WATER CARRIERS WORKING GROUP – SUB-COMMITTTE ON RATES

Potential Operational Changes – Prior to Rate Discussion

- Reservation System
- Consolidation – on or off premise
- Deregulate LCL?
- Reconfigure Piers and Traffic Flow
- Create more Efficient Routes
- Other Operating Efficiencies

Considerations for Rate Setting – After Operational Changes

- Fixed Costs
  - Harbor Leases
  - Debt Service
  - Equipment Leases
  - Medical Premiums
  - Retirement Contributions
  - Salaried Employees
  - Replacement/Deferred Maintenance
  - Storage Rental
- Variable Costs
  - Hourly Wages and Overtime
  - Fuel Costs
  - Utility Costs
- Pass-Through Costs
  - Wharfage
  - Taxes
- Return on Investment
  - Rate of Return for Invested Capital
  - Operational Return for Risk

<u>Rate Setting Considerations</u>

Option #1 – Price each route at levels to ensure reasonable profitability for each route

Option #2 – Price all routes at standardized rates to smooth out both profitable and unprofitable routes while ensuring an overall reasonable rate of return

Other Considerations

Set rates on prioritized needs or desired outcomes

Lower rates – Ag products, livestock, farm equipment and supplies, medicines, essentials (toilet paper, toothpaste, etc.), renewable energy materials, electric vehicles

Higher rates – luxury goods, alcohol, cigarettes, sugary items (soda, candy, etc.), vehicles (maybe with value cap)

Standard rates – construction materials, furniture, imported food, electronics

First class rate for fixed routes vs. regular rate for a flexible route

Avoid future large rate adjustments by allowing an annual COLA tied to Honolulu CPI-U (say for 5 years) to be applied to new rates

How to address volume fluctuations?

Emergency pricing

Triggers to enable emergency pricing and/or revert to regular pricing (scalable?)

WATER CARRIERS WORKING GROUP – SUB-COMMITTTE ON RATES

Discussion outline presented by Steve Hunt

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Group Discussion

Jay Ana

- Rate adjustment submit in Sept. 2019 (pre-pandemic) was for a 34% increase, which included an anticipated rate of return on operations and capital invested
- The emergency 46% rate approved was projected to be breakeven with no rate of return, nor contingency if projections fell short
- Despite additional local usage by Matson and Pasha, volume is still down 23%
- The water carrier utility has different rate making mechanisms that other utilities (for example, there's no surcharge or profit margin on fuel cost pass throughs)

Andrew Okabe

- Clarified the rate making differences between HECO and YB

Lorraine Inouye

- How was the shipment of equipment and supplies handled for Hurricane Iselle in 2014? (Jay Ana responded – YB did this at no change out of a sense of community responsibility)
- In future, can we coordinate and add this to the federal reimbursement request since it was a real cost to YB?

Chris Edwards

- Will provide rate history at next meeting (include losses in 2017, 2018, and 2019 as well as capital invested with no return)
- Evaluate the Annual Freight Rate Adjustment (AFRA) pilot program that allowed rate adjustments within a reasonable range of -5% to +5% for interim years (sunset in 2014)
- Look at surface transportation rate making

Jesse Andrade

- Can we look at intra-state rate adjustments of "big brother" companies (Matson and Pasha) as part of the framework?
- Reinstating a program like AFRA might be a low hanging fruit

Jay Ana

- Under the "Island Ag" program, raw agricultural materials receive a 30% discount
- Pressure mounting to redefine Island Ag to include finished products

Jesse Andrade

- There are issues with customers sending full containers trying to utilize the Island Ag discount for cargo that isn't qualified
- Difficult to police these shipments

Jay Ana

- Stop-in-Transit/Storage-in-Transit (SIT) continues to have a significant impact on YB operations
- Island Ag especially difficult to police in refrigerated containers
- How to products, like certain brands of lau-lau end up in grocery stores while not being on any manifest?

Lorraine Inouye

- SB 1253 is proposed to expand the Ag definition even further, which if passed would require discounts to Ag products from the mainland
- YB needs to make sure they submit testimony and request to speak at the virtual hearing on this bill

Steve Hunt

- Next meeting date/time – Friday, February 12th 8:30-10:00 am
- Kris Nakagawa to host on Teams sending out invitations from the email distribution list previously provided by Tammie Kotani
- Chris Edwards to provide additional information to the group (rate history, YB losses, AFRA information)
- Steve Hunt to create agenda for next meeting and distribute prior to meeting – please feel free to add suggested items for the agenda

Proposed Agenda for Water Carriers Working Group Subcommittee Meeting on Rates
Friday, February 12, 2021
8:30 – 10:00 a.m.
Virtual meeting via Teams

1. **Approve Agenda**

2. **Review Minutes from 01/29/2020 Subgroup Meeting** – 5 minutes (8:35)
   - Any corrections, additions, or deletions to prior meeting's minutes

3. **Review Desired Futures, Supporting Forces, and Restraining Forces (Steve Hunt)** – 10 minutes (8:45)
   - Overarching guidance for subgroup decision-making on rates
   - Other suggestions to make sure Rates subgroup produces meaningful suggestions

4. **Presentation by YB (Chris Edwards, et al.)** – 30 minutes (9:15)
   - Rate history including PUC rate hikes not approved
   - Capital investment by YB
   - Operating losses sustained by YB
   - Other intra-state water carrier pricing (Matson, Pasha)

