

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of )  
 )  
YOUNG BROTHERS, LIMITED ) Docket No. 2008-0266  
 )  
For Approval of a General Rate Increase )  
and Certain Tariff Changes in )  
Local Freight Tariff No. 5-A )  
\_\_\_\_\_ )

**APPLICATION OF YOUNG BROTHERS, LIMITED FOR APPROVAL OF A  
GENERAL RATE INCREASE AND CERTAIN TARIFF CHANGES IN  
LOCAL FREIGHT TARIFF NO. 5-A**

**EXHIBITS:**

**DIRECT TESTIMONIES AND TESTIMONY EXHIBITS:**

**WORK PAPERS:**

**VERIFICATION:**

and

**CERTIFICATE OF SERVICE**

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GENERAL RATE INCREASE AND CERTAIN TARIFF CHANGES IN  
LOCAL FREIGHT TARIFF NO. 5-A**

YOUNG BROTHERS, LIMITED (*Young Brothers*, *YB*, or the *Company*) respectfully submits to the Honorable Public Utilities Commission of the State of Hawaii (the *Commission* or the *PUC*) this Application of Young Brothers, Limited for Approval of a General Rate Increase and Certain Tariff Changes in Local Freight Tariff 5-A (together with supporting exhibits, testimony, and work papers, the *Application*). On October 16, 2008, Young Brothers filed its Notice of Intent regarding this Application. This Application is made pursuant to section 6-61-94 and chapter 6-65 of the Hawaii Administrative Rules (*HAR*) and sections 271G-16 and 271G-17 of the Hawaii Revised Statutes (*HRS*).

Young Brothers respectfully seeks Commission approval to increase its revenues in the amount of \$10,458,000 or 17.91 percent, over revenues at current rates in the amount of \$58,387,483, no earlier than August 1, 2008.

Without the requested rate relief (*i.e.*, under current rates), Young Brothers projects a rate of return of 2.26 percent for its intra-state operations in the normalized test year of 2009<sup>1</sup> (**Test Year**) for this rate proceeding, well below its current authorized rate of return of 10.76 percent.<sup>2</sup> With the rate relief requested, Young Brothers would achieve a revenue requirement of \$68,845,483 for the Test Year at a rate of return of 11.20 percent.

Young Brothers points out that the rate relief proposed in this Application is *less* than the rate relief that would be necessary to meet Young Brothers' estimated total revenue requirement, initially determined by the Company for the normalized Test Year 2009 to be \$69,832,483, based on a rate of return of 12.04 percent on its average rate base. See **YB-DT-400** (Testimony of Arlie G. Sterling, President of Marsoft Inc.) in which Dr. Sterling computes and explains YB's entitlement to an opportunity to earn a rate of return of 12.04 percent. Using the initially determined estimate of total revenue requirement, Young Brothers would have sought Commission approval to increase its revenues in the amount of \$11,445,000, or 19.60 percent, over revenues at current rates, rather than the increase of 17.91 percent it proposes in this Application.

Given the economic downturn that has affected the State of Hawaii, and Young Brothers' customers in particular, the Company has lowered its request

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<sup>1</sup> Pursuant to HAR § 6-65-31(e)(2), the test year for any general rate increase application of a water carrier is "January 1 to December 31 of the year following the year in which the application is filed, if the application is filed within the last six months of the year." Young Brothers files this Application on December 19, 2008, which is within the last six months of the year 2008.

<sup>2</sup> *In re Young Bros.*, Docket No. 2006-0396, Decision & Order No. 23714 at 75 (Oct. 12, 2007) (Commission finding YB's rate of return of 10.76 percent to be fair).

for rate relief, despite higher projections of what would be required to support its operations and to provide its investors with an opportunity to earn a fair rate of return. YB's lowered rate relief request would result in a rate of return of 11.20 percent (rather than the projected 12.04 percent) on its average rate base.<sup>3</sup>

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## I. INTRODUCTION

YOUNG BROTHERS, LIMITED, whose principal place of business is located at 1331 North Nimitz Highway, Honolulu, Hawaii, is a corporation organized and existing under the laws of the State of Hawaii. It is wholly owned by Marine Resources Group, Inc. (formerly known as Marine Resources, Inc.) (**MRG**). MRG is in turn wholly owned by Saltchuk Resources, Inc. (**Saltchuk**) and was created to manage Saltchuk's tug and barge companies.<sup>4</sup>

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<sup>3</sup> By lowering its request for rate relief, Young Brothers, however, does not waive its position that the Company is entitled to have an opportunity to earn the proposed fair rate of return of 12.04 percent. See **YB-DT-200** (Testimony of P. Roy Catalani, Vice President, Strategic Planning and Government Affairs).

<sup>4</sup> See *In re Young Bros.*, Docket No. 00-0359, Decision & Order No. 18348 (Jan. 30, 2001) (approving transfer of all outstanding YB stock by Saltchuk to MRG; see also *In re Hawaiian Tug & Barge Corp.*, Docket No. 98-0231, Decision & Order No. 17283 (Oct. 20, 1999) (approving sale of all YB stock by Hawaiian Tug & Barge Corp. to Saltchuk).

Young Brothers is a common carrier by water, transporting property by barge between the islands of Oahu, Hawaii, Kauai, Maui, Molokai, and Lanai of the State of Hawaii. The Company is authorized to transport property by water under the Hawaii Water Carrier Act (chapter 271G, HRS) and is currently licensed by the Commission to serve all major islands of the State. Shipment of goods under its regulated water carrier service is governed by YB Local Freight Tariff No. 5-A (**Tariff 5-A**). In addition to commodity rates, the tariff contains the sailing schedules for all port destinations and general rules applicable to all shipments.

Presently, there are twelve scheduled departures weekly from Honolulu serving the ports of Hilo and Kawaihae on the island of Hawaii, Kahului on Maui, Kaunakakai on Molokai, Kaunapali on Lanai, and Nawiliwili on Kauai. The Company has cargo handling facilities at each of the ports it serves.

## II. SUMMARY OF THE APPLICATION

### A. Summary of Rate-Impacting Factors

1. YB's Strategic Plan and Collaboration with the State. This rate case falls within a larger context of (a) YB's ten-year strategic (recapitalization) plan to increase, in particular, vessel cargo capacity and (b) collaboration with other harbor users and the State of Hawaii (as described below) to meet the cargo transportation needs of this State and, in particular, increase harbor (land side) cargo capacity. See Testimony of Glenn K.Y. Hong, President of Young Brothers, attached to this Application as **YB-DT-100** and Testimony of P. Roy Catalani, YB's

Vice President of Strategic Planning and Government Affairs, attached to this Application as **YB-DT-200**.

As YB announced in April 2006, it has embarked on its implementation of a strategic plan that includes an approximately \$186 million investment in its next generation of water transportation equipment and infrastructure for the purpose of making necessary improvements to cargo transportation, developing needed additional cargo capacity, and enhancing customer service. This investment is planned to take place over a ten-year period and includes the acquisition of new barges, tugboats, containers, cargo handling equipment, and freight information systems (including revamping these systems to provide customers real time freight and invoice data with on-line access and container tracking capability) to benefit its customers throughout the State. See **YB-DT-600** (Testimony of Matthew J. Humphrey) for a discussion of **FACE**, YB's new freight and container equipment data system, and other shore-side improvements.

This investment also complements YB's collaboration with other harbor users and with the State of Hawaii to prioritize critical harbor development projects. As members of the Hawaii Harbor Users Group, or **HHUG**, YB and other maritime industry representatives completed in 2006 a capital improvement plan for Hawaii's harbors. See *Harbor Facility Development to Serve the State of Hawaii* prepared by the Hawaii Harbor Users Group<sup>5</sup>, dated

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<sup>5</sup> The Hawaii Harbor Users Group consists of Matson Navigation Company, Inc., Horizon Lines, LLC, NCL America Inc., Young Brothers, Limited / Moana Pa'akai, Inc., *dba* Hawaiian Tug & Barge, Sause Bros., Inc., Northland Services, Inc. (Aloha Cargo Transport division), McCabe, (footnote continued on next page)

December 1, 2006 (the **HHUG Report**).<sup>6</sup> The plan's essential elements has since been enacted into law as Act 200 (2008). Known as the Harbors Modernization Plan, or **HMP**, it was passed by the 2008 State Legislature and signed into law by Governor Linda Lingle. Specifically for YB, HMP calls for reconfiguring, expanding and/or improving facilities in Honolulu, Kawaihae, and Kahului and for developing a new Hilo pier. Achieving the goal of meeting the State's intra-island water transportation needs includes the need to coordinate numerous facilities enhancements and meet varied but related milestones. See **YB-DT-200** (Testimony of P. Roy Catalani) for a more detailed discussion on this matter.

**2. Replacement of Aging, Smaller Vessels and Acquisition of New, Larger Vessels.** As Young Brothers reported to the Commission in its last general rate increase proceeding,<sup>7</sup> beginning in 2006 and continuing through 2015, YB has committed to raising the quality of service to customers by bringing on line modernized vessels and equipment to facilitate the flow of cargo in Hawaii's economic stream. The Company aims to raise the level and quality of service it provides to customers and to improve the opportunity to earn a fair return on significant investments during the Test Year (calendar year 2009) and in the next

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Hamilton & Renny Company, Limited, Hawaii Stevedores, Inc., Hawaii Superferry, Inc., Tesoro Hawaii Corporation, The Gas Company, LLC and Ameron International Corporation, *dba* Ameron Hawaii.

<sup>6</sup> YB filed a copy of the HHUG Report with the Commission on April 13, 2006 as YB-Ex-2 to YB's Application for Approval of Tariff Change to Eliminate Less Than Container Load Service to and from Kahului Harbor on the Island of Maui, Transmittal No. 06-0001, in Docket No. 2006-0120 and respectfully requests that it be incorporated by reference in this general rate case Application.

