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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of YOUNG BROTHERS, LIMITED For Allowance of Rate Flexibility Within a Reasonable Zone or, In the Alternative For A General Rate Increase	DOCKET NO. 01-0255

ORDER NO. 20454

Filed September 19, 2003

At 9:00 o'clock A.M.

Chief Clerk of the Commission

ATTEST: A True Copy
KAREN HIGASHI
Chief Clerk, Public Utilities
Commission, State of Hawaii.

Acting Administrative Director

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ORDER

I.

By Decision and Order No. 19115, filed on December 20, 2001, the commission approved a three-year pilot rate flexibility program ("Rate Flexibility Program") and required, among other things, YOUNG BROTHERS, LIMITED ("YB") to file its initial 2001 cost of service study for commission approval by the second quarter of 2002. On June 28, 2002, YB submitted its initial 2001 cost of service study ("COSS") for commission approval, which is the subject of this order.

II.

BACKGROUND AND PROCEDURAL HISTORY

Specifically, Decision and Order No. 19115 approved and made part of the order the terms and conditions of the Stipulation for Rate Flexibility Within a Reasonable Zone, dated December 14, 2001, between the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate") and YB ("Rate Flexibility Program Stipulation").

The Rate Flexibility Program Stipulation stated, in relevant part, the following:

> 3. Cost of Service Study. During the first year of the three-year pilot program, YB will file, by separate filing under protective order, a cost of service study for commission approval. The filing will be made no later than the second quarter of 2002.
>
> a. The cost of service study will be based on 2001 operating data and will include the current costs of providing each cargo category, and a breakdown between regulated and non-regulated revenues, expenses and plant investment. The study will also set forth rates that would be necessary for each tariff rate to be fully compensatory.
>
> b. The cost of service study should also enable the parties to ascertain the level of change in the existing rates that would be necessary for [YB] to have fully compensatory rates for each of its cargo offerings.
>
> c. For each of the second and third years of the three-year program, YB also agrees to file the then approved cost of service study under protective order by June 30 of the following year, to reflect the prior year's results. This filing will include the breakdown between regulated and non-regulated revenues, expenses, and plant investment and should enable the parties to determine the contribution margin of each of the then existing tariffs, based on current operations.[1]

On June 24, 2002, YB and the Consumer Advocate (collectively, referred to as "Parties") submitted a proposed stipulation for protective order. On June 27, 2002, the commission issued Protective Order No. 19437. On June 28, 2002, YB submitted its COSS, pursuant to Decision and Order No. 19115.

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[1]By Order No. 20239, filed on June 19, 2003, the commission amended Decision and Order No. 19115 to allow YB to defer filing its 2002 COSS from June 30, 2003 to no later than 45 days from the issuance of instant order.

On November 22, 2002, the Parties filed a Stipulated Cost of Service Procedural Order establishing, among other things, the issues and procedures schedule to assist in our review and disposition of the COSS. By Order No. 19851, filed on December 5, 2002, the commission approved and adopted the Parties' Stipulated Cost of Service Procedural Order.[2]

Discovery was conducted throughout this proceeding by the Parties in accordance with the schedule of proceedings set forth in Order No. 19851. On November 29, 2002, the Consumer Advocate served informational requests on YB. From October 14, 2002 to October 17, 2002, the Parties and their respective consultants held technical sessions to discuss the COSS model and related issues, conducted site inspections and reviewed YB's operations at piers 39 and 40 in Honolulu and at the port of Nawiliwili on Kauai. On December 16, 2002, YB submitted its responses to the Consumer Advocate's informational requests.

On November 29, 2002, YB submitted the following worksheets that were requested by the Consumer Advocate during the October 14, 2002 to October 17, 2002 technical sessions: (1) rate of return calculation by cargo type; (2) list of worksheets for hard entry to model; (3) copy of barge plans

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[2]By Order No. 19851, filed on December 5, 2002, the commission set forth the issues in this proceeding. The issues in this proceeding are as follows: 1) Is YB's COSS, filed on June 28, 2002, subject to Protective Order No. 19437, just and reasonable? 2) What other factors and considerations, aside from YB's COSS, should be used in setting just and reasonable rates for YB's services in accordance with Section 271G-16, Hawaii Revised Statutes.

(to identify Roll-on/Roll-off ("RORO") capacity); (4) detailed listing of asset cost, accumulated depreciation, estimated life, and method; (5) affiliated cost for 2001; and (6) reconciliation of commission and commodity summary report for 2001.