5. **Questions and Answers on YB Presentation** – 15 minutes (9:30)

6. **Decisions for Rate Setting** - 30 minutes (10:00)
   - Possibility to reinstate AFRA (or similar interim adjustment program) as a short-term solution that could be implemented now (low-hanging fruit)
   - LCL to remain regulated or deregulate and re-price at market
   - Price individual routes separately or price on the sustainability/profitability as an entire operation (i.e. standalone or subsidized model)
   - Maintain current weekly routes (Maui 3x, Kauaʻi 2x, Kawaihae 2x, Hilo 2x, Molokaʻi 2x, and Lānaʻi 1x) or allow alternative route scheduling
   - Suggestions on Agricultural and Livestock pricing beyond the current 30% discount (subsidies, tax credits, higher prices for other cargo, etc.)

7. **Set Date and Time for Next Subgroup Meeting**

YOUNG BROTHERS

UNDERSTANDING THE BASIC DIFFERENCES BETWEEN INTRASTATE VS. INTERSTATE REGULATION OF WATER CARRIERS

Young Brothers is the only intrastate water carrier for property in Hawai'i and is regulated by the Hawai'i Public Utilities Commission (PUC). The PUC oversees YB's operations from our rate changes to our sailing schedule across the islands and more. Meanwhile, interstate water carriers – who bring goods from the mainland or other countries into the islands – do not face the same regulations as Young Brothers. So, how does the regulation of intrastate and interstate water carriers differ?

What is the difference between intrastate vs. interstate water carriers?	Young Brothers – Intrastate	Interstate
	Water carriers responsible for any cargo transportation between the islands within the State of Hawai'i.	Water carriers responsible for any cargo transportation between the U.S. mainland and Hawai'i as well as Alaska and U.S. territories like America Samoa.
Who has jurisdiction over the water carriers?	The Hawai'i State Public Utilities Commission (PUC) has jurisdiction over intrastate water carriers. Learn more about the PUC's responsibility here: HRS Section 271G-2	The Surface Transportation Board (STB) – a federal agency – has jurisdiction over interstate water carriers carrying cargo between the U.S. mainland and Alaska, Hawai'i and U.S. Territories. Learn more about the STB's responsibility here: Section 13101 of Title 49, U.S.C
Do water carriers need approval to raise rates?	Yes, the PUC must approve of all rate changes.	No, interstate carriers do not require STB approval to change rates.
How can water carriers raise rates?	Any rate change requires an application or tariff transmittal.	A rate case application or tariff transmittal to the STB is not required to change rates or rules.
What is the time frame water carriers must follow to raise rates?	The PUC can allow a rate change to take effect within 45 days' notice or schedule a hearing to decide within six months.	Water carriers can change the rates with little to no notice. All that STB requires is that the tariff is posted online.
When can a rate increase go into effect?	Typically, rate changes take 6 to 11 months for review by the PUC before going into effect.	Rate changes are effective immediately upon updating the tariff.
Are all of Young Brothers' services regulated by the State?	No. The PUC regulates YB's transportation of intrastate cargo. However, the PUC does not regulate YB's transportation of interstate or international cargo, charter services, and other unregulated services.	

Surface Transportation Board (aka, STB)

- STB has jurisdiction over transportation by or with a water carrier in the contiguous domestic trade (i.e., INTERSTATE cargo transportation between the U.S. mainland and Alaska, Hawaii and U.S. territories (e.g., America Samoa, Puerto Rico, etc.) (49. U.S.C. Section 13521)
- No rate case application or tariff transmittal required to change rates or rules.
- STB's primary requirement or rule for domestic water carriers is that the carrier's applicable tariff needs to be posted online so carriers can change their rates/rules with little to no notice.

Hawaii Public Utilities Commission (aka, HPUC)

- HPUC has jurisdiction over water carriers transporting property (cargo) and/or passengers within the State of Hawaii (i.e., INTRASTATE/REGULATED cargo and passenger operations).

- As a matter of practice, any rate change requires an application.

- HPUC can allow rate change to take effect within 45 days notice, or set it for hearing to be decided no later than six months.

STATE OF HAWAII
PUBLIC UTILITIES COMMISSION

Exemptions from HPUC Regulation

- Interstate or International Cargo arriving into Hawaii ports not subject to oversight (HRS Section 271G-4)

- Charters (private carriage of services between islands) not subject to oversight. (HRS Section 269-1)

- Other specific exemptions as set forth under HRS Section 271G-6 (e.g., Nonprofit agricultural cooperative associations transporting their own property or property of members (HRS Section 271G-6(2))

Primary Differences between Intrastate Water Carriers and Other Water Carriers

- Intrastate water carriers (passengers or property) need to obtain prior HPUC approval of rate changes; as interstate and other non-regulated carriers do not.

- Rate changes for intrastate water carriers normally require 6-11 months review before becoming effective (while interstate and other non-regulated carriers are usually effective immediately upon updating tariff).

- For YB, its transporting of cargo between islands are unique as certain services are regulated (i.e., intrastate cargo under Tariff 5-A) while other services are non-regulated (i.e., interstate cargo, charters, etc.).

Mahalo!

- Questions?
- Comments?
- Feedback?