<sup>7</sup> See generally *In re Young Bros.*, Docket No. 2006-0396.

few years ahead. See generally **YB-DT-100** (Direct Testimony of Glenn K.Y. Hong) and **YB-DT-200** (Direct Testimony of P. Roy Catalani) attached to this Application.

As part of the ten-year recapitalization plan, the Company will be retiring its smaller barges and replacing them with larger, new flat-deck barges.<sup>8</sup> Young Brothers expects to add its new-built barge no. 3, the *Kala`enalu*, to its fleet in December 2008. New-built barge no. 4, the *Ha`aheo*, is expected in 2009. The new barges will provide more service capacity, increased reliability, reduced maintenance and repair costs, and enhanced fuel efficiency. See **YB-DT-300** (Direct Testimony of Mark A. Houghton, YB's Vice President of Maritime Operations) attached to this Application for a more detailed discussion on vessel acquisitions.

In addition, deployment of the larger new barges will permit YB to eliminate its special (*i.e.*, its non-regulated) sailings. As recently approved by the Commission, changes in our sailing schedule for Hilo Harbor and inauguration of our new and larger flat-deck barge, *Kala`enalu*, will allow elimination of both tandem barge use and the "drop-and-swap" system employed at that harbor. See *In re Young Bros.*, Transmittal No. 08-0007, filed on Oct. 24, 2008 (Application of Young Brothers, Limited for Approval to Amend its Sailing

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<sup>8</sup> Young Brothers has already retired the *Malana* and the *Kahoku*, each of which is less than 300 feet in length. See *In re Young Bros.*, Docket No. 2007-0356, Decision & Order No. 24055, filed on February 26, 2008 (approving the disposal of these two barges), and Order Approving Two-Year Amortization Period, filed on July 2, 2008. Young Brothers recently received Commission approval to dispose of the barge *Aukai* (see *In re Young Bros.*, Docket No. 2008-0269, Decision & Order filed on Nov. 13, 2008, at 8:38 a.m.); the Company will also be applying for Commission approval to dispose of the barges *Makoa*, *Maukana*, and *Kakela*, each of which, including the *Aukai*, is also less than 300 feet in length, and to dispose of the tug *Moana Hele*.

Schedules for Hilo Harbor and Kawaihae Harbor, Island of Hawai'i, in Local Freight Tariff No. 5-A).

In Transmittal No. 08-0007, Young Brothers also sought to modify its regulated sailing schedule in a manner that allows it to take full advantage of its new flat-deck barge, the *Maka`ala*, for Kawaihae sailings by consolidating its Kawaihae special sailing into one of its two regulated Kawaihae sailings (being precisely the type of efficiency for which the new barges were designed). This larger barge will provide enough capacity to consolidate cargo transported on the Kawaihae special sailing with regulated sailings. Please note that, although the Kawaihae special sailing was intended as a non-regulated transport, this sailing did also carry cargo under YB's regulated services.

When the *Ha`aheo* is placed into service next year (the Test Year 2009), Young Brothers intends to eliminate its special sailing to the port of Kahului. To achieve efficiencies in its sailing schedule with the *Ha`aheo*, the Company will be seeking Commission approval to change its sailings to Kahului, Molokai, and Lanai.

3. **Declining Revenues in the Face of Increased Costs.** Even with the efficiencies achieved and anticipated, declining revenues dampen YB's projected results of operation for the 2009 Test Year. See Testimony of Wayne M. Matsunaga at *YB-DT-500* attached to this Application. To project revenue requirements for the Test Year, Young Brothers applies growth factor forecasts determined by its expert economic witness, Dr. Byron Gangnes. See *generally*

Testimony of Byron Gangnes attached to this Application as **YB-Ex-700**. The specific growth factors we apply to project revenues are a negative 3.2 percent (-3.2%) to determine intra-state cargo demand and a negative 8.4 percent (-8.4%) to determine interstate cargo demand.<sup>9</sup>

Although YB generally projects its Test Year expenses based on 2008 actual results with no inflation factor applied, Young Brothers expects negotiated wage increases in 2009, all of which are factors in this general rate increase request. See Testimony of Wayne M. Matsunaga at **YB-DT-500** attached to this Application.

To fulfill the intent of private and public investment and efforts to meet the State's cargo transportation demands and to ensure that YB's vessel capacity complements the planned improvements to YB's land side facilities (on State land) to increase capacity, YB must systematically and timely make substantial investments in and put into service larger vessels. See **YB-DT-100** (Testimony of Glenn K.Y. Hong). In its commitment to serve the State of Hawaii effectively in the 21<sup>st</sup> Century, YB's shareholders are recapitalizing the local water carrier for the future. To sustain this commitment, the financial viability of Young Brothers depends on its ability to defray reasonable operating expenses and requires an opportunity to earn a fair return on its investments.

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<sup>9</sup> See Testimony of Byron Gangnes attached to this Application at **YB-DT-700** for a discussion on the economic growth factors applied in Young Brothers' projections. The difference between Dr. Gangnes' factors (3.2% for intra-state and 8.4% for interstate) and comparable growth factors used by YB (*i.e.*, 3.17% for intra-state demand and 8.42% for interstate demand) is attributable to rounding.

The general rate increase requested in this Application will contribute to the Company's financial viability in the face of declining revenues.

**B. Summary of Proposed Tariff Revisions.**

Young Brothers' requested tariff revisions in this Application may be divided into two categories:

1. **Proposed Rate Increase.** By this Application, Young Brothers requests approval of a general rate increase and revisions to its commodity rates, fees and charges, and certain provisions of Tariff 5-A. With its proposed rate increase, Young Brothers seeks an increase in revenues in the amount of \$10,458,000 over revenues at present rates totaling \$58,387,483. See exhibit ***YB-Ex-6B*** attached to this Application for YB's projected results of operations for Test Year 2009 with and without rate relief; see also ***YB-DT-500*** (Direct Testimony of Wayne Matsubara, YB's Manager of Regulatory Affairs) attached to this Application. The requested increase represents an overall rate increase of 17.91 percent. As noted above, this requested rate relief is lower than what would be needed to meet YB's projected revenue requirement and to provide its investors with an opportunity to earn a fair rate of return of 12.04 percent. YB's lowered rate relief request would result in a rate of return of 11.20 percent on its average rate base.

The proposed rate increase is reflected in revisions to rates and fees set forth in Tariff 5-A. See exhibit ***YB-Ex-1*** attached to this Application for tariff sheets setting forth the specific revisions proposed; see also *infra* for a discussion on rate design. The proposed rates are designed to move toward prior

Commission rulings that support and direct the ultimate achievement of full compensatory pricing for all lines of business (see, e.g., *In re Young Bros.*, Docket No. 01-0255, Decision and Order No. 19115 (Dec. 20, 2001)). However, by lowering its request for rate relief, Young Brothers has decelerated movement toward the goal of compensatory pricing across the board.

**2. Proposed Tariff Provision Revisions.** Young Brothers continues to propose revisions to provisions of Tariff 5-A to achieve consistency and clarity throughout the tariff and to update tariff rules. See exhibit **YB-Ex-1** attached to this Application for Tariff 5-A sheets setting forth the specific revisions proposed.

The major changes include (1) deletion of commodity codes, which really are used for internal data processing purposes only; (2) increase in detention and storage charges for G-vans for deterrence purposes; (3) increasing the automobile length limitation from 17 feet to 20 feet in response to customer feedback; (4) conforming the rates for the islands of Molokai and Lanai to the rate for the island of Maui (*i.e.*, all islands comprising the County of Maui) with respect to canoes and hazardous RoRo cargo. See also **YB-DT-200** (Testimony of P. Roy Catalani) and exhibit **YB-Ex-206** attached to the testimony, which explain the major tariff revisions requested.

**C. Summary of Exhibits.**

In support of this Application, Young Brothers submits the following exhibits, testimony, and work papers, which are attached to this Application and incorporated by reference:

<b><u>Exhibits</u></b>	<b><u>Title</u></b>
<b>YB-Ex-1</b>	Tariff Sheets reflecting Proposed Changes to Young Brothers Limited Local Freight Tariff No. 5-A
<b>YB-Ex-2</b>	Recorded Actual Results of Operation, Balance Sheet, and Income Statement for Prior Calendar Year 2007
<b>YB-Ex-3</b>	Balance Sheet as of October 2008 and Income Statement from January 1, 2008 through October 31, 2008
<b>YB-Ex-4</b>	Analysis of Property and Equipment and Accumulated Depreciation at December 31, 2007
<b>YB-Ex-5</b>	Analysis of Property and Equipment and Accumulated Depreciation from January 1, 2008 through October 31, 2008
<b>YB-Ex-6A</b>	Projected Results of Operations, Balance Sheet and Income Statement, Rate Base Computation, Depreciation Schedule, and Schedule of Computation of Working Cash for Test Year 2009 Without Rate Relief (Consolidated) and With Rate Relief (Intra-State) at 19.60% (RORB 12.04%)
<b>YB-Ex-6B</b>	Projected Results of Operations, Balance Sheet and Income Statement, Rate Base Computation, Depreciation Schedule, and Schedule of Computation of Working Cash for Test Year 2009 Without Rate Relief (Consolidated) and With Rate Relief (Intra-State) at 17.91% (RORB 11.20%)
<b>YB-Ex-7</b>	Summary of Charter Hire Expenses Paid by Young Brothers, Limited for Test Year 2009
<b>YB-Ex-8</b>	Schedule of Operating Revenues and Tonnage for All Ports for Test Year 2009
<b>YB-Ex-9</b>	Cost of Service Summary and Cargo Type Summary for Test Year 2009 (With and Without Rate Relief)

