Matson

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September 26, 2022

Dear Port Commissioners,

Thank you for your continued dedication to the Port of Alaska Modernization Program (PAMP). I am writing on behalf of Matson to express our support for the Repayment of Port Debt for the PAMP (Surcharge Concept) originally presented by Ross Risvold to the Port Commission on July 22, 2022.

The Surcharge Concept proposes a uniform surcharge of $3.40/ton on cargo beginning January 1, 2023. The rate will be reviewed annually and adjusted as needed. We agree with the Municipality that the Surcharge Concept is fair, transparent, and equitable. Given the timeliness of the cargo-dock replacements and their significance to the state, implementing a tariff as soon as possible prevents a finance-related delay to design, permitting and construction.

The Surcharge Concept has undergone rigorous review by financial experts, including the Municipality's Bond Counsel, Municipal Advisor and two independent advisors to the Port. [i]We concur with the experts that this approach to fund public infrastructure is in the best interest of Alaskans, as it reduces financial risk and maintains precedence of a uniform tariff and level-playing field among current and future cargo carriers. It also incentivizes all users to support federal and state funding efforts while managing PAMP costs.

Under the Surcharge Concept, users would continue paying for user-requested improvements. Examples include the 2003 Terminal 3 trestle modification to meet a user's unique operational constraints and the Terminal 2 gate house automation that Matson financed in 2017. Additionally, Matson currently maintains the three Port-owned gantry cranes at a cost of $1.6M per year. Once the Municipality completes its new general-purpose cargo dock, Matson is committed to purchasing and maintaining the new cranes.

Independent consultants have found that the alternative approach, utilizing a disparate surcharge between cargo terminals, lacks a strong "logical justification" and is likely to have "unintended adverse consequences" including reduced Port revenue and negative impacts to the debt service coverage ratio. (HDR Inc., Port of Alaska Modernization Program Rate Study, pp. 9-10.)

As public infrastructure, users are not "subsidizing" each other's operations under the Surcharge Concept. Funds collected will be used for the design and construction of public infrastructure owned by the Municipality for the benefit of the 90% of Alaskans who rely on cargo handled at the Port. As such, cargo carriers' customers, many of which are shared, and consumers are likely to bear the cost of the PAMP rather than individual Port users.

Matson is committed to finding an affordable solution to the PAMP. We have no interest in gaining a competitive market advantage through a tariff structure. Our goal is simply to continue operating our life-line service, compete on a level playing field, and meet the needs of Alaskans for decades to come. We support the Surcharge Concept and advocate for its passage and January 1, 2023, implementation.

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Sincerely,

Vic Angoco
Senior Vice President, Alaska
Matson

Attachments:

HDR Inc., Port of Alaska Modernization Program Study, August 26, 2021

Cc:

Ron Ward, Chair, Port of Alaska Commission
Garret Wong, Vice-Chair, Port of Alaska Commission
Kevin Mackey, Commissioner, Port of Alaska
Paul Mehler, Commissioner, Port of Alaska
Christopher Manculich, Commissioner, Port of Alaska
Mike W. Robbins, Commissioner, Port of Alaska
Peggy Jean Rotan, Commissioner, Port of Alaska
Scott Selzer, Commissioner, Port of Alaska
Aves Thompson, Commissioner, Port of Alaska
Ross Risvold, Interim Chief Fiscal Officer, Municipality of Anchorage
Kolby Hickel, Deputy Municipal Manager, Municipality of Anchorage
Steve Ribuffo, Port Director, Municipality of Anchorage
Christopher Constant, Chair Enterprise Utility Oversight Committee, Anchorage Assembly
Meg Zalatel, Vice-Chair Enterprise Utility Oversight Committee, Anchorage Assembly

Port of Alaska Modernization Program
Draft Rate Study

Prepared for

Port of Alaska

2000 Anchorage Port Road
Anchorage, Alaska 99501

August 26, 2021

HDR, Inc.
Anchorage, Alaska

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Executive Summary

The Port of Alaska (POA) contracted with HDR to review proposed changes to tenant rate structure to fund the Phase II of the Port of Alaska Modernization Program (PAMP). The POA defines the change as a **surcharge** on the current rate. Based on the current Plan of Finance approach of “cost causer cost payer”, the surcharge will be significantly higher for Matson than for TOTE. Of particular interest for this review was the fairness of the proposed disparate rate surcharge on the two affected carriers, and the impact of the structure of the surcharge on POA’s future ability to service projected debt required to fund the PAMP.