Young Brothers, LLC

Rates History & Long-Term Profitability

February 12, 2021

YOUNG BROTHERS
Your Neighbor Island Partner

How did Young Brothers, LLC get here today?

We have struggled with rate relief…

Rate Increase	ASK	Overall	Delta	Allowed RoR	Actual Intra RoR
2005 Zone of Reasonableness	5.50%	5.50%	0.00%	11.06%	5.60%
2006 Zone of Reasonableness	5.50%	5.50%	0.00%	11.06%	1.70%
2007 General Rate Increase	10.70%	7.51%	-3.19%	10.76%	6.96%
2008 Zone of Reasonableness	5.50%	5.50%	0.00%	10.76%	2.99%
2009 General Rate Increase	17.91%	13.46%	-4.45%	10.82%	0.94%
2010 No Increase	0.00%	0.00%	0.00%	10.82%	0.04%
2011 General Rate Increase	23.97%	16.58%	-7.39%	10.25%	-3.24%
2012 No Increase	0.00%	0.00%	0.00%	10.25%	6.65%
Average		6.76%			
2013 AFRA Increase	5.50%	5.50%	0.00%	10.25%	6.31%
2014 AFRA Increase	2.21%	2.21%	0.00%	10.25%	10.52%
2015 No Increase	0.00%	0.00%	0.00%	10.25%	10.86%
2016 General Rate Increase	4.36%	0.12%	-4.24%	10.25%	1.12%
2017 No Increase	0.00%	0.00%	0.00%	9.56%	-2.81%
2018 No Increase	0.00%	0.00%	0.00%	9.56%	-7.17%
2019 General Rate Increase	13.32%	4.32%	-9.00%	9.56%	-10.03%
2020 No Increase	0.00%	0.00%	0.00%	9.56%	-13.51%
Average		1.52%			

46.03%
ERI eff
9.1.20

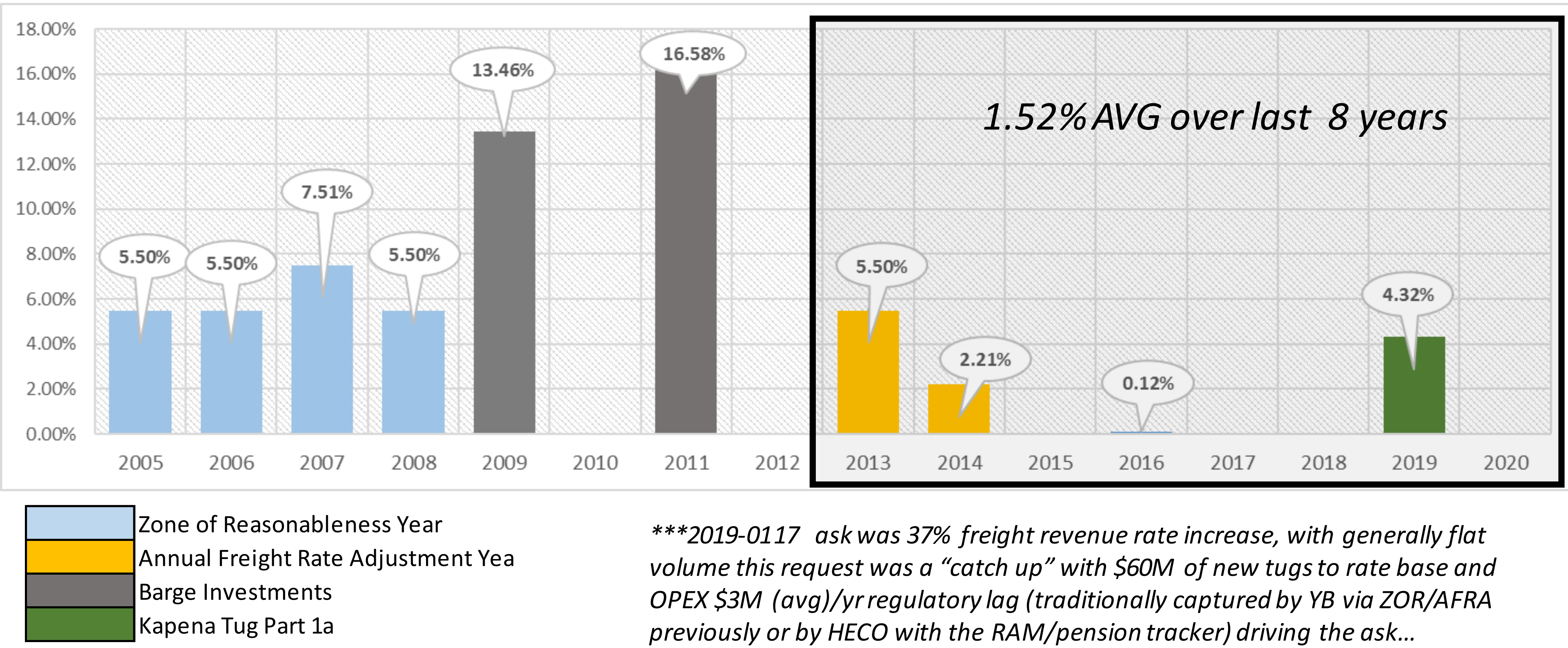
<17%>
RoR Nov
2020

Zone of Reasonableness Year
Annual Freight Rate Adjustment Year

How did Young Brothers, LLC get here today?