<b><u>Testimony</u></b>	<b><u>Witness</u></b>
<b>YB-DT-100</b>	Testimony of Glenn K. Y. Hong, President, Young Brothers, Limited
<b>YB-DT-200</b>	Testimony of P. Roy Catalani, Vice President of Strategic Planning and Government Affairs, Young Brothers, Limited

<b>YB-DT-300</b>	Testimony of Mark A. Houghton, Vice President of Maritime Operations, Young Brothers, Limited
<b>YB-DT-400</b>	Testimony of Arlie G. Sterling, President, Marsoft Inc.
<b>YB-DT-500</b>	Testimony of Wayne M. Matsubara, Regulatory Affairs Manager, Young Brothers Limited
<b>YB-DT-600</b>	Testimony of Matthew J. Humphrey, General Manager and Vice President, Young Brothers, Limited
<b>YB-DT-700</b>	Testimony of Byron S. Gangnes, Economic Consulting
<b>YB-DT-800</b>	Testimony of Dean Kapoi, Vice President of Human Resources and Labor Relations, Young Brothers, Limited

**Work Papers**

**Description**

<b>YB-WP-101</b>	Test Year 2009 Revenues
<b>YB-WP-201</b>	Test Year 2009 - Labor Expenses (20 pages)
<b>YB-WP-202</b>	Test Year 2009 - Fringe Benefits (5 pages)
<b>YB-WP-203</b>	Test Year 2009 - Repairs & Maintenance Expenses (3 pages)
<b>YB-WP-204</b>	Test Year 2009 - Shoreside Fuel & Power and Other Cargo Handling Expenses (2 pages)
<b>YB-WP-205</b>	Test Year 2009 - Other Maintenance Department Expenses (1 page)
<b>YB-WP-206</b>	Test Year 2009 - Administrative Maintenance and Miscellaneous Expenses (2 pages)
<b>YB-WP-207</b>	Test Year 2009 - Marine Insurance and Tug Expenses (2 pages)
<b>YB-WP-208</b>	Test Year 2009 - Capital Expenditures and Book Depreciation Expense for 2009 Expenditures (3 pages)
<b>YB-WP-209</b>	Test Year 2009 - Book Depreciation Expense for Assets Prior to 2009 (99 pages)
<b>YB-WP-210</b>	Test Year 2009 Tax Depreciation Expense for Assets Prior to 2009 (99 pages)
<b>YB-WP-211</b>	Test Year 2009 - Tax Depreciation Expense for 2009 Expenditures (3 pages)
<b>YB-WP-212</b>	Test Year 2009 – Capital Goods Excise Tax (1 page)
<b>YB-WP-301</b>	Lead-Lag Study Analysis (12 pages)
<b>YB-WP-302</b>	Lead-Lag Study – Details of Employees Fringes Payments (4

	pages)
<b>YB-WP-303</b>	Lead-Lag Study – Summary of Rent Expense (1 page)
<b>YB-WP-304</b>	Lead-Lag Study – Details of Premises & Equipment Leases Payments (1 page)
<b>YB-WP-305</b>	Lead-Lag Study – Details of Wharfage Payments (1 page)
<b>YB-WP-306</b>	Lead-Lag Study – Details of Dockage & Port Entry Fees Payments (35 pages)
<b>YB-WP-307</b>	Lead-Lag Study – Details of Other State of Hawaii Department of Transportation Payments (12 pages)
<b>YB-WP-308</b>	Lead-Lag Study – Details of Insurance Payments (2 pages)
<b>YB-WP-309</b>	Lead-Lag Study – All Other Invoice Payments (341 pages)
<b>YB-WP-401</b>	Cost of Service Study for Test Year 2009 (Without Rate Relief)

Young Brothers has redacted, and submitted under seal, information in the exhibits and related text of the Application that it deems confidential. The Company is discussing a stipulation for a proposed protective order with the Division of Consumer Advocacy, Hawaii State Department of Commerce and Consumer Affairs (**Consumer Advocate**) for submittal to the Commission. Until a protective order is issued, Young Brothers respectfully requests that the Commission treat the information submitted under seal as confidential.

Data relating to Young Brothers' tugs, labor force (except for aggregated data), its parent company, and interstate operations are deemed confidential. The information comprises internal Young Brothers proprietary data, analysis, or computations. Young Brothers considers the entirety of the data to be confidential, commercial, business sensitive, trade secrets, and proprietary information the disclosure of which would (1) disadvantage the Company because it touches upon Young Brothers' or its customers' privacy, (2)

violates certain laws, regulations and guidelines, (3) violates the terms and conditions of non-disclosure agreements with consultants or other third parties, or (4) directly or indirectly gives another party to these proceedings, or person not a party to these proceedings, information which the party or person could use to its competitive advantage or the competitive disadvantage of Young Brothers or Young Brothers' customers. The confidential data and information are data and information that Young Brothers would not ordinarily disclose to its competitors or among its customers.

### **III. HISTORY OF RELEVANT DOCKETS**

#### **A. General Rate Cases Other Than Under YB's Zone Practice**

The Commission granted Young Brothers its last general rate increase in 2007 in Docket No. 2006-0396. Under Decision and Order No. 23714, issued on October 12, 2007, Young Brothers received Commission approval to increase its rates by approximately 7.51 percent. The Commission held that a rate increase that allows YB the opportunity to earn a return of 10.76 percent on its average rate base is fair. Before this rate proceeding, Young Brothers had filed the following rate-related applications since 1992:

1. On **August 28, 1992**, in consolidated Dockets No. 7398 and No. 7506, Young Brothers filed a notice of intent to increase its rates for the first time since 1982. After the full file and suspend procedures, YB received approval to increase its rates by approximately 5.5 percent effective July 8, 1993 (Decision

and Order No. 12479 in the consolidated docket and Decision and Order No. 12471 in Docket No. 5925 regarding the effects of the Tax Reform Act of 1986).

2. Due to a continuing decline in the State's economy, on **March 15, 1994**, YB again filed a notice of intent to increase its rates (Docket No. 94-0059). After the full file and suspend procedures, YB received approval to increase its rates by 6.0 percent, effective December 15, 1994 (Decision and Order No. 13860). Further, the Commission authorized an increase in rates of 2.66 percent effective January 1, 1995, to recover the full cost of postretirement benefits under a generic docket filed in 1992 by all utilities affected, including YB (consolidated Dockets No. 7243 and No. 7233, Decision and Order No.13659).

3. On **November 14, 1994**, in Docket No. 94-0317, YB filed a notice of intent to restructure its tariff and revise its rate schedules. After the full file and suspend procedures, YB received approval to restructure its tariff on September 29, 1995 (Decision and Order No.14295). The new tariff and revised rates did not result in any additional revenues to the Company, although they did result in rate decreases for some shippers and rate increases for others. The tariff restructure and revised rate schedules were driven by YB's need to migrate towards the recovery of costs for services provided to customers in transporting the various cargo offerings without resulting in substantial rate shock to customers. YB rebalanced the rates to reflect the differences in costs, which were supported by a cost study. The study identified costs by commodity type and was fully investigated by the Commission and the Consumer Advocate. Prior to the study, there were no means to fully review the individual commodity rates charged by the Company.

4. With a continued slump in the economy, on **March 15, 1996**, YB filed a notice of intent to increase its rates (Docket No. 96-0079). After the full file and suspend procedures, YB received approval to increase its rates by approximately 3.90 percent effective December 16, 1996 (Decision and Order No.15228).

5. With no sign for economic recovery, on **December 20, 1996**, YB again filed a notice of intent to increase its rates Docket No. 96-0483. Under Decision and Order No. 16008 filed on October 10, 1997, Young Brothers received Commission approval to increase its rates by approximately 3.71 percent. The Commission held that a rate increase that allows YB the opportunity to earn a return of 11.06 percent on its average rate base is just and reasonable.

6. Ten years after its last general rate case, Young Brothers filed a notice on **October 2, 2006** in Docket No. 2006-0396, indicating its intent to increase its rates. Under Decision and Order No. 23714, issued on October 12, 2007 in that proceeding, the Commission approved, with certain conditions, the stipulation between Young Brothers and the Consumer Advocate settling all the issues in that proceeding. The decision allowed YB to increase its rates by approximately 7.51 percent. The Commission held that a rate increase that allows YB the opportunity to earn a return of 10.76 percent on its average rate base is fair.

**B. Establishment of YB's Zone of Reasonableness (Docket No. 01-0255)**

The Commission has authorized Young Brothers to engage in the practice of rate flexibility within an approved zone of reasonableness (the **Zone Practice**). The history relating to the Zone Practice includes the following:

1. On **October 1, 2001**, YB filed an Application for Allowance of Rate Flexibility Within A Reasonable Zone in Docket No. 01-0255 (the **2001 Application**). In the 2001 Application, YB sought to establish a practice relating to its rates under which YB could continue to earn a just and reasonable return on its average rate base (as authorized by the Commission) without having to proceed through a general rate case in each instance. As stated in the 2001 Application (at page 5), the intent was for YB to undertake a practice similar to the federal procedure authorizing interstate water carriers regulated by the Surface Transportation Board to file for a rate change, provided it is within a zone of reasonableness, without having to secure Board approval each time a rate change is sought.

The federal procedure, set forth in 49 U.S.C. 13701, provides that interstate water carriers can file for a rate increase up to 7.5 percent above, or a rate decrease up to 10 percent below, the rate in effect one year before the effective date of the proposed change. 2001 Application at 5.<sup>10</sup> As noted on the Commission's website (<http://www.hawaii.gov/budget/puc/transportation/Zone-FAQ.pdf>):

At the federal level, Matson Navigation Company and Horizon Lines (fna, CSX Lines [fna Sea-Land]), both interstate water carriers, can file with the Federal Maritime Commission for a rate increase of 7.5 per cent above or a rate decrease of 10 per cent below the rate in effect one year before the effective date of the proposed rate change. Further, interstate water

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<sup>10</sup> Further, interstate water carriers have authority to (a) adjust the range of the zone by the percentage change in the Producers Price Index, as published by the U.S. Department of Labor, (b) impose and adjust a fuel surcharge unlimited by zone increases and (c) impose and adjust a terminal handling charge.

carriers may adjust the range of the Zone by the percentage change in the Producer Price Index.

