **Q. Does this conclude your direct testimony?**

10 A. Yes.

11

Schedule DJE-1

A&R MARINE CORP
RATE YEAR REVENUE REQUIREMENT

		<u>Company</u> <u>Position</u>	<u>Adjustments</u>	<u>Division</u> <u>Position</u>
Cost of Service	(A)	1,149,285	(100,105)	1,049,180
Miscellaneous Revenues	(B)	<u>32,548</u>	-	<u>32,548</u>
Net Revenue Requirement		1,116,737	(100,105)	1,016,632
Tariff Revenues, Present Rates	(B)	<u>552,328</u>	-	<u>552,328</u>
Revenue Deficiency		<u>564,409</u>	<u>(100,105)</u>	<u>464,304</u>
Percentage Rate Increase		<u>102.19%</u>		<u>84.06%</u>

Sources:

- (A) Schedule DJE-2
- (B) Schedule DGB-1

A&R MARINE CORP
COST OF SERVICE

	(A) Company <u>Position</u>	<u>Adjustments</u>		<u>Division Position</u>
Cash Operating Expenses	670,932	(21,170)	(B)	649,763
Depreciation	223,323	(44,022)	(C)	179,301
Return on Rate Base	<u>255,030</u>	<u>(34,914)</u>	(E)	<u>220,116</u>
Total Cost of Service	<u>1,149,285</u>	<u>(100,105)</u>		<u>1,049,180</u>

Sources:

- (A) Schedules DGB-9, DGB-7
- (B) Schedule DJE-3, Page 1
- (C) Schedule DJE-3, Page 2
- (D) Schedule DJE-4

A&R MARINE CORP
CASH OPERATING EXPENSES

Test Year Gallons of Fuel	(A)	42,337
Proposed Fuel Floor Rate		<u>\$1.50</u>
Pro Forma Fuel Expense		63,506
Company Fuel Expense	(A)	<u>84,675</u>
Adjustment to Company Fuel Expense		<u><u>(21,170)</u></u>

Sources:

- (A) Schedule DGB-1
- (B) See Testimony

A&R MARINE CORP
ADJUSTMENTS TO DEPRECIATION EXPENSE

		<u>Vessels</u>	<u>Vessel Impr.</u>	<u>Docks</u>	<u>Total</u>
Book Cost	(A)	771,250	897,783	1,620,618	3,289,651
Depreciation Life		<u>20</u>	<u>20</u>	<u>25</u>	
Annual Depreciation		38,563	44,889	64,825	148,276
Company Depreciation	(A)	<u>51,416</u>	<u>59,852</u>	<u>81,030</u>	<u>192,298</u>
Adjustment		<u>(12,854)</u>	<u>(14,963)</u>	<u>(16,205)</u>	<u>(44,022)</u>

Sources:

- (A) Response to Division Data Request 1-6
- (B) See Testimony

Schedule DJE-4

A&R MARINE CORP
RETURN ON RATE BASE

		<u>Company Position</u>	<u>Adjustments</u>	<u>Division Position</u>
Net Rate Base	(A)	\$ 2,886,770	-	\$ 2,886,770
Rate of Return	(B)	<u>8.83%</u>	<u>-1.21%</u>	<u>7.63%</u>
Return on Rate Base		<u>\$ 255,030</u>	<u>\$ (34,914)</u>	<u>\$ 220,116</u>

Sources:

- (A) Schedule DGB-11
- (B) Schedule DJE-5

Schedule DJE-5

A&R MARINE CORP
RATE OF RETURN

Company Position	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long Term Debt	37.66%	5.25%	1.98%
Common Equity	<u>62.34%</u>	11.00%	<u>6.86%</u>
Total Capital	<u>100.00%</u>		<u>8.83%</u>

Division Position	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Long Term Debt	50.00%	5.25%	2.63%
Common Equity	<u>50.00%</u>	10.00%	<u>5.00%</u>
Total Capital	<u>100.00%</u>		<u>7.63%</u>

Sources:
 Company Position - Schedule DGB-12
 Division Position - See Testimony

A&R MARINE CORP
PROOF OF REVENUES

	Present Billing Units	Proposed Billing Units	Present Rate	Present Revenue	Proposed Rate	Proposed Revenue
<u>Passenger Revenues</u>						
Adult One Way	40,550		2.85	115,568	5.40	218,970
Child One Way	5,087		1.00	5,087	1.90	9,665
10 Trip Book (\$33)	3,972		1.85	7,348	3.30	13,108
20 Trip Book (\$56)	9,893		1.75	<u>17,313</u>	2.80	<u>27,700</u>
Total Passenger Revenues				<u>145,315</u>		<u>269,443</u>
<u>Vehicle Revenues</u>						
Cars	7,804		15.50	120,962	30.00	234,120
Cars-(6 book - \$123)	4,461		12.50	55,763	20.50	91,451
SUV, Van, Pickup	8,778	5,585	15.50	136,059	30.00	167,550
SUV, Van, Pickup (6 book - \$123)		3,193			20.50	65,457
Trucks (1-2 tons)	246		21.50	5,289	43.00	10,578
Trucks (2-3 tons)	44		34.00	1,496	68.00	2,992
Trucks (4-5 tons)	239		37.50	8,963	75.00	17,925
Trucks (5-10 tons)	160		62.00	9,920	124.00	19,840
Trucks (10-20 tons)	395		77.50	30,613	155.00	61,225
Trucks (20-30 Tons)	258		124.00	<u>31,992</u>	248.00	<u>63,984</u>
Total Vehicle Revenues				<u>401,056</u>		<u>735,121</u>
Trailers and Boats				937		1,874
Freight				3,733		7,466
Bikes, Mopeds, etc.				<u>1,287</u>		<u>2,574</u>
Total Rate Revenues				<u>552,328</u>		<u>1,016,478</u>
Net Revenue Requirement						<u>1,016,632</u>

Sources:

Present Rates and Billing Units - Schedule DGB-17

Proposed Rates - See Testimony