Key findings of this report are:

- When faced with rising port rates, carriers will pass on costs to consumers, and sales should not change substantially. Consumers with few options will pay more for most essential goods and buy slightly less of other non-essential goods.
- By implementing a surcharge, steamship carriers are expected to lose some business to the primary competitive barge operator Alaska Marine Lines (does not operate at POA) and significantly less to over-the-road trucking via Canada due to higher overall fixed cost structures. The relatively small loss of business is estimated to have a minor impact on POA’s ability to service their long-term debt for the PAMP.
- Implementing a disparate surcharge rate will likely result in a significant shift in Alaska bound cargo business from Matson to TOTE. It’s estimated for every five percent change in market share, a 2.1 percent decrease in surcharge revenue will occur from Terminal 1. Consequently, Matson losing significant business to TOTE will have an adverse effect on POA revenues and in maintaining its debt service coverage ratio since lost surcharge revenue from Matson is greater than the new surcharge revenue from TOTE.
- If the POA further increases the surcharge on Matson to make up for these losses in servicing the debt on Terminal 1, this could lead to unstable financial consequences in which Matson increasingly loses more market share to TOTE and the POA increasingly loses additional surcharge revenue with each subsequent rate increase.
- A more uniform per ton surcharge rate increase on both carriers that covers the long-term debt coverage and results in a non-disparate rate environment would create a more equitable financial situation.
- Under any surcharge scenario it is Alaskan consumers who will bear the burden of paying for the infrastructure through slightly higher prices.

Note: This rate study focuses *solely* on Phase II of the PAMP, and the accompanying rate surcharges the POA will charge for said modernization.

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Contents

Acronyms and Abbreviations

CFO	Chief Fiscal Officer
LOLO	Lift On Lift Off
MOA	Municipality of Anchorage
PAMP	Port of Alaska Modernization Program
POA	Port of Alaska
ROLO	Roll On Roll Off
TEU	twenty-foot equivalent unit

Scope of Study

HDR has been tasked by the Port of Alaska (POA) to perform the following professional services:

- Review the current Plan of Finance and provide guidance on a rate structure that does not by design or happenstance give a financial advantage to one port user over another, yet equitably and fairly distributes debt service coverage to all users who will benefit from the new infrastructure.
- Facilitate conversations with applicable Municipal leadership, Port personnel, and contractors to understand the current Port of Alaska Modernization Program (PAMP) financial requirements
- If part of the resultant recommendations, present any alternative public-private partnership models, real estate public-to-private change in ownership models, or any other similar recommendation action.
- Determine if any other mechanisms are advisable to complete PAMP financing framework

Background

The POA serves most Alaskan residents, providing them with essential goods and commodities, including food, clothing, electronics, building supplies, fuel, and vehicles. The POA also serves as a transshipment point for transport of these consumer items to rural Alaska. The POA suffers from aging infrastructure; the PAMP, an effort to replace this infrastructure, will allow the POA to effectively serve as Alaska's port well into the future. The POA has identified the need to review its vessel calling rate structure to suggest a framework for establishing fair, equitable rates, and tariffs to help fund the PAMP.

Rate setting is always challenging for ports, especially in the case of markets like Alaska where there are few options for getting goods to market. Most consumer goods arrive in Alaska via scheduled carrier services on container vessels from the contiguous United States. The POA handles most maritime traffic, excluding Southeast Alaska maritime traffic which is served directly from the contiguous United States. There is also direct barge transport service close to Anchorage and to some other Alaskan ports; however, given the infrequent calls and slow speed for barge traffic, it is generally limited to bulkier, less time-sensitive goods. Non-maritime freight options are generally impractical for nearly all goods because road transport via the route through Canada is generally cost-prohibitive for most goods. Air transport is only practical for the relatively small amount of more valuable (per ton) and time-sensitive items.

This rate study focuses solely on Phase II of the PAMP, which involves rebuilding and modernizing infrastructure to current port standards for terminals used by the scheduled container carriers Matson and TOTE, and the accompanying rate surcharges the POA will charge them for said modernization. These carriers jointly handle approximately 465,000 twenty-foot equivalent units (TEUs) annually (2020) and more than 1.6 million tons of cargo.[1] In any given year, their percent share of volume at the POA is similar. These carriers jointly provide approximately 63 percent of the POA's revenues. Alaska Marine Lines, which does not operate at the POA, is the principal barge operator in Alaska and a competitor of Matson and TOTE, primarily for bulkier, less time-sensitive goods.