2. On **December 14, 2001**, YB and the Consumer Advocate filed a Stipulation (**2001 Stipulation**) regarding the 2001 Application in Docket No. 01-0255, and recognized and agreed that YB's proposal to utilize the federal maritime thresholds was based on available case precedents, a track record of how the procedure works as enacted, ease of reference, and consistency with federal maritime statutes. 2001 Stipulation at 3. However, instead of using the federal thresholds, the parties stipulated that the maximum annual increase would be 5.5 percent over a 12-month period, with a maximum decrease of 10 percent over a 12-month period (the **YB Zone**). 2001 Stipulation at 6.

3. On **December 20, 2001**, the Commission issued Decision and Order No. 19115 in Docket No. 01-0255, approving the agreements set forth in the 2001 Stipulation as reasonable and in the public interest. Decision and Order No. 19115 at 8. The Commission approved the Zone Practice as a pilot program for a period of three years (to December 20, 2004) and provided that YB and the Consumer Advocate could agree to continue the practice in the future. Decision and Order No. 19115 at 5. In its decision, the Commission required, among other things, YB to file its cost of service study (**COSS**) for Commission approval. The decision also established guidelines that the cost of service study must: (1) be based on 2001 operating data; (2) include the current costs of providing each cargo category; (3) include a breakdown between regulated and non-regulated revenues, expenses and plant investment; and (4) set forth rates that would be necessary for

each tariff rate to be fully compensatory. The cost of service study is the basis for proposed rate restructuring and is further discussed below.

**C. Filings Under YB's Zone Practice**

In addition to any tariff filings under YB's Zone Practice, the Commission required Young Brothers to file a COSS for Commission approval during the first year of the 3-year pilot program. For each of the second and third years of the 3-year pilot program, YB was directed to file the then approved COSS by June 30 of the following year, to reflect the prior year's results. Decision and Order No. 19115 at 6.

1. On **May 6, 2002**, in Docket No. 02-0118, YB applied for PUC approval of changes to its tariff to reflect a rate increase of 3.0 percent for non-containerized commodity rates, pursuant to Decision and Order No. 19115 in Docket No. 01-0255 (**2002 Zone Application**). By Decision and Order No. 19425 filed on June 20, 2002, the Commission approved the rate increase.

2. On **June 28, 2002**, YB filed its initial COSS (**2001 COSS**). On June 12, 2003, the Consumer Advocate and YB filed their Stipulated Settlement Agreement (**2001 COSS Stipulation**). In Decision and Order No. 20454 filed on September 19, 2003, the Commission approved the 2001 COSS, as modified by the 2001 COSS Stipulation.

3. The Commission allowed an extension of time to file its second year COSS by the Commission's Order No. 20239 filed on June 19, 2003, and YB filed its 2002 COSS on **November 3, 2003**. YB filed its 2003 COSS on **June 30, 2004**.

4. On **December 6, 2004**, YB and the Consumer Advocate filed their 2004 Stipulation in Docket No. 01-0255 to continue the Zone Practice for three additional years (from December 20, 2004, through December 20, 2007). 2004 Stipulation at 5.<sup>11</sup>

5. In Decision and Order No. 21768 filed on **April 22, 2005**, in Docket No. 01-0255, the Commission approved YB's 2002 and 2003 COSS and the agreements set forth in the 2004 Stipulation. Decision and Order No. 21768 at 6-7. Like Decision and Order No. 19115, Decision and Order No. 21768 provides YB the ability to adjust rates within the YB Zone for any customer class or classes, on the condition that any decrease proposed for a given customer class does not result in non-compensatory rates for the customer class. The Commission also continued the requirement for annual filings of YB's COSS by June 30. *Id.*

6. On **June 1, 2005**, YB filed, as Transmittal No. 16-0605, an Application for Approval of 2005 Rate Increase Pursuant to Decision and Order No. 21768 (the **2005 Zone Application**), seeking a 5.5 percent across-the-board increase. In Order No. 21926 issued on July 18, 2005, the Commission ordered that YB's 2005 Zone Application take effect as of July 18, 2005.

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<sup>11</sup> The Consumer Advocate and YB agreed that the zone of reasonableness concept deserves further consideration. By extending the program for an additional three years, the parties stated that they would have more time to assess the impact to ratepayers before agreeing to continue the program on a permanent basis. Further the Consumer Advocate contended that the additional three years will allow the parties an opportunity to determine the impact of the Hawaii Superferry, Inc.'s proposed operations on YB's operations because the Hawaii Superferry, Inc. is expected to have two ferries in commercial operation during the last year of the three-year extension period.

7. YB filed its 2004 COSS on **June 30, 2005**, and its 2005 COSS on **June 29, 2006**, and continues to file its annual COSS by June 30<sup>th</sup> of the year, unless extended with Commission approval.

8. On **August 4, 2006**, YB filed, as Transmittal No. 06-0002, Application of Young Brothers, Limited for Approval of Tariff Change to Reflect 2006 Rate Increase Pursuant to Decision and Order No. 21768 (the **2006 Zone Application**), requesting an across-the-board increase of 5.5 percent on its rates set forth in Tariff 5-A. On September 15, 2006, the Commission approved YB's 2006 Zone Application, to take effect on September 18, 2006.

9. On December 19, 2007, Young Brothers and the Consumer Advocate filed a stipulation in Docket No. 01-0255 to effectively end the pilot program nature of Young Brothers' Zone Practice (**2007 Stipulation**). The 2007 Stipulation provided for continuation of the Zone Practice, with the following added features:

a. Set a new maximum of 7.5 percent by which rates for any one customer class may be increased, while retaining 5.5 percent as the maximum overall increase, to allow Young Brothers "an opportunity to achieve compensatory rates in a graduated fashion over a period of time." 2007 Stipulation at 5.

b. Imposed time limits between Young Brothers' requests for rate relief under Zone Practice filings "to mitigate the impact of proposed rate changes on Young Brothers customers—(1) a minimum time period of 10 months between successive Zone Practice filing effective dates and (2) a minimum of one

year between the effective dates of a general rate case filing and a subsequent Zone Practice filing, provided that Young Brothers may seek a rate adjustment in a Zone Practice filing with an effective date of August 1, 2008. *Id.* at 6-8.

c. Requested that the new Zone Practice be effective on January 1, 2008.

In Decision and Order No. 24139 issued on April 9, 2008, the Commission approved the 2007 Stipulation with modifications (the **New Zone Practice**): (1) the maximum annual increase in rates for any customer class was reduced from 7.5 percent to 5.5 percent, (2) the minimum time between successive Zone Practice filing effective dates was increased from 10 months to one year, and (3) the effective date of the New Zone Practice was set as of the date of Decision and Order No. 24139 (that is, April 9, 2008). “For clarity purposes and ease of administration,” the Commission directed Young Brothers to file “a document that sets forth the parameters of the New Zone, which incorporates the commission’s modifications, including the effective date of the New Zone.” Decision & Order No. 24139 at 28, 30. On April 22, 2008, Young Brothers filed its Parameters of Zone Practice of Young Brothers, Limited Pursuant to Decision and Order No. 24139, which the Commission accepted by Order No. 24179 issued on May 7, 2008.

10. Pursuant to the New Zone Practice Parameters at page 4, Young Brothers submitted a Zone Practice filing on June 17, 2008, with the requisite 45-day notice for an effective date no earlier than August 1, 2008. By Decision and Order filed on July 29, 2008, at 11:42, the Commission approved the filing, allowing Young Brothers to increase its rates across-the-board by 5.5

percent.

**D. YB's Application For Expedited Approval of Tariff Change to Impose a Fuel Price Adjustment.**

As a result of rapid and unforeseen increases in and volatility of diesel fuel prices, which were entirely unanticipated by Docket 01-0255 and the proceedings resulting in Order No. 21926 (YB's 2005 Zone Application), YB sought authority to implement an fuel price adjustment (**FPA**) clause by and through its Application For Expedited Approval of Tariff Change to Impose a Fuel Price Adjustment, dated November 14, 2005 (Transmittal Number 17-1105). This rise in the cost of fuel effectively took back the cost recovery YB hoped to achieve by and through Order No. 21926. The fuel Price adjustment, as proposed by YB, would have allowed YB to automatically increase or decrease its rates to reflect the changes in YB's costs for diesel fuel above or below levels included in YB's base rates upon thirty days' notice (without a rate proceeding), with prices reconciled quarterly.

On December 1, 2005, in Decision and Order No. 22154, the Commission denied YB's Application for Expedited Approval of Tariff Change to Impose a Fuel Price Adjustment. Although the Commission stated that it "is not unconcerned about the effect of rising diesel prices on YB's business" and that by its decision, "the commission does not pass judgment on the sufficiency of the data provided by YB in support of its application," the Commission concluded that "[t]he public should have the opportunity to comment on YB's proposal, and the full impact of the proposal should be carefully considered in the context of a full rate proceeding."

**E. YB's Application Regarding Elimination of Less Than Container Load Service to and from Kahului Harbor (Docket No. 2006-0120)**

On April 13, 2006, YB filed an Application for Approval of Tariff Change to Eliminate Less Than Container Load Service to and from Kahului Harbor on the Island of Maui under Transmittal No. 06-0001. Young Brothers sought Commission approval to amend Tariff 5-A to reflect discontinuance of LCL service and rates for the transportation of cargo to and from Kahului Harbor on the island of Maui, effective January 1, 2007.