On November 29, 2002, the Consumer Advocate served YB with its First Submission of Information Requests. On November 29, 2002, the Consumer Advocate served YB with its confidential Information Requests. On December 16, 2002 and December 18, 2002, YB filed its Responses to the Consumer Advocate's First and Second Submission of Information Requests.

On January 3, 2003, the Consumer Advocate served YB with Supplemental Information Requests. On January 13, 2003, the Parties met in a technical meeting in lieu of YB's written responses to the Supplemental Information Requests. On January 27, 2003, YB filed various schedules with the commission that the Consumer Advocate had requested during the January 13, 2003 technical meeting.

On February 3, 2003, the Consumer Advocate filed its Direct Testimonies, exhibits and work papers. On February 10, 2003, YB filed its Settlement Proposal noting the areas of agreement and disagreement between the parties.

On March 3, 2003, the Parties met to discuss matters that were disputed between them and to exchange further information relating to the COSS. On March 25, 2003 the Parties submitted to the commission a letter of understanding, dated March 25, 2003, resolving many of the outstanding issues.

The Parties also agreed to meet again to further discuss the remaining outstanding matters. On April 7, 2003, YB filed various schedules with the commission that the Consumer Advocate requested during the March 3, 2003 technical meeting. On April 24, 2003, the Parties met again to discuss unresolved issues, and as a result of this meeting, the Parties agreed to resolve all of the outstanding issues raised in the Consumer Advocate's Direct Testimony.

On June 12, 2003, the Parties filed a Stipulated Settlement Agreement regarding the COSS ("2001 COSS Stipulation"). The Parties agreed that the 2001 COSS Stipulation, "taken in its entirety and given the evidence in the record, represents a reasonable resolution" of the outstanding issues in this matter.

III.

PURPOSE OF COSS

The purpose of the COSS is to distribute the costs incurred to provide the utility service across all revenue categories to determine the rates that would provide an opportunity to earn the authorized return on investment (i.e., the rate of return). Ideally, the rates for each revenue source should be cost based, resulting in an equal contribution to the authorized rate of return.

YB's present rates are not cost based. On November 1, 1994, the Company filed an application seeking commission

approval to restructure its tariff and rate schedules.[3] The restructured rates, however, did not result in cost based rates because of YB's need to migrate towards the recovery of costs for service provided to its customers. Thus, further rate rebalancing must occur to achieve the desired result of having cost based rates.

The cost of service model is intended to distribute the costs of providing service, and the investment utilized in providing the service, across all service offerings for purposes of developing cost based rates[4]. If the allocation factors do not result in an appropriate distribution of the costs and/or investment, the resulting rates will not be reflective of cost based rates. Since YB provides both interstate and intrastate service, a proper distribution of costs and investment must first be made between the Company's regulated (i.e., intrastate) operations and its non-regulated (i.e., interstate) operations[5].

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[3]See Decision and Order No. 14295, filed on September 29, 1995, in Docket No. 94-0317.

[4]To develop rates that result in a revenue amount that allows the utility an opportunity to earn its authorized return on investment, the total costs and investment must first be determined. In a rate proceeding, this determination is made in the revenue requirement analysis that first identifies the costs of providing the service, and the investment (i.e., rate base) utilized to provide the service. The revenue requirement is then compared to the level of revenues that would be realized at the utility company's present rates to determine any change in the revenue levels.

[5]The commission has regulatory jurisdiction over YB's intrastate operations, but not the Company's interstate operations.

IV.

STIPULATED ISSUES

A.

Normalization

The need to reflect a reasonable level of revenues and costs for YB's operations under "normal" conditions is the basic premise underlying the "normalization" principle in ratemaking. If rates are based on revenue and expense levels that are not representative of "normal" operations, YB could be in an over- or under-recovery situation. The level of over- or under-recovery depends upon the variance between the actual and test year revenues and costs upon which rates were set. Thus, it is important that the revenues and costs included in base rates are truly representative of the "normal" level of revenues and expenses that will likely continue to be incurred on an ongoing basis.

The Parties agreed that the annual and monthly financial reports currently filed with the commission would reflect the actual revenue and costs incurred for the month and/or year. The Parties also agreed that during the three-year pilot program, the cost of service studies for the year 2001 and also for subsequent years 2002 and 2003, as required in Decision and Order No. 19115, would reflect the normalized operations for the year. The adjustments between the financial information reported to the commission and the normalized operations reflected in the COSS should be identified with each cost of service study filing. It was further agreed that in future rate

filings during the pilot period, the Company would not be required to file a revised cost of service study to support the request for a change in rates, unless YB chose to do so. For those filings, the parties would rely upon the then current cost of service study filed with the Commission for the purpose of evaluating the reasonableness of YB's requests.