We have struggled with rate relief cont…

Young Brothers, LLC: General Rate Increases

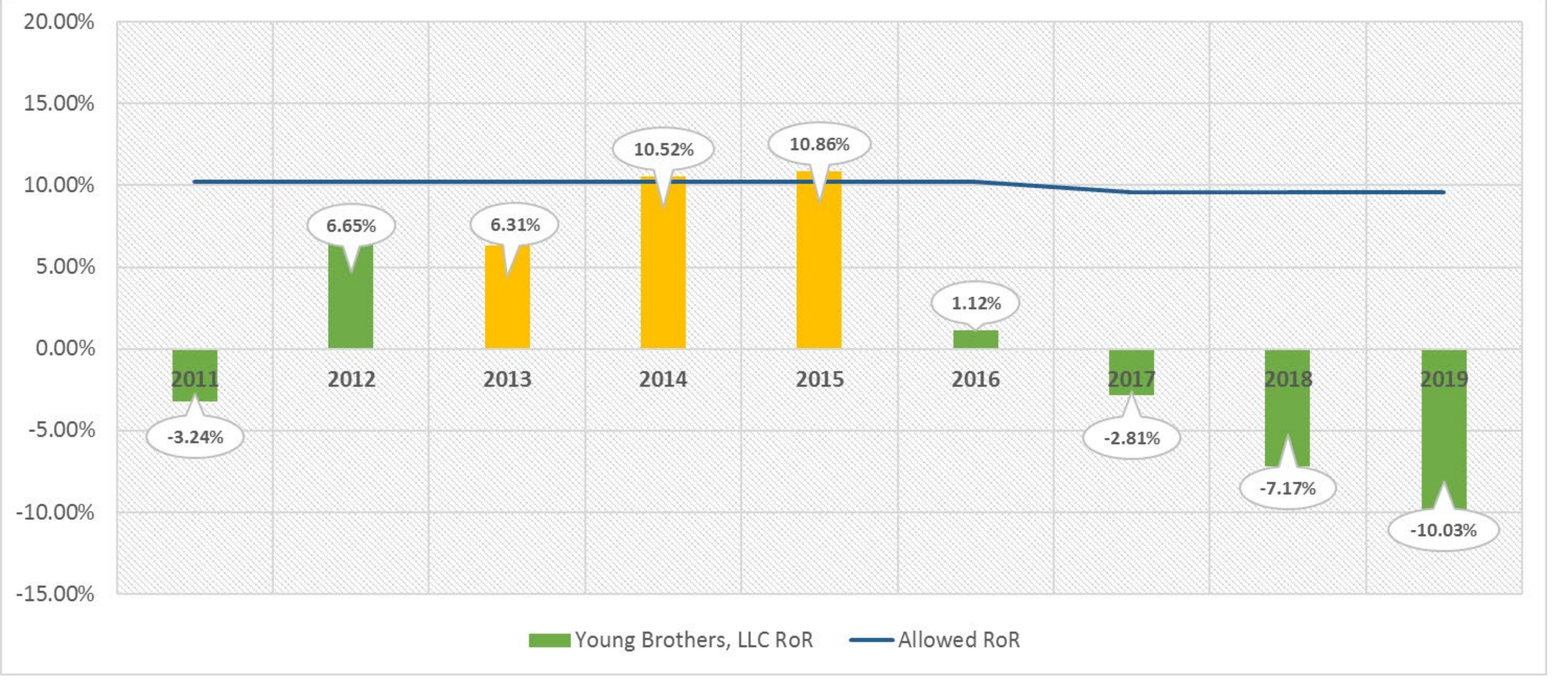


****2019-0117 ask was 37% freight revenue rate increase, with generally flat volume this request was a "catch up" with $60M of new tugs to rate base and OPEX $3M (avg)/yr regulatory lag (traditionally captured by YB via ZOR/AFRA previously or by HECO with the RAM/pension tracker) driving the ask…*

The 46.03% was modeled with intrastate volumes down YoY 17% (annual mean)…2019-0117 volumes were only slight down YoY 1-2% (annual mean)

How did Young Brothers, LLC get here today?

Rate of return is significantly off track, even in periods of strong rate relief - due to regulatory lag…only during times with cost recovery mechanisms have we come close to our allowed rate of return



Annual Freight Rate Adjustment Year

How did Young Brothers, LLC get here today?

Over the recent 5yr time period, consolidated (fig1) (Inter/Intra) state volumes remained flat 2017-2019 until the 2020 world pandemic

Fig 2 shows intrastate volumes without the interstate subsidized cargo. LCL/MIX are in the GC categories (dry/reefer) are down over the time period as market trends drive the change (Amazon effect, big box store, less consolidation in Hawaii et al)

<20%>
YoY

Fig 1 – Consolidated (Inter/Intra)

Cargo Type	2016	2017	2018	2019	2020
Automobile	457,562	403,371	411,604	427,822	358,584
Container	6,825,845	6,540,280	6,707,659	6,682,021	6,082,762
Dry General Cargo	486,170	469,202	441,890	428,476	374,902
Racks (straight load)	291,822	310,731	317,165	331,677	280,810
Reefer General Cargo	38,823	35,663	33,972	32,424	27,971
RoRo	240,214	219,272	235,267	227,169	210,547
Total	**8,340,436**	**7,978,519**	**8,147,557**	**8,129,588**	**7,335,576**