This application was prompted by increased container traffic statewide, potentially critical space shortages at Kahului Harbor, and the recommendation by the State Department of Transportation (the **DOT**) that the function of consolidation and deconsolidation of LCL cargo utilize space other than critically limited harbor space. The DOT's recommendation was based on its conclusions that (1) consolidation and deconsolidation of LCL cargo is not an essential or priority harbor purpose and (2) Pier 2 at Kahului Harbor (YB's cargo operations area) cannot safely accommodate the level of congestion generated by the combination of the anticipated inauguration of Hawaii Superferry operations in 2007 and YB's continued use of harbor space for LCL cargo operations. See letter, dated February 8, 2006, from Barry Fukunaga, then DOT Deputy Director of Harbors, addressed to Glenn K. Y. Hong, President of YB. (YB filed a copy of this letter with the Commission on April 13, 2006 as YB-Ex-1 to YB's Application for Approval of Tariff Change to Eliminate Less Than Container Load Service to and from Kahului Harbor on the Island of Maui, Transmittal No. 06-0001, in Docket No.

2006-0120 and respectfully requests that it be incorporated by reference in this Application).

By Order No. 22463 issued on May 11, 2006, in Docket No. 2006-0120, the Commission suspended Transmittal No. 06-0001 for six months and instituted an investigation “to examine the merits of Young Brothers’ transmittal.” The Commission named the Hawaii Transportation Association and the Western Motor Tariff Bureau, Inc. as participants in the proceeding “to provide information that will assist the commission in its investigation of Transmittal No. 06-0001, and in developing a sound record.” Order No. 22463 at 13. By Order No. 22549 filed on June 21, 2006, the Commission also named the Hawaii Farm Bureau Federation (the **HFBF**) as a participant.<sup>12</sup>

On August 23, 2006, Young Brothers withdrew its application based on representations made and set forth in that certain Memorandum of Understanding (the **MOU**) into which YB entered with the State of Hawaii Department of Commerce and Consumer Affairs and the DOT, effective August 21, 2006. In the MOU, the DOT states that it is willing to allocate certain additional harbor space and complete certain harbor improvements for YB by dates specified in the MOU. YB, in turn, states that, provided DOT makes available such space and improvements as set forth in the MOU, YB is willing to continue LCL service to and from Kahului Harbor, as well as statewide, for the

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<sup>12</sup> On May 31, 2006, the HFBF filed a motion to intervene in this proceeding. After discussions with YB and YB’s development of a proposed implementation action plan to address concerns of the agricultural community, the HFBF entered into a stipulation with YB to withdraw its motion, requesting instead participation in the proceeding, which YB supported. See *Stipulation on Hawaii Farm Bureau Federation’s Motion to Intervene* (the **Stipulation**) filed on June 9, 2006, in Docket No. 2006-0120 (Attachment B to the Stipulation sets forth the action plan).

periods and as otherwise described in the MOU. The MOU, and its relationship to cargo capacity and YB's planned investments, is described in greater detail in Testimony of P. Roy Catalani attached to this Application as **YB-DT-200**. YB filed the MOU with the Commission on August 23, 2006 as YB-Ex-1 to YB's Notice of Withdrawal of Application in Docket No. 2006-0120 relating to Transmittal No. 06-0001 (Young Brothers, Limited, for Approval of Tariff Change to Eliminate Less Than Container Load Service to and from Kahului Harbor on the Island of Maui) and respectfully requests that it be incorporated by reference in this Application.

By Order No. 22814, filed September 1, 2006, the Commission approved the withdrawal of YB's Application, without prejudice.

**F. Tariff Filing Regarding General Excise Tax**

On November 6, 2006, under Transmittal No. 06-0003, Young Brothers filed an application requesting Commission approval to change Rule No. 60 of Tariff 5-A to reflect assessment of the State general excise tax (**GET**) in lieu of the State public service company (**PSC**) tax (following a legislative change that makes GET rather than PSC applicable to transportation companies). Under HRS § 271G-17(b), the 45-day notice requirement was fulfilled on December 21, 2006.

**G. YB's Application for Approval to Treat GET Settlement Payment as a Regulatory Asset (Docket No. 2008-0039)**

On February 21, 2008, in Docket No. 2008-0039, Young Brothers applied for Commission approval to treat, as a regulatory asset, payments it made in settlement of its general excise tax (**GET**) liabilities covering the years 2001 to

the first half of 2007. Specifically, YB sought approval to treat an amortized amount of the payment (the proposed amortization period being 5¾ years) as an expense, and to include the remaining unamortized amount as a regulatory asset in YB's rate base. By Decision and Order issued on December 10, 2008, at 1:57 in the proceeding, the Commission approved YB's treatment of the settlement payment as an expense amortized over a 5¾-year period, but denied inclusion of the remaining unamortized amount in YB's rate base.

**IV. YB'S PROPOSED RATE INCREASE IS JUST AND REASONABLE BECAUSE IT MOVES INCREMENTALLY TOWARD COMPENSATORY RATES WHILE RECOGNIZING CUSTOMER HARDSHIPS**

HRS §271G-16(b) states, with emphasis added, YB's obligations as a water carrier of property:

It shall be the duty of every water carrier of property to ***provide safe and adequate service, equipment, and facilities for the transportation of property and to establish, observe, and enforce just and reasonable rates***, charges, and classifications, and just and reasonable regulations and practices relating thereto, and to the manner and method of presenting, marking, packing, and delivering property for transportation, the facilities for transportation, and all other matters relating to or connected with the transportation of property.

Similarly, the State policy of HRS chapter 271G is as follows:

The legislature of this State recognizes and declares that the transportation of persons and of property, for commercial purposes, by water within the State or between points within the State, constitutes a business affected with the public interest. It is intended by this chapter to provide for fair and impartial regulation of such transportation, so administered as to recognize and preserve the inherent advantages of such transportation, in the interest of preserving for the public the full benefit and use of the waterways consistent with the public safety and the needs of commerce: to promote safe, adequate, economical, and efficient service among carriers, to encourage the establishment and maintenance of reasonable rates and charges for transportation and related accessorial service, without unjust

discrimination, undue preference or advantage, or unfair or destructive competitive practices, ***all to the end of developing, coordinating, and preserving a sound transportation system by water.*** This chapter shall be administered and enforced with a view to carrying out the above declaration of policy.

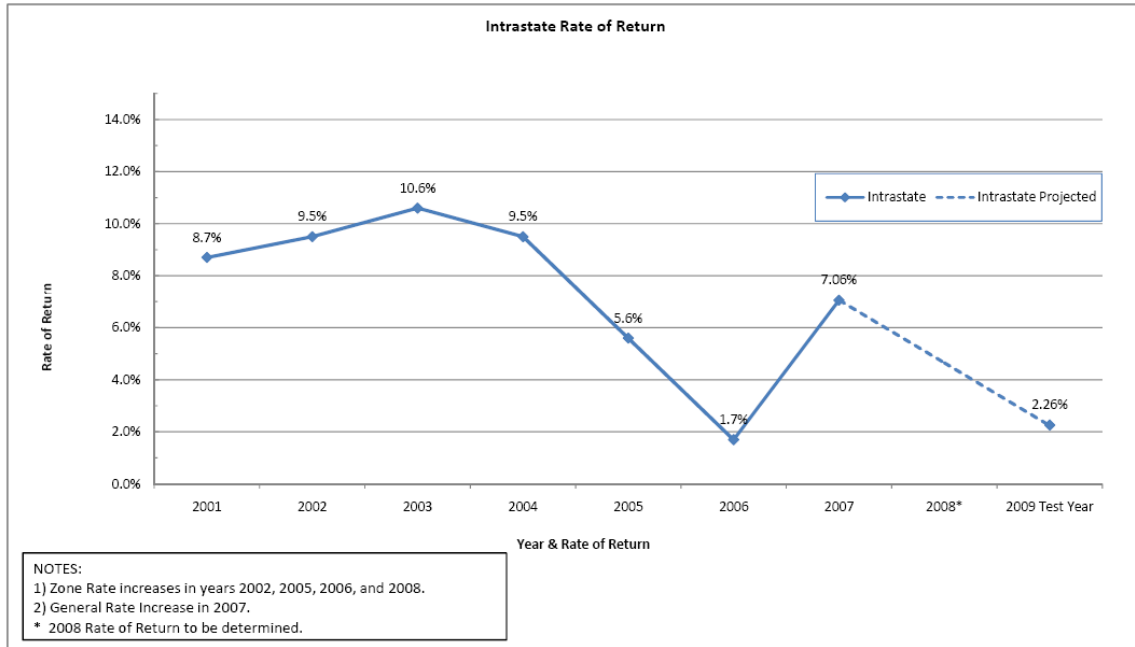
YB proposes to fulfill its statutory obligation of providing “safe and adequate service, equipment, and facilities for the transportation of property” and the public interest in “developing, coordinating, and preserving a sound transportation system by water” through the execution of public and private plans, collaboration with the State on resolution of critical harbor and cargo capacity issues, and the public and private investments described above.

YB is entitled to an opportunity to earn a fair rate of return on investments made for such purposes. To achieve this return, YB must establish, observe, and enforce just and reasonable rates. Guided by prior Commission decisions on what is just and reasonable, Young Brothers proposes rates in its revision to Tariff 5-A that more effectively reflect the cost to provide each line of service. *See, e.g., In re Young Bros.*, Docket No. 01-0255, Decision and Order No. 19115 (December 20, 2001).

