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…

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%
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9.1.20

<17%>
RoR Nov
2020

Zone of Reasonableness Year
Annual Freight Rate Adjustment Year

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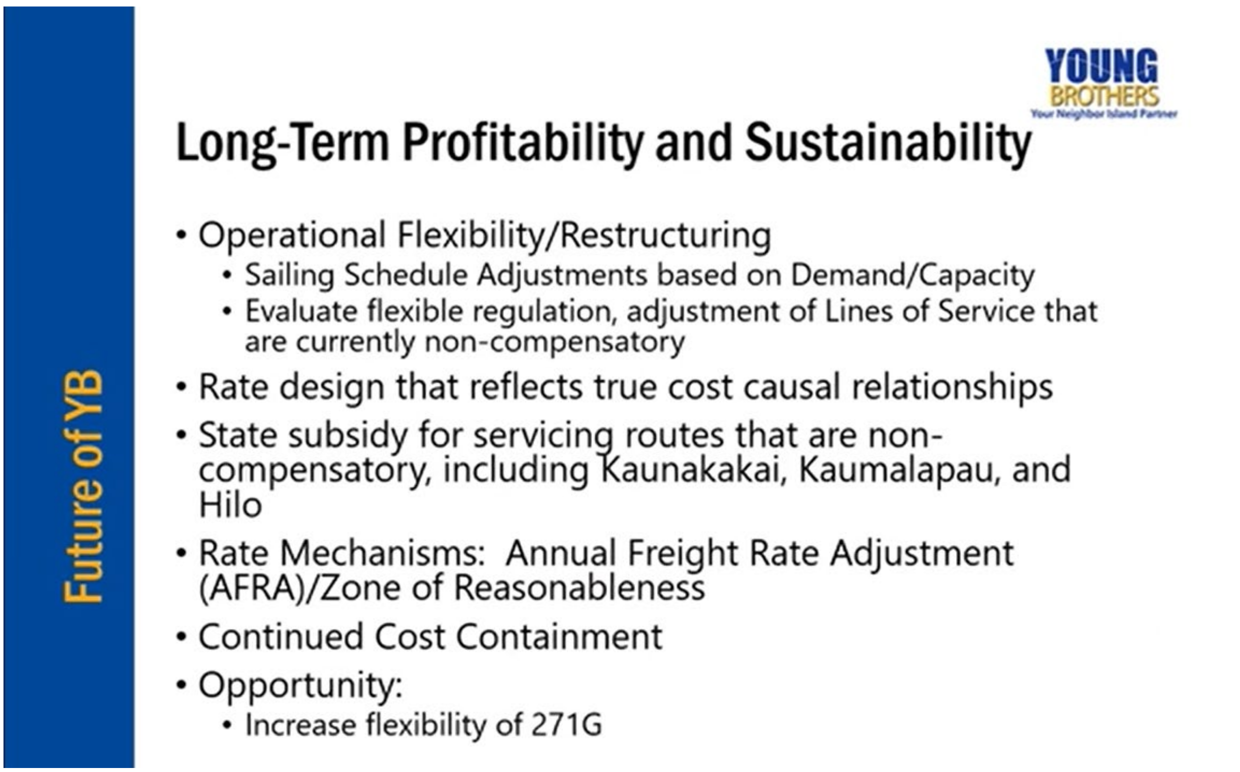
- Of recent, the only times YB has managed to remain profitable has been when the Zone of Reasonableness or Annual Freight Rate Adjustments were in place
- 2019 ask of 37% was a catch up for increasing operational costs ($3M/yr. avg.) as well as additional investment into YB ($60M in new tugs)
- Rate 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