Freight Per Tonnage by Cargo Type and Year

Fig 2 – Intrastate ONLY

Cargo Type	2016	2017	2018	2019	2020
Automobile	339,922	352,882	352,153	352,822	245,814
Container	2,512,312	2,520,636	2,730,442	2,568,654	2,045,903
Dry General Cargo	469,210	445,571	423,094	408,447	358,421
Racks (straight load)	148,336	164,689	174,821	161,160	146,254
Reefer General Cargo	38,823	35,663	33,972	32,424	27,971
RoRo	201,430	191,580	207,798	202,779	155,103
Total	**3,710,034**	**3,711,021**	**3,922,280**	**3,726,287**	**2,979,465**

Freight Per Tonnage by Cargo Type and Year

****46.03% based on drop in volume YoY drop of 17% w/ no earning component (RoR) November Marsoft TTM Return on Rate Base is around a 17.5% loss*

Future of YB

Long-Term Profitability and Sustainability

- Operational Flexibility/Restructuring
  - Sailing Schedule Adjustments based on Demand/Capacity
  - Evaluate flexible regulation, adjustment of Lines of Service that are currently non-compensatory
- Rate design that reflects true cost causal relationships
- State subsidy for servicing routes that are non-compensatory, including Kaunakakai, Kaumalapau, and Hilo
- Rate Mechanisms: Annual Freight Rate Adjustment (AFRA)/Zone of Reasonableness
- Continued Cost Containment

Mahalo!

WATER CARRIERS WORKING GROUP – SUB-COMMITTTE ON RATES

February 12, 2021

Reviewed Desired Futures, Supporting Forces, and Restraining Forces (Steve Hunt)

Desired Futures:

1.) Incremental rate increases rather than large, catch-up adjustments (COLA or AFRA to base rates)
2.) All carriers involved in the movement of cargo have the ability to be sustainable and profitable
3.) Standardized and streamlined ratemaking in ports and cargo types that are negative earners

Supporting Forces:

1.)
- Review services to determine what services should be regulated versus services priced by competitive market
- Financial stability of the Utility to drive capital investment, resulting in customer satisfaction and operational efficiencies
- Tax credits allowed by the Legislature
- Other options to subsidize shipping

2.)
- Increased flexibility in implementation of current rate design to address less profitable regulated services/ports/routes
- Review services to determine what should continue to be provided as regulated services or what could be provided by a competitive market

3.)
- Increased flexibility in implementation of current rate design to address less profitable regulated services/ports/routes
- Financial stability of the Utility to drive capital investment, resulting in customer satisfaction and operational efficiencies
- Potential incorporation of rate adjustment mechanisms

Restraining Forces:

1.)
- YB is operating a regulated service in a competitive environment (others are pricing their product at a market rate)
- The cost of providing LCL services is greater than the revenue because of the labor, fees, equipment and infrastructure

2.)
- The need to service the broad customer needs creates inefficiency and development of a niche
- YB is operating a regulated service in a competitive environment (others are pricing their product at a market rate)

3.)

- The cost of providing LCL services is greater than the revenue because of the labor, fees, equipment and infrastructure
- The mandated routes may be inherently inefficient
- Regulatory burden and lag

Additional Discussion on Desired Futures, Supporting Forces, and Restraining Forces

- Route schedule and equipment needs are interdependent and would need to be managed
- Limited dock space and storage at harbors can lead to high piling which creates a dangerous working condition
- Need to consider customer needs in route scheduling too, especially for perishables
- Rate making linked to the frequency of routes that are mandated