B.

Revenue Neutrality

Under YB's Rate Flexibility Program approved in Decision and Order No. 19115, YB can increase its rates by an annual maximum of 5.5 per cent for any customer class or classes and reduce rates by an annual maximum of 10 per cent for any customer class or classes, provided that any decrease for a given class does not result in non-compensatory rates for the class and also provided that YB does not exceed an 11.06 per cent rate of return on its average depreciated rate base.[6]

The Consumer Advocate initially proposed that any future price increase under YB's Rate Flexibility Program should be revenue neutral until a full evaluation of the interstate/intrastate separations procedure could be conducted. This concern existed due to the unresolved issues related to the allocation of YB's costs between the interstate and intrastate operations.

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[6]YB's current authorized rate of return of 11.06 per cent was set by Decision and Order No. 16008, filed on October 10, 1997, in Docket No. 96-0483 (YB's last general rate proceeding using a 1997 test year).

As this matter has been resolved and documented within their 2001 COSS Stipulation, the Parties agreed that when YB files for a rate adjustment under the Rate Flexibility Program, YB's filing would not be required to be revenue neutral (i.e., any increase in revenues would be offset by a corresponding and simultaneous decrease in revenues and vice versa), as long as YB does not exceed its authorized rate of return on its average depreciated rate base for its intrastate operations.

C.

Fully Compensatory Rates

The Parties agreed that for purposes of defining fully compensatory rates, in "theory", each cargo type should earn the most recent commission authorized allowed rate of return. However, in reality, the Parties agreed that when establishing rates, other factors must be taken into consideration that may not result in the setting of a uniform rate of return for all cargo types. Therefore, in future rate filings, YB agreed to identify the specific factors that were considered in establishing the proposed rate adjustment(s).

D.

Amortization of Rate Case Proceedings

YB utilized a two-year amortization period in its COSS. The Consumer Advocate did not propose an adjustment to YB's two-year amortization period for the 2001 data since the dollar impact of changing the amortization to a three-year period

(the time period preferred by the Consumer Advocate) was nominal. The Parties agreed that in future rate filings YB will provide supporting documentation to justify the amortization period used in its filing to match the amortization of the rate case costs incurred to the expected period of usefulness, as opposed to the most recent period authorized by the commission.

E.

Service Awards, Company Party, Charitable Gifts and Donations, and Goodwill Advertising

YB incurred expenses for service awards, company parties, charitable gifts and donations and goodwill advertising expenses in 2001 and included these costs in the COSS. The Consumer Advocate did not propose an adjustment (i.e., decreasing YB's 2001 expenses for these items), because these expense items represent a minimal amount of YB's total operating revenues. In future filings, YB agreed to adjust the actual expenses incurred for these items by excluding the charitable contributions made by its community advisory boards and by excluding political contributions. For costs relating to customer service, community service and customer events (such as the Annual Harbor Festival and Aloha Boat Days to support the maritime industry, contributions in response to customer requests to support agricultural industry luncheons, etc.), .as well as costs relating to service awards and employee recognition, YB may choose to include these expenses in future filings, and the Consumer Advocate reserves the right to object, upon review of the data in future filings.

F.

Working Cash and Lead-Lag Study

YB's working cash calculation relies on 1992 revenue collection and payment lag day information. The Consumer Advocate determined that YB's working cash methodology was reasonable for the purposes of the COSS since working cash represented less than 7 per cent of YB's total 2001 rate base. YB agreed to submit a new lead-lag study at the time of either (1) the filing of a general rate increase application; or (2) on December 31, 2004, the end of the three-year pilot program for the Rate of Flexibility Program, whichever is earlier. The Consumer Advocate agreed that a new lead-lag study would not be required for any zone of reasonableness filing pursuant to Decision and Order No. 19115.

G.

Inbound Weighing Factor

YB's COSS includes a 35 per cent Inbound Cargo Factor as the assumed per cent of the cargo that is inbound. For the purposes of this proceeding, the Consumer Advocate indicated that it would accept YB's proposed factor of 35 per cent. However, the Consumer Advocate reserves the right to request additional data, re-assess, change its position after reviewing the additional data and conduct further analysis of the reasonableness of the 35 per cent inbound cargo factor in future filings.

H.

Allocation Percentage for Honolulu Lifts and Hustler/Chassis

YB inadvertently switched the allocation percentage in its submission and agreed to correct the allocation percentage, as identified by the Consumer Advocate. The correction is as follows:

> Cargo Handling Equipment Tab of the Allocation Module should read: "45 percent of the costs of lifts and hustlers and 55 percent of the costs of chassis to the Neighbor Islands."