At the same time, as discussed in detail below, in recognition of the economic predicament affecting our State, Young Brothers has elected to request a rate increase that is lower than what is required to meet its estimated revenue requirement for the normalized Test Year. *See exhibits YB-Ex-6A and YB-Ex-6B* setting forth the projected results of operation under the rate relief being requested in this Application (reflecting a rate of return of 11.20 percent) and the projected results of operation (reflecting a rate of return of 12.04 percent; *see a/so* Testimony

of Wayne M. Matsubara at **YB-DT-500** for a more detailed discussion of the supporting financial information.

In addition to the Commission’s directive to establish compensatory rates, a rate increase is also timely as YB’s intra-state returns have steadily declined over the past five years (despite YB’s Zone Practice) as demonstrated by the following:



**A. Cost of Service Model**

In establishing YB’s Zone Practice, Young Brothers and the Consumer Advocate collaborated on a model for cost of service reflecting a separation between YB’s intra-state and interstate operations. See discussion above on the History of Relevant Dockets. The model was first used in the COSS submitted on June 28, 2002, under YB’s Zone Practice and is used in the COSS for this Application to support a requested rate of return of 11.20 percent applicable to YB’s intra-state operations. See generally **YB-DT-500** (Testimony of Wayne M.

Matsubara) for a discussion on YB's cost of service model; see *also* **YB-DT-400** (Testimony of Arlie Sterling) for a discussion on an allowed rate of return of 12.04 percent.

The purpose of the COS model is to determine the costs and asset requirements of YB's transportation services by type of cargo and by origin of cargo (interstate versus intra-state). The analysis includes a detailed assessment of YB's operations and resource allocation, and how those factors determine the cargo-specific costs of its transportation services. The COS model cost analysis provides two key types of information: (a) the profitability of YB's operations for each major category of cargo transported, and (b) the relative cost and profitability of YB's separated intra-state and interstate lines of business.

YB is a complex operation in which many different types of cargoes are transported, using specialized cargo-handling equipment and labor and a unique barge and tug fleet. The COS model captures the main elements of YB's operations. Lines of service are essentially categorized by cargo-handling requirements: containers (dry v. refrigerated); straight-load racks (flatracks and platforms); automobiles (roll-on/roll-off v. racked) and other roll-on/roll-off cargo; and LCL cargo, including G-vans, pallets (dry v. refrigerated), mixed LCL cargo (dry v. refrigerated). Total costs for of each line of service include labor (straight and overtime costs plus benefits), capital (depreciation, repairs, insurance and fuel), voyage (capital and operating costs of the tug and barge fleet as well as the crew), general and administrative, insurance, and taxes (non-income).

As noted in establishing the Zone Practice, Young Brothers developed and the Consumer Advocate agreed to a COS model reflecting a separation between YB's intra-state and interstate operations. The PUC approved this agreement. See *In re Young Bros.*, Docket No. 01-0255, Order No. 20454 (approving YB's 2001 COSS and citing *Stipulated Settlement Agreement Between Young Brothers, Limited and the Division of Consumer Advocacy Regarding Cost of Service Study filed June 28, 2002* filed on June 12, 2003, in that proceeding). The COS model was first used in the filing submitted on June 28, 2002 under YB's Zone Practice.

In the first rate case following Commission approval of YB's COS model, and consistent with the Commission's original and expressly stated intent for imposing upon YB the requirement for establishing a COS model, YB sought to have its authorized rate of return based on its intra-state results. See Docket No. 2006-0396. Young Brothers continues to seek to have its authorized rate of return based on its intra-state results.

**C. Test Year**

The test year used to support this Application is January 1 to December 31, 2009, pursuant to HAR § 6-65-31(e). Young Brothers' results of operations are presented on a consolidated basis (*i.e.*, reflecting its combined interstate and intra-state results of operations), as well as on an interstate and intra-state basis. Our request for rate relief, however, covers only our intra-state operations.

Test year revenues, expenses, rate base, and allowed rate of return details and calculations are set forth in exhibits **YB-Ex-6A** and **YB-Ex-6B**, and related work papers attached to this Application as **YB-WP-101** to **YB-WP-401**. Exhibit **YB-Ex-6B** comprises financial statements for Test Year 2009, without and with rate relief as requested in this Application (reflecting a proposed rate increase of 17.91 percent and an allowed rate of return of 11.20 percent), in the format similar to Young Brothers' monthly financial statements. Exhibit **YB-Ex-6A** comprises financial statements for Test Year 2009, without and with rate relief as initially determined (reflecting a proposed rate increase of 19.60 percent and an allowed rate of return of 12.04 percent).

Using YB's cost of service (**COS**) model, exhibit **YB-Ex-9** contains cost of service and cargo type summaries, each with and without rate relief. The cost of service summaries set forth consolidated operating revenues and expenses, as well as a separation of revenues and expenses by interstate and intra-state operations. The cargo type summaries set forth the profitability of each line of service (e.g., container types, automobiles, RoRo, and LCL categories) for intra-state operations, with and without rate relief.

For comparison purposes, YB includes recorded results of operations, a balance sheet, and income statement for calendar year 2007 (exhibit **YB-Ex-2**) and a balance sheet and income statement for the period January 1, 2008 through October 31, 2008. An analysis of property and equipment and accumulated depreciation at December 31, 2007 is included as exhibit **YB-Ex-4**; and similar analysis for the period January 1, 2008 through October 31, 2008

(exhibit **YB-Ex-5**). As Young Brothers compiles November and December 2008 financial data, YB will submit updated exhibits to the Commission and the Consumer Advocate.

Other information required by HAR § 6-35-31 are set forth in exhibits **YB-Ex-7** (a summary of charter hire expenses paid by Young Brothers for Test Year 2009) and **YB-Ex-8** (a schedule of operating revenues and tonnage for all ports for Test Year 2009).

**C. Revenues**

To project revenue requirements for the Test Year, Young Brothers applies growth factor forecasts determined by its expert economic witness, Dr. Byron Gangnes. See *generally* Testimony of Byron Gangnes attached to this Application as **YB-Ex-700**. The specific growth factors we apply to project revenues are a negative 3.2 percent (-3.2%) to determine intra-state cargo demand and a negative 8.4 percent (-8.4%), see footnote 9, *infra*, to determine interstate cargo demand. In past rate filings, Young Brothers used the forecasted change in the real Gross Domestic Product (**GDP**) as the proxy in determining growth in demand for general freight services. See, e.g., Young Brothers' applications in its 2008 Zone Practice filing under Transmittal No. 08-0005; 2006 Zone Practice filing under Transmittal No. 06-0002; and its general rate increase filing in Docket No. 2006-0396. Please refer to Dr. Gangnes' testimony for his analysis supporting the growth factor forecasts used in this proceeding.

Young Brothers forecasts intrastate revenues of \$65,145,067 for the Test Year without the benefit of any rate relief. Total revenues comprise the following and are based on projected growth over the Comparison Year:

General Freight	\$58,387,483
General Excise Tax	2,094,249
Cargo Insurance	2,332,495
Miscellaneous	1,310,000
Stevedore and Tug Charter	<u>603,000</u>
Amortized Gain on Sale of Barges	<u>417,840</u>
TOTAL REVENUES	<u>\$65,145,067</u>

Test Year revenues reflect an amortized amount of the gain resulting from the sales of the barges *Malana* and *Kahoku*. See *In re Young Bros.*, Docket No. 2007-0356. We have not included any gain from the sale of the barge *Aukai*, since the transaction has yet to close and the actual amount to be realized by YB is, accordingly, not known at this time. See *In re Young Bros.*, Docket No. 2008-0269. In addition, although YB expects to dispose of three more barges and a tug in 2009, the gains, if any, from these anticipated sales have not been reflected in the Test Year results of operations; please note that YB will be filing an application for approval shortly. If a sale of any of these vessels is consummated in 2009, the gains, if any, will be reflected as adjustments to Test Year revenue projections during the course of this proceeding. See **YB-DT-500** (Testimony of Wayne M. Matsubara) for a more detailed discussion on revenue projections.

**D. Operating Expenses**

In past rate proceedings, Young Brothers has generally applied an inflation factor to actual results of the prior year to project its test year expenses.

For this proceeding, YB generally projects its Test Year expenses based on 2008 actual results with *no* inflation factor applied.

Young Brothers also uses anticipated events (such as the anticipated service dates of two new barges and negotiated wage increases) where appropriate in forecasting revenues and expenses for the Test Year. In addition, the rate relief YB requests in this Application reflects the regulatory asset treatment that the Commission authorized in its Decision and Order issued on December 10, 2008, at 1:57, in Docket No. 2008-0039 for settlement of its general excise tax (**GET**) liabilities covering the years 2001 to the first half of 2007. Specifically, an amortized amount of the payment (the amortization period being 5¾ years) is shown as an expense in Test Year 2009.

Young Brothers operating expenses comprise of cargo handling expenses, voyage expenses, administrative and general expenses, taxes on other than income, and depreciation. See generally **YB-DT-500** (Testimony of Wayne M. Matsubara) for a detailed discussion of YB's operating expense projections for the Test Year.

Young Brothers cargo handling expenses are related to port operations, including receipt of cargo, bill-of-lading processing, bookings, and actual movement of cargo (*i.e.*, staging, loading, unloading, and restaging). These expenses reflect labor costs and related fringe benefits, the cost to repair and maintain shore-side equipment, rental of the premises, and all other costs necessary to YB's port operations.

Young Brothers voyage expenses are costs associated with tug and barge operations, including repair and maintenance costs, dockage and port entry fees, protection and indemnity insurance, hull and machinery insurance, and fuel and lubrication costs.

Young Brothers administrative and general expenses include costs associated with labor and related fringe benefits, professional fees, office supplies, office rentals, dues and subscriptions, travel, meetings and seminars, and other miscellaneous charges (such as port security). It also includes allocations of costs incurred on YB's behalf by YB's affiliate HTB.