Chris Edwards – Presentation on Rates and Profitability

Key slide regarding rates and profitability

We have struggled with rate relief…

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Average		**1.52%**			

46.03% ERI eff 9.1.20

<17%> RoR Nov 2020

Zone of Reasonableness Year
Annual Freight Rate Adjustment Year

PRIVLEGED AND CONFIDENTIAL

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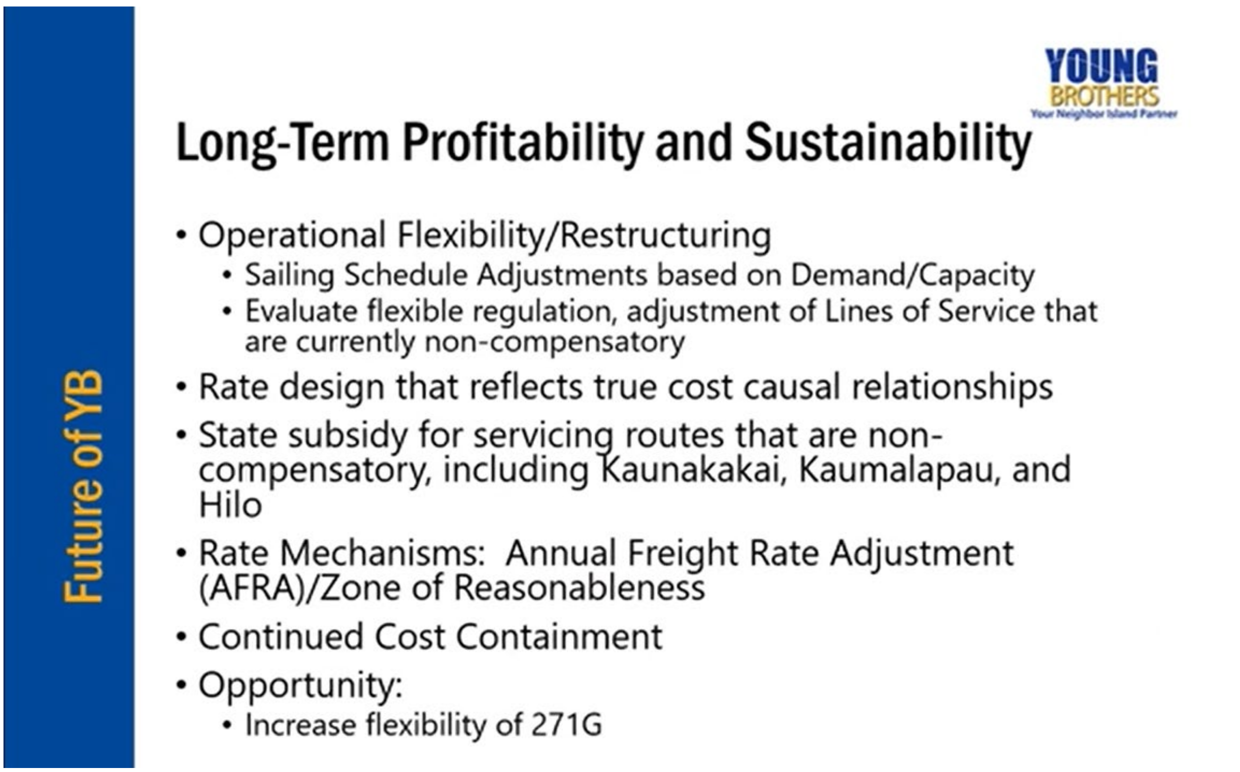
- Of recent, the only times YB has managed to remain profitable has been when the Zone of Reasonableness or Annual Freight Rate Adjustments were in place
- 2019 ask of 37% was a catch up for increasing operational costs ($3M/yr. avg.) as well as additional investment into YB ($60M in new tugs)
- Rate of return is based on profit compared to net asset value after recapturing 1-for-1 operating expenses
- Volume was generally flat from 2016 to 2020 (pre-pandemic) with the exception of 2017 when Matson had some drydock work done that reduced volume
- High fixed cost structure makes YB susceptible to volume declines

- The 46% emergency rate increase was based on an estimated 17% drop in cargo volume and assuming 0% rate of return
- Actual cargo volume trending at a 20% decline for 2020
- To achieve the allowable maximum rate of return, the pricing would have had to been adjusted to produce an additional $8 million in net profit
- Lost substantial amounts in 2017, 2018, and 2019; and likely that 2020 will not breakeven despite the 46% rate increase
- Zone of Reasonableness was discontinued because the tool intended for adjustments to pricing on specific lines began to be used as an overall price adjustment without any metrics being provided by the water carrier

YB's Suggested Changes to Ensure Profitability and Sustainability



- Unregulated large containers are profitable and are subsidizing the LCL and Mix cargo
- Need to have the flexibility to match demand/volume of cargo with regular cadence of routes for those customers that depend on shipping

Kris Nakagawa - Surface Transportation Board vs. Hawaiʻi Public Utility Commission in Rate Making

- YB is operating in a competitive environment (except for routes to Kaunakakai and Kaumalapau) with regulated pricing and route structure
- STB oversees rates for Matson and Pasha for interstate cargo
- No rate case or tariff application to STB is required, just post tariffs online
- In contrast, HPUC can approve rate request to take effect within 45 days notice or must schedule rate hearing for decision within 6 months

- Rate changes requiring HPUC approval typically don't go into effect for 6 to 11 months from the time of the request
- There are portions of YB intrastate business that are not regulated – including Matson and Pasha freight continuing on the neighbor island ports and chartered cargo routes

Decisions for Rate Setting (Steve Hunt)

- Possibility to reinstate AFRA (or similar interim adjustment program) as a short-term solution that could be implemented now (low-hanging fruit)

  Majority of the small group agreed that an interim rate adjustment mechanism is needed for the water carrier to remain sustainable and profitable, but another member cautioned that there must be a reasonable nexus to justify increases to specific lines (or as a whole) so that the water carrier wouldn't be given unfettered authority to use this rate tool indiscriminately. There needs to be accountability in adjusting rates.

- LCL to remain regulated or deregulate and re-price at market

  No consensus was reached on this topic as some ports simply do not have the volume nor consolidation alternatives to make deregulation feasible. Types of regulated cargo may need to be looked at on a port-by-port basis if this is going to be a viable solution.

Next Meeting – February 24, 2021 2:00 – 3:30

Outline for Framework on Rates

Desired Futures:

1.) Incremental rate increases rather than large, catch-up adjustments (COLA or AFRA to base rates)
2.) All carriers involved in the movement of cargo have the ability to be sustainable and profitable
3.) Standardized and streamlined ratemaking in ports and cargo types that are negative earners

Supporting Forces:

1.)

- Review services to determine what services should be regulated versus services priced by competitive market
- Financial stability of the Utility to drive capital investment, resulting in customer satisfaction and operational efficiencies
- Tax credits allowed by the Legislature
- Other options to subsidize shipping

2.)

- Increased flexibility in implementation of current rate design to address less profitable regulated services/ports/routes
- Review services to determine what should continue to be provided as regulated services or what could be provided by a competitive market

3.)