I.

Financial Flow of Information for COSS

On April 7, 2003, YB filed a schedule entitled "Financial Flow of Information for the COSS," which was intended to provide users with a guide to further reconcile and justify the allocation of various costs. For the purposes of settlement, the Consumer Advocate agreed to accept YB's representations presented in the Financial Flow of Information Guide. YB agreed that should the Consumer Advocate have any further questions concerning the Financial Flow of Information Guide in the future, YB representatives would be made available to meet and discuss the questions of the Consumer Advocate.

J.

Recalculation of Palletized Cargo Units

In the COSS, YB listed a number of different cargo types in the total palletized general cargo. YB represented that the numbers reflected as total palletized general cargo could not be compared for all years because in 1999, YB began to record a new commodity line item for Mixed Dry Cargo and Refrigerated Mixed Cargo. Based upon YB's oral representations, the Consumer Advocate agreed to accept YB's numbers.

K.

Normalization of Revenues and Expenses related to the Carriage of Automobiles

In the COSS, YB reflected the revenues and expenses based on the 2001 actual automobile movement. The Consumer Advocate recommended that the cost of service data for intrastate automobiles be reflective of the 2000 and 2001 piece count data. For 2001, the Parties agreed that if the revenues associated with the automobiles count were normalized, then normalized level of expenses for the additional automobile movements should also be included in the Consumer Advocate's proposed adjustment. For the approval of YB's COSS only, the Consumer Advocate agreed to withdraw its normalization adjustment related to the carriage of automobiles and accept the 2001 revenues and expenses, as reflected in YB's COSS.

L.

Uninsured Claims Elimination

In January 2001, YB's Insurance Deductible Reimbursement Program ("DRP") provided coverage for YB's deductible portions of workers' compensation, hull and machinery, and protection and indemnity insurance claims. YB incurred over $90,000 in deductible insurance costs in 2001. The Consumer Advocate did not agree that these costs were representative of YB's expenses on a going-forward basis. Since DRP began in the year 2001, YB incurred expenses for both the claims incurred prior to the inception of the DRP and also for the premium for the DRP in its costs. Future DRP premiums would be increasing based on the actual experience of YB for claims incurred and reflect higher premium amounts based on the actual experience of YB for claims incurred in 2001 and prior to 2001. At this time, the Consumer Advocate agreed to accept 2001 uninsured claims expense reflected in the COSS.

M.

Elimination Of PSC/GE Taxes

In the COSS, YB included amounts for the public service company tax and public utility commission fee in taxes other than income tax ("TOTIT"). The Consumer Advocate did not believe that the 2001 TOTIT was representative of YB's taxes on a going forward basis because YB was no longer required to pay the public service company ("PSC") tax as a result of a change in state law,

effective October 1, 2001.[7] YB reported that during 2001, it collected both the PSC tax and the general excise ("GE") tax from its customers and that these amounts were reflected in its revenues. If YB made an expense reduction for the GE tax, then a corresponding amount must be deducted from YB's revenues. After further clarification, the Consumer Advocate accepted the 2001 PSC/GE taxes reflected in the filing since the revenues related to these expenses were included in the COSS. The Parties agreed that for future filings, the COSS would not reflect PSC/GE tax expenses and the related revenues where YB's customers are exempt from such taxes under the state law.

N.

G-Vans Per Container/Platform Equivalent

The COSS assumed 2 G-Vans[8] per Container/Platform equivalent ("CPE"). Based upon its statistical analysis, the Consumer Advocate calculated the CPE data for each voyage and then took the mean of all CPE data points per voyage for the entire year. Based on this methodology, the Consumer Advocate then determined that the actual mean value of G-Vans per CPE was 2.2. Using a rule of thumb approach, the Consumer Advocate recommended a G-Van per CPE of 3.

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[7]Instead of paying the PSC tax, YB was subject to payment of the general excise ("GE") tax for only cargo, insurance and miscellaneous revenues.

[8]G-Vans are containerized units that are about one-third the size of a 20-foot container.

YB's methodology differed in that in the COSS calculations for CPE data for all cargo types, YB took the average of the sum of all data points during the year for each cargo type by port to account for the minor differences in the timelines of the paper flow and cargo flow.

In the interest of reaching a compromise on this issue, the Consumer Advocate agreed to withdraw its recommendation to use 3 G-Vans per CPE and proposed that its calculated mean of 2.2 G-Vans per CPE be used. For purposes of this COSS, YB accepts the Consumer Advocate's 2.2 calculated mean value for the CPE for G-Vans since the impact to the returns are nominal, but disagrees with the methodology used by the Consumer Advocate.