Young Brothers projects intrastate operating expenses of \$62,531,668 for its 2009 Test Year (without rate relief). The projection comprises the following (see **YB-Ex-6B**):

<u>Expense Description</u>	<u>2009 Test Year</u>
Cargo Handling (including Maint Dept)	\$28,283,786
Voyage	18,257,741
Administrative and General	5,996,771
Depreciation	7,003,210
Taxes Other Than On Income	<u>2,990,160</u>
Total Operating Expenses	<u>\$62,531,668</u>

See **YB-DT-500** (Testimony of Wayne M. Matsubara).

**E. Rate Base**

Young Brothers' rate base comprises its net plant-in-service (*i.e.*, the plant-in-service minus accumulated depreciation), *plus* materials and supplies inventory, *minus* accumulated deferred income taxes and the Hawaii State Capital Goods Excise Tax Credit, *plus* working cash. For its Test Year, the Company uses

an average rate base, averaging the year-beginning and year-ending balance of rate base components in calculating its rate base.

In YB's last general rate case, the Commission authorized an average depreciated rate base of \$44,606,597. See Docket No. 2006-0396, Decision & Order No. 23714 filed on Oct. 12, 2007. For Test Year 2009, Young Brothers projects an average depreciated rate base of \$70,647,528 (without rate relief), or an increase of \$26,040,931 over its rate base for test year 2007. See **YB-DT-500** (Testimony of Wayne M. Matsubara).

The Test Year rate base reflects improvements and investments that will be made in 2009 comprising acquisitions and upgrades to tugs, barges, and shore-side equipment (see work paper **YB-WP-208** for assets placed in service in 2009). Young Brothers continues to invest in plant and equipment to maintain its level of reliable service and commitment to customers. These improvements include purchase of containers, reefers, chassis, and lifts for shore-side operations. In the years to come, Young Brothers expects to continue upgrading its barges and tugs to achieve higher reliability, increase its capacity while becoming more fuel efficient, and remain competitive in providing the level of service expected by customers. Complementing its collaboration with the State and other harbor users and in furtherance of the plans and investments described above, YB has commenced its strategic (recapitalization) plan for which YB will necessarily seek to increase its rate base.

**F. Rate of Return**

As the Commission notes in YB's last rate case decision:

In determining an appropriate rate of return on Young Brothers' rate base, we are guided by our past rate cases and by the guidelines set forth in Bluefield Waterworks and Improvement Co. v. Pub. Serv. Comm'n, 262 U.S. 679 (1923), and Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944). These guidelines prescribe that a fair return must:

1. Be commensurate with returns on investment in other enterprises having corresponding risks and uncertainties;
2. Provide a return sufficient to cover the capital costs of the business, including service on the debt and dividends on the stock; and
3. Provide a return sufficient to assure confidence in the financial integrity of the enterprise to maintain its credit and capital-attracting ability.

Docket No. 2006-0396, Decision & Order No. 23714 at 55 (Oct. 12, 2007) (quoting Decision & Order No. 16008 filed on Oct. 10, 1997, in Docket o. 96-0483).

In Decision and Order No. 23714, the Commission notes further a decision of the Hawaii Supreme Court and quotes from it:

A fair return is the percentage rate of earnings on the rate base allowed a utility after making provision for operating expenses, depreciation, taxes and other direct operating costs. Out of such allowance the utility must pay interest and other fixed dividends on preferred and common stock. In determining a rate of return, the Commission must protect the interests of a utility's investors so as to induce them to provide the funds needed to purchase plant and equipment, and protect the interests of the utility's consumers so that they pay no more than it reasonable.

To calculate the rate of return, the costs of each component of capital – debt, preferred equity and common equity – are weighted according to the ratio each bears to the total capital structure of the company and the resultant figures are added together to yield a sum which is the rate of return.

The proper return to be accorded common equity is the most difficult and least exact calculation in the whole rate of return

procedure since there is no contractual cost as in the case of debt or preferred stock[:]

Equity capital does not always pay dividends; all profits after fixed charges accrue to it and it must withstand all losses. The cost of such capital cannot be read or computed directly from the company's books. Its determination involves a judgment of what return on equity is necessary to enable the utility to attract enough equity capital to satisfy its service obligations.

....

Questions concerning a fair rate of return are particularly vexing as the reasonableness of rates is not determined by a fixed formula but is a fact question requiring the exercise of sound discretion by the Commission. It is often recognized that the ratemaking function involves the making of "pragmatic" adjustments and there is no single correct rate of return but that there is a "zone of reasonableness" within which the commission may exercise its judgment.

Docket No. 2006-0396, Decision & Order No. 23714 at 56-57 (Oct. 12, 2007) (quoting *In re Hawaii Elec. Light Co.*, 60 Haw. 625, 594 P.2d 612 (1979)) (with emphasis added and citation omitted as in Decision & Order No. 23714).

Young Brothers' authorized rate of return on rate base is currently 10.76 percent. See *In re Young Bros.*, Docket No. 2006-0396, Decision & Order No. 23714 (Oct. 12, 2007). The Commission accepted Young Brothers' proposed capital structure of 45 percent debt to 55 percent equity, finding this structure "closely approximates the capital structure previously approved by the commission in Young Brothers' most recent general rate case." *Id.* at 59 (footnote omitted).

Based on the guidelines outlined above and on the decisions in YB's prior rate cases, Young Brothers cost of capital witness, Dr. Arlie Sterling, recommends an allowed rate of return of 12.04 percent for the Test Year. See generally **YB-DT-400** (Testimony of Arlie G. Sterling, Marsoft, Inc.) attached to this

Application. Dr. Sterling (a) for the purposes of this proceeding, recommends that YB be assumed to be 55 percent equity and 45 percent debt financed (although, in fact YB's balance sheet does not include any long-term debt – it is nominally 100 percent equity financed; YB's debt is managed by its parent company), (b) estimates that YB's cost of long-term debt is approximately 8.46 percent, (c) estimates that YB's cost of equity is 15.43 percent and, finally (d) estimates that YB's overall cost of capital, at the recommended 55 percent equity share, is 12.04 percent.

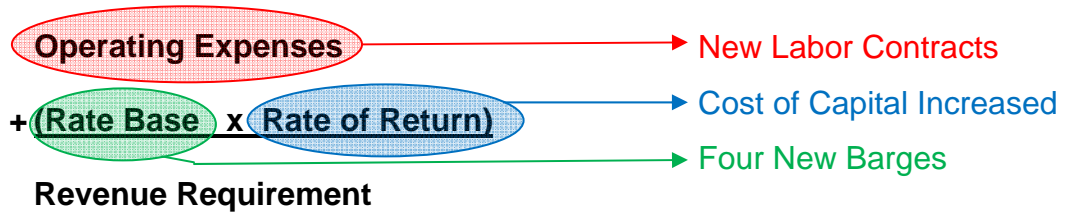
Dr. Sterling's recommendation is 128 basis points above YB's current allowed rate of return of 10.76 percent. See *YB-DT-400* (Testimony of Arlie G. Sterling, Marsoft, Inc.).

Young Brothers respectfully requests that the Commission approve Dr. Sterling's recommendation of an allowed rate of return of 12.04 percent in its decision on this Application.

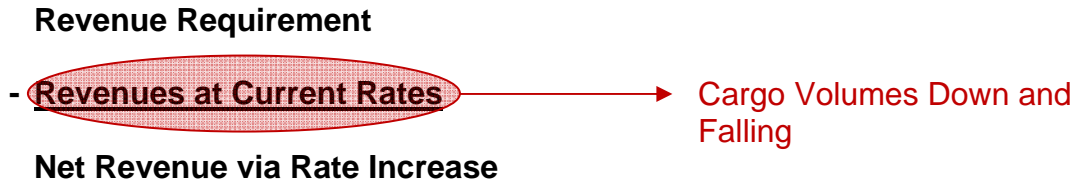
I. **Summary of Revenue Requirement and Extraordinary and One-Time Adjustment to Net Revenue Requirement.**

As noted, Young Brothers, without rate relief, projects a rate of return of 2.26 percent in the 2009 test year. To place the foregoing revenue requirement discussion into the context of certain of the major drivers of the present general rate case, we offer the following summary of the revenue requirement and rate increase formula:

1. **Determine revenue requirement:**



2. **Determine amount of rate increase:**



Putting numbers to the formula, this rate case may be summarized as follows:

1. **Determine revenue requirement:**

<b>Operating Expenses</b>	\$63,025,717
+ <b>(Rate Base x Rate of Return)</b>	+ <b>(\$70,731,451 x 12.04%)</b>
<b>Revenue Requirement</b>	<b>\$69,832,483</b>

2. **Determine amount of rate increase:**

<b>Revenue Requirement</b>	\$69,832,483
- <b>Revenues at Current Rates</b>	- <b>\$58,387,483</b>
<b>Net Revenue via Rate Increase</b>	<b>\$11,445,000</b>

For Revenue Requirements under the above abbreviated formula, see **YB-Ex-6A**; for full details on operating expenses, revenues and rate base projected in Test Year 2009, please refer to **YB-DT-500** (Direct Testimony of Wayne Matsubara, Regulatory Affairs Manager); for details on new and anticipated labor contracts, please refer to **YB-DT-700** (Direct Testimony of Dean Kapoi, Vice President, Human Resources and Labor Relations); for a discussion of YB's cost of capital,

see **YB-DT-400** (Direct Testimony of Arlie G. Sterling, President, Marsoft Inc.); and for a discussion of YB's 2008 loss and projected 2009 losses of cargo volume, please refer to **YB-DT-800**, Direct Testimony of Byron Gangnes, University of Hawaii Economic Research Organization).