- Increased flexibility in implementation of current rate design to address less profitable regulated services/ports/routes
- Financial stability of the Utility to drive capital investment, resulting in customer satisfaction and operational efficiencies
- Potential incorporation of rate adjustment mechanisms

Restraining Forces:

1.)

- YB is operating a regulated service in a competitive environment (others are pricing their product at a market rate)
- The cost of providing LCL services is greater than the revenue because of the labor, fees, equipment and infrastructure

2.)

- The need to service the broad customer needs creates inefficiency and development of a niche
- YB is operating a regulated service in a competitive environment (others are pricing their product at a market rate)

3.)

- The cost of providing LCL services is greater than the revenue because of the labor, fees, equipment and infrastructure
- The mandated routes may be inherently inefficient
- Regulatory burden and lag

Proposed Agenda for Water Carriers Working Group Subcommittee Meeting on Rates
~~Thursday, February 24, 2021~~ Friday, February 25, 2021 - Rescheduled
~~2:00 – 3:30 p.m.~~ 3:00 – 4:30 p.m.
Virtual meeting via Teams

1. **Approve Agenda**

2. **Review Minutes from 02/12/2021 Subgroup Meeting** – 5 minutes (2:05)
   - Any corrections, additions, or deletions to prior meeting's minutes

3. **Decisions for Rate Setting (con't. from 02/12/2021 meeting)** - 30 minutes (2:35)
   - Price individual routes separately or price on the sustainability/profitability as an entire operation (i.e. standalone or subsidized model)
   - Maintain current weekly routes (Maui 3x, Kauaʻi 2x, Kawaihae 2x, Hilo 2x, Molokaʻi 2x, and Lānaʻi 1x) or allow alternative route scheduling
   - Suggestions on Agricultural and Livestock pricing beyond the current 30% discount (subsidies, tax credits, higher prices for other cargo, etc.)

4. **Review WCWG Small Group Status Report Template** – 55 minutes (3:30)
   - Prepare recommendations from the Rate group

5. **Set Date and Time for Next Subgroup Meeting (if needed)**
   - Review completed WCWG Small Group Status Report prior to 03/18/2021 meeting?

WATER CARRIERS WORKING GROUP – SUB-COMMITTTE ON RATES

February 25, 2021

Approved minutes from February 12, 2021 meeting

Recapped discussion on Rate Setting from prior meeting

- Possibility to reinstate AFRA (or similar interim adjustment program) as a short-term solution that could be implemented now (low-hanging fruit)

  Majority of the small group agreed that an interim rate adjustment mechanism is needed for the water carrier to remain sustainable and profitable, but another member cautioned that there must be a reasonable nexus to justify increases to specific lines (or as a whole) so that the water carrier wouldn't be given unfettered authority to use this rate tool indiscriminately. There needs to be accountability in adjusting rates.

- LCL to remain regulated or deregulate and re-price at market

  No consensus was reached on this topic as some ports simply do not have the volume nor consolidation alternatives to make deregulation feasible. Types of regulated cargo may need to be looked at on a port-by-port basis if this is going to be a viable solution.

Continued discussion on Rate Setting

- Price individual routes separately or price on the sustainability/profitability as an entire operation (i.e. standalone or subsidized model)

  If we try to price the sustainability/profitability as an entire operation, then we are in the same position as we are today. Might be better to price routes separately based on their sustainability/profitability by route and then look for subsidies (or federal assistance) to make up the difference on negative earners.

  Currently there's a cross-subsidy structure: unregulated cargo, autos, and regulated on the profitable routes help carry the regulated unprofitable cargo. (YB shared link to tariff 5A – Local-Tariff-No.-5-A-Effective-09.01.2020.pdf (htbyb.com) covering commodity types and pricing by port).

  Cost of service docket covers the whole of operations. Difficult to decouple individual routes in terms of profitability.

- Maintain current weekly routes (Maui 3x, Kauaʻi 2x, Kawaihae 2x, Hilo 2x, Molokaʻi 2x, and Lānaʻi 1x) or allow alternative route scheduling

  Consider reducing some of the existing fixed-routes and replace with modified fixed-route and flex-route schedules. Routes are established by Commission order (rule based), not by statute.

Consumers need predictability for supply-chain needs. Might need added warehouse space to store cargo between shipping dates if sailings are reduced.

During disasters/emergencies, what happens to regular shipping schedules when having to move equipment and supplies for disasters? Need policy on how regular intrastate cargo moves while carrier also attends to the emergency needs of each affected area.

Tradeoff on the number of routes vs. level of efficiency. Pricing is higher when less efficient.

While reduced sailings have created increased daily burdens when delivering higher volume, the efficiencies that may have been lost in a day are borne out over a week of operations.

- Suggestions on Agricultural and Livestock pricing beyond the current 30% discount (subsidies, tax credits, higher prices for other cargo, etc.)

  Current discounted prices are established by tariff and approved by HPUC.

  Some Ag products are inelastic in their pricing due to competition from mainland produce. Despite "buy local" advertising, consumers are only willing to pay so much for local produce. O'ahu is greatest market within Hawai'i due to population.