O.

Non-Auto RoRo CPE Factor

The Consumer Advocate performed a sensitivity analysis of the non-auto RoRo and recommended a 0.8 calculated mean for the CPE for Non-auto RoRo. For purposes of this COSS, YB accepts the Consumer Advocate's recommended 0.8 calculated mean for the CPE for non-auto RoRo, as opposed to YB's factor of 0.7 mean for CPE for non-auto RoRo since the impact to the returns are nominal. However, YB disagrees with the methodology used by the Consumer Advocate.

P.

Use of Bills of Lading rather than CPE
To Allocate Consolidated Costs

The Consumer Advocate questions the allocation of the freight clerk costs and the documentation and billing costs to the intrastate category. As described in the Financial Flow of Information Guide filed on April 7, 2003, the freight clerk costs reflect the time spent by the clerks on receiving and delivery of the cargo between the ports. YB noted that the freight clerks spend minimal time checking in interstate cargo due to the electronic interface with major shipping carriers resulting in the automation of the booking, equipment tracking and billing process (work normally done by the other clerks identified below). Its customer, documentation, and reservation clerks do not generally handle interstate cargo on a day-to-day basis. These clerks primarily focus on the intrastate shippers and perform duties that range from notifying customers of cargo delivery, to booking containerized and RoRo cargo, to entering the bill of lading into the computer system for processing.

The customer service representative clerks (which YB currently employs four clerks at its Honolulu port) do, however, split their function between intrastate and interstate. One position is dedicated entirely to the interstate cargo activity with the tracking of the database to ensure proper receipt, delivery and billing of interstate revenues. The cost of this one position was allocated entirely to the interstate segment of the business.

YB submitted a video to the commission on June 12, 2002, which highlights the Company's operations as well as the steps involved in checking in a 40-foot YB container and dry mixed cargo. Further, YB also submitted a comparative list of tasks performed for a 40-foot container, a dry mixed cargo shipment, and an interstate container movement.

Based on YB's representations, the Consumer Advocate agreed to accept YB's methodology to allocate costs between the Company's interstate and intrastate operations using the Bills of Lading rather than CPE for both the freight clerk costs and the documentation and billings costs. Further, the Company agreed to work with the Consumer Advocate to develop a validation procedure to ensure that the representations made by the Company relating to the work performed by the freight clerk, documentation, reservation, and customer service representative clerks are complete and accurate by December 31, 2003.

III.

Upon review of the record including, without limitation, the 2001 COSS, we find that the agreements, terms and conditions agreed to by the Parties in the 2001 COSS Stipulation are reasonable and in the public interest. We thus conclude that the 2001 COSS Stipulation should be approved in its entirety.

Further, based on the representations made by the Parties, we find that the 2001 COSS, as modified by the 2001 COSS Stipulation, is just and reasonable and appears to represent a fair allocation between YB's interstate and intrastate

operations. Accordingly, the commission concludes that YB's initial 2001 COSS, as modified by the 2001 COSS Stipulation, should be approved.

IV.

THE COMMISSION ORDERS:

1. The proposed agreements, terms and conditions set forth in the 2001 COSS Stipulation is approved in its entirety.

2. YB's COSS, as modified by the 2001 COSS Stipulation, is approved. This approval does not constitute an approval for a change in rates, pursuant to HRS chapter 271-G. Any future rate filings are subject to commission review and approval.

3. Unless ordered otherwise, YB shall file its 2002 Cost of Service Study within 45 days of the date of this order consistent with the terms and conditions set forth in Order No. 20239.

DONE at Honolulu, Hawaii this 19th day of September, 2003.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By _____
Carlito P. Caliboso, Chairman

By _____
Wayne H. Kimura, Commissioner

By _____
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

_____
Kevin M. Katsura
Commission Counsel

01-0255.eh

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Order No. 20454 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
P. O. Box 541
Honolulu, HI 96809

J. DOUGLAS ING, ESQ.
WRAY H. KONDO, ESQ.
WATANABE, ING & KAWASHIMA
First Hawaiian Center
999 Bishop Street, 23rd Floor
Honolulu, HI 96813-4423

LISA M.K. SAKAMOTO
VICE PRESIDENT FINANCE AND GOVERNMENT AFFAIRS
YOUNG BROTHERS, LIMITED
P. O. Box 3288
Honolulu, HI 96801

Elaine Higa
for Karen Higashi

DATED: September 19, 2003