In the present case, as noted above, Young Brothers' actual net revenue requirement is \$11,445,000. However, recognizing that its customers and the company share the pressures and difficulties of the current economic predicament, Young Brothers proposes what it considers an extraordinary and one-time adjustment from the revenue formula (and its entitlement to revenue enhancement based on this formula) in the form of taking \$987,000, or 8.6239 percent, from the net revenue to be raised via this rate case, resulting in a net revenue requirement of \$10,458,000 and the following adjustment to the above formula:

3. ***Make one-time adjustment to net revenue from rate case:***

<b>Net Revenue via Rate Increase</b>	\$11,445,000
<b>- One-time adjustment of 8.6239%</b>	<b>- <u>\$987,000</u></b>
<b>Adjusted amount of net revenue</b>	<b>\$10,458,000</b>

Young Brothers makes this one-time adjustment for the purpose of providing one-time rate increase mitigation in light of the economic downturn.

Young Brothers, however, wishes to make clear that Young Brothers does not intend this adjustment to be additive (or considered cumulative) to other adjustments that may be sought by the Consumer Advocate or adjudicated by the Commission. That is, for example, if the Consumer

Advocate were to seek (or the Commission were to determine) a downward adjustment in YB's operating expenses, YB would consider any such reduction in operating expenses to reduce the amount of the one-time adjustment of \$987,000 by the same dollar amount.

The same rationale would, of course, apply to sought or determined increases in forecasts of revenue, adjustments to the allowed rate of return or other changes which result in lesser revenue requirement. We believe that any other interpretation would, in effect, use YB's desire to help its customers (and put real dollars behind this desire) to YB's tactical and financial disadvantage. We believe YB's approach here, although perhaps unusual, is consistent with this Commission's desire to encourage utilities to take an aggressive stance when it benefits ratepayers. See, e.g., Decision and Order, *In re Young Bros.*, (*Application for Approval to Treat General Excise Tax Settlement Payment as Regulatory Asset and Include Unamortized Balance in Rate Base*), Docket No. 2008-0039 (December 10, 2008).

Once we take this step of decreasing net revenue by \$987,000 and restating the revenue requirement as \$10,458,000, then certain other "upstream" numbers in the formula shift slightly. Specifically, as demonstrated in **YB-Ex-6A** and **YB-Ex-6B** "taxes other than income" decrease slightly from \$3,425,105 to \$3,387,596 and "administrative and general expenses" also decrease slightly from \$6,055,875 to \$6,050,778. In addition, allocations in the model shift slightly, resulting in a slight reduction to average depreciated rate base from \$70,731,451 to \$70,724,216. Perhaps most significantly, by reducing the revenue

requirement, we “back into” a rate of return of 11.20 percent, although we again stress and maintain, by this exercise, YB is not waiving its entitlement to an opportunity to earn a maximum 12.04 percent rate of return in the event of an economic rebound and in a future year when cargo volumes increase. In essence, by artificially reducing YB’s revenue requirement by \$987,000, the revenue requirement and rate increase formula, as more fully set out in **YB-Ex-6B**, may be set out as follows:

1. **Determine revenue requirement:**

<b>Operating Expenses</b>	\$62,983,111
<b>+ <u>(Rate Base x Rate of Return)</u></b>	<b>+ <u>(\$70,724,215 x 11.20%)</u></b>
<b>Revenue Requirement</b>	<b>\$68,845,483</b>

2. **Determine amount of rate increase:**

<b>Revenue Requirement</b>	<b>\$68,845,483</b>
<b>- <u>Revenues at Current Rates</u></b>	<b>- <u>\$58,387,483</u></b>
<b>Net Revenue via Rate Increase</b>	<b>\$10,458,000</b>

With this downward adjustment of the net revenue requirement, Young Brothers requests a rate increase of 17.91 percent (**see YB-Ex-6A**). In the absence of this one-time measure for this current economic climate, YB’s requested rate increase would be 19.6 percent. The combined and intended effect of proposing this \$987,000 downward adjustment and maintaining its requested return on rate base of 12.04 percent (see Direct Testimony of Arlie Sterling at **YB-DT-400**) is that Young Brothers will share with its customers the impacts and detriment of negative growth forecasted by its economic expert, Byron Gangnes (see Direct Testimony of

Byron Gangnes at **YB-DT-800**), and, in effect, receive a lesser rate of return (of 11.20 percent **see YB-Ex-6B**); however, if the economy rebounds in the Test Year or future years, Young Brothers does not and will not waive its opportunity to (a) earn the full amount of allowed rate of return (which we contend is 12.04%, as calculated and justified by Dr. Sterling) and (b) thereby gain the benefit of an economic rebound as its customers benefit from such a rebound.

**J. Rate Design.**

YB proposes to increase its rates to attain additional revenue in the amount of \$10,458,000 over revenues at present rates (for overall rate relief in the amount of 17.91 percent and a resulting rate of return of 11.20 percent).

YB's proposed increases for each line of service is intended to be in furtherance of prior Commission directives to move towards compensatory rates. Specifically YB proposes to raise its rates for less than container load (**LCL**) cargo by 25 percent in order to realize revenues that allow the Company to move closer to compensatory rates (on an investment of approximately \$21.88 million in LCL-related assets with an overall rate of return for LCL of 9.84 percent). YB includes dry and refrigerated pallets, dry and refrigerated mixed cargo and G-vans within the LCL lines of service. Further, the company is seeking to increase its minimum bill of lading by the same percentage (25 percent) from \$29.63 to \$37.04.

For containers (including flatracks and platforms), is requesting a rate increase of 15 percent. This same increase is also proposed for the minimum charge for platforms, raising the minimum for 20-foot platforms from \$184.63 to \$212.32 and for 40-foot platforms from \$369.25 to \$424.64.

Young Brothers proposes a rate increase of 10 percent for automobiles and roll-on/roll-off cargo. Under the proposed revision of YB's automobile length limitation (from 17 feet to 20 feet), the Company expects that some automobiles, now rated as roll-on/roll-off cargo, will be assessed automobile rates.

The revenue, operating expenses, rate base and specific returns associated with each line of service are summarized in **YB-Ex-9** (Cargo Type Summary (With Rate Relief)).

	<u>Percent Increase</u>
Dry Containers (20-foot)	15.0%
Dry Containers (24-foot)	15.0%
Dry Containers (40/45-foot)	15.0%
Reefer Containers (20-foot)	15.0%
Reefer Containers (24-foot)	15.0%
Reefer Containers (40-foot)	15.0%
Flatracks/Platforms	15.0%
Automobiles	10.0%
Roll-on/Roll-off	10.0 %
G-Vans	25.0%
Pallets (Dry)	25.0%

	<u>Percent Increase</u>
(Pallets (Reefer))	25.0%
Mixed (Dry)	25.0%
Mixed (Reefer)	25.0%

Notwithstanding the foregoing, during the course of these proceedings Young Brothers anticipates working with our Molokai and Lanai customers to discuss a possible lesser increase in rates for Molokai and Lanai LCL cargo than proposed in the above rate design and with our customers who are farmers to discuss the possibility of a higher Island Agricultural Product discount. We also anticipate working with the Consumer Advocate on these and any similar issues that may arise.

#### **VIII. CONCLUSION**

As Young Brothers traverses the 21<sup>st</sup> Century, YB is committed to continuing its tradition of dependable customer service reflecting the island way of life. To continue its partnership with island businesses and residents in the State's economic recovery, the Company must follow through in its modernization of its fleet and shore-side resources. In this effort, Young Brothers seeks regulatory recognition of the investment made by YB and its parent company in order to put in place the necessary water transportation infrastructure; at the same time, given the economic downturn that has affected the State of Hawaii, and Young Brothers' customers in particular, the Company has lowered its request for rate relief, despite

higher projections of what would be required to support its operations and to provide its investors with an opportunity to earn a fair rate of return.

Accordingly, based on the foregoing, Young Brothers respectfully requests that the Commission:


A. Approve such rates as will allow YB an opportunity to earn a fair rate of return on its investments to go into effect without suspension in 45 days, on February 2, 2009.

B. In the alternative, if a suspension and investigation of this tariff change is ordered and the Company is required to go to evidentiary hearing, (a) allow Young Brothers to update the supporting financial statements to reflect actual year-to-date results for Test Year 2009 and to base its rate increase on the revised projections and (b) grant the level of increase, as established in the evidentiary hearings, in order provide Young Brothers with an opportunity to earn a fair return on its investment.

C. Grant such other relief as the Commission deems just and appropriate under the circumstances.

DATED: Honolulu, Hawaii, December 19, 2008

YOUNG BROTHERS, LIMITED

By 

P. Roy Catalani  
Its Vice President of Strategic Planning  
and Government Affairs



CERTIFICATE OF SERVICE

I hereby certify that, on this date, copies of the Application of Young Brothers, Limited For Approval of a General Rate Increase and Certain Tariff Changes in Local Freight Tariff No. 5-A, were hand-delivered or mailed, postage prepaid and properly addressed, to the following:

1. Two copies hand-delivered to the following:

CATHERINE AWAKUNI  
Executive Director  
Division of Consumer Advocacy  
Department of Commerce and Consumer Affairs  
335 Merchant Street, Room 326  
Honolulu, Hawaii 96813

2. One copy mailed to each of the following:

MAYOR WILLIAM KENOI  
County of Hawaii  
25 Aupuni Street  
Hilo, Hawaii 96720

MAYOR CHARMAINE TAVARES  
County of Maui  
200 South High Street  
Wailuku, Maui 96793

MAYOR BERNARD P. CARVALHO  
County of Kauai  
4396 Rice Street  
Lihue, Kauai 96766

MAYOR MUFU HANNEMAN  
City and County of Honolulu  
Honolulu Hale  
530 South King Street  
Honolulu, Hawaii 96813

DATED: Honolulu, Hawaii, December 19, 2008.

YOUNG BROTHERS, LIMITED



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P. Roy Catalani  
Its Vice President of Strategic Planning  
and Government Affairs