Draft of Status Report

- Steve Hunt provided a partially completed WCWG Small Group Status Report for discussion and editing
- Made initial edits through group discussion and consensus
- Sent out revised draft to group members for further refinement and suggestions with a due date on March 9th

Next Meeting – March 12, 2021 8:30 – 10:00 am

Template for PUC WCWG Small Group Status Reports
For Meeting on March 18, 2021

Small Group Topic/Issue:

Create a compelling case to convince other WCWG members that your topic/issue needs to be addressed by our group:

- How will addressing this issue make a significant impact on our ability to successfully ensure effective, efficient, and continuous water carrier service throughout the state of Hawaii?
  Establishing the ideal rate matrix is both complex and interdependent on the decisions (or suggested solutions) being made by the other small groups. Intrastate rate increases , when approved by the Hawai'i Public Utilities Commission, are but one means by which a water carrier can achieve financial viability but at the same time must be affordable to all customers. In addition to intrastate rate increases, a water carrier's financial viability is also dependent on its ability to:
  - Readily access the financing market and obtain reasonably costs, whether from affiliates or third-party lenders;
  - manage its operating costs;
  - obtain profitable contracts for interstate goods and services;
  - obtain state financial incentives such as tax credits, bond financings, property tax holidays, etc. from the legislature

  The timing and amount of the requested rate increase for rate cases are at the discretion of the water carrier.
- What are the significant (negative) ramifications of us not addressing this issue?
  Not addressing the rate structure could place the water carrier service at risk in terms of sustainability and profitability. It also impacts our local economy as the demand for shipping is somewhat inelastic and high fixed costs may adversely affect the viability of local farms and businesses which compete with produce and goods being imported from mainland or international ports.

Articulate Small Group Goal or Objective:

- This goal or objective was probably generated as you talked about what the group was trying to accomplish.
  Fair and predictable cargo rates that are affordable to all customers for intrastate services that meet customers' needs.
- What is the desired outcome you are trying to achieve?
  Ensure the long-term financial sustainability and profitability of the water carrier by establishing rate structures for affordable intrastate services that are in parallel with the State's and customers' needs and other holistic operational changes proposed.

Prioritized List of Actions or Strategies to Address Goal or Objective:

- This discussion might have started with a discussion of relevant supporting forces from the Force Field Analysis that will help you achieve your goal or objective.

  The rate setting framework includes three desired futures:

  1.) Incremental adjustment to rates
  2.) All carriers involved in the movement of cargo have the ability to be sustainable and profitable
  3.) Standardized and streamlined ratemaking in ports and cargo types that are negative earners

- The group probably generated additional strategies during your discussion.

  What are the state's goals for food independence, agriculture, and sustainable economies for each island?
  What investment should the state make in terms of additional harbor space and facilities with refrigeration?
  What cargo types should remain regulated?
  LTL is not currently profitable and impacts operational efficiency
  Can offsite cargo consolidation become part of the efficiency solution? (At what cost?)
  Non-regulated cargo from interstate water carriers moving within the state is profitable and helps offset certain non-profitable intrastate cargo type
  Returning to an Annual Freight Rate Adjustment (AFRA) or Zone of Reasonableness adjustment should require performance metrics where each commodity class would recover its fair share of costs … not just a tool for across-the-board rate increases
  What third-party financing is available to water carriers?
  Should State and Counties be subsidizing mandated routes to Kaunakakai, Kaumaapau, and Hilo since these
  are negative earners? (Tax credits, free harbor leases, no property taxes, etc…)
  Alternatively, should water carrier be given sailing schedule flexibility based on demand/capacity?

- Actions or strategies also have to take into consideration restraining forces that may prevent you from achieving your goal or objective. You may have identified relevant restraining forces from the FFA or generated new ones that have to be addressed.

  Balancing the rates necessary to achieve water carrier sustainability and profitability may not be the same rates that consumers, especially our local farms and businesses, are able to afford. If this is the case, what source of subsidy is available to fill this rate imbalance?
  Perishables might require more frequent routes but total cargo loads might dictate otherwise. Establishing sailing schedules affects pricing and ability of customers to transport cargo in good or healthy (in terms of livestock) condition.

- The group needs to think about prioritizing actions or strategies i.e., important ones need to be addressed first to create momentum for your plan.

  Incremental rate adjustments can be one part of the solution to avoid large catch-up escalations but must include performance metrics that will determine whether customers are satisfied with the services provided

- Actions or strategies might also have a time relationship i.e., some have to be accomplished first before others are considered.
  The determination of fixed route schedules, what types of cargo should remain regulated, what operational efficiencies can be achieved, what cost containment efforts have been achieved, what third-party financing has been obtained, and what state subsidies are available must all precede rate making strategies or recommendations. This group recognizes that the Hawaiʻi state legislature controls what cargo is regulated and the Hawaiʻi Public Utilities Commission makes the decisions on actual rates. Nonetheless, in the context of what types of cargo or routes might warrant subsidies, we needed to have a larger discussion on rates strategy.

Proposed Agenda for Water Carriers Working Group Subcommittee Meeting on Rates
Friday, March 12, 2021
8:30 – 10:00 a.m.
Virtual meeting via Teams

1. **Approve Agenda**

2. **Review Minutes from 02/25/2021 Subgroup Meeting** – 5 minutes (8:35)
   - Any corrections, additions, or deletions to prior meeting's minutes

3. **Complete WCWG Small Group Status Report** – 85 minutes or until complete
   - Finalize recommendations from the Rate group on standardized form