While the final plans for PAMP construction is not yet complete, a Plan of Finance for the Phase II terminals has been developed. Terminal 1 will consist of a modern 'Lift On Lift Off' (LOLO) crane-

[1] Per the Container TEU Tonnage Revenue spreadsheet provided to HDR by POA.

operated facility, which is forecasted to cost approximately $672 million.[2] Matson will be the primary Terminal 1 user, although this general-purpose cargo terminal will also support large, non-containerized cargo and military surface deployment operations as required. Terminal 2 will consist of a modern 'Roll On Roll Off' (RORO) truck-operated facility, which is forecasted to cost approximately $275 million.[3] TOTE will be the primary user of Terminal 2. Per the Plan of Finance, both proposed terminal improvements would be financed through upcoming debt (revenue bonds). While Matson and TOTE are the primary users, these are POA's terminals; neither Matson nor TOTE are terminal operators. These are general cargo terminals serving all Alaskans.

The current finance plan involves Matson and TOTE paying for Terminals 1 and 2 improvements through fees, respectively. This payment would be via a cargo surcharge assessed on the amount of cargo handled by each carrier at each Terminal. Therefore, the primary purpose of this rate study report is to examine the impacts from this proposed surcharge to the carriers and to consumers, as well as to POA's ability to service the debt required to fund these investments.

The average projected surcharge per ton on Matson and TOTE to cover debt service, based upon 2020 cargo activity, would equal $29.04 per ton.[4] Current rates per ton (wharfage, dockage, and security) are slightly more than $3 per ton for both carriers.[5] This proposed rate represents more than an eightfold increase based on total costs (more than thirteenfold based on only wharfage fees). With such large increases, it is anticipated that the carriers would attempt to pass on any surcharge to shippers. The market for container services is expected to be price-inelastic (i.e., demand does not respond sharply to changes in shipping rates) due to lack of viable shipping alternatives. Given that containerized cargo is primarily consumer goods (e.g., daily household goods) that cannot readily be sourced from anywhere else, it's probable the final consumer will likely pay the extra cost. Given the average value of products in a container and the costs charged by the carriers to move the container, the increased rates will not greatly affect final retail prices. The proposed large surcharge increase could result in the carriers losing some business to barge service. To the extent this occurs, surcharge revenue needed to service the POA's debt would be reduced accordingly. This study examines these effects in detail in the rate setting analysis.

The planned financing approach is not to have a uniform surcharge but rather a "cost causer cost payer" approach in which both Matson and TOTE pay for Terminals 1 and 2 improvements, respectively. Due to the more costly estimate to improve Terminal 1 ($672 million) versus Terminal 2 ($275 million), this would result in a disparate surcharge for Matson being approximately $39 per ton and for TOTE being approximately $17 per ton.[6] A disparate surcharge could produce several unintended consequences. Primarily, it could result in Matson raising their cargo rates higher, thus losing business to TOTE. In this scenario, since the surcharge assessed to TOTE would be less, the POA's surcharge revenues overall would decrease whenever Matson loses business to TOTE. The lost revenue from Matson would create issues with the Municipality of Anchorage's (MOA) ability to service the debt (i.e., every ton lost by Matson and gained by TOTE reduces revenues to the POA because of the disparate surcharges). This study examines these effects in detail in the rate setting analysis.

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[2] As reported in the *Port of Alaska Modernization Program Comprehensive Plan of Finance*, dated July 6, 2021.

[3] *Ibid.*

[4] *Ibid.*

[5] As reported in the *Port of Alaska Modernization Program Financial Advisory Services Final Report* (Capstan Report), dated November 8, 2018. Note that these rates are low compared to inferred rates at large, west coast ports serving ocean carriers. However, these ports require different cost structures for handling large, ocean-going vessels from the major alliance carriers. This skews costs; therefore, the comparison needs to be viewed with that perspective.

[6] As reported in the *Port of Alaska Modernization Program Comprehensive Plan of Finance*, dated July 6, 2021.

In addition to the costs of moving a container, schedule frequency and reliability as well as shipping time matter as much, if not more.[7] Consequently, shippers who are satisfied with their current service may be hesitant to accept smaller changes in price. However, the extent of what is considered a small change depends on the shipper. This study examines these relationships.

This rate study report includes:

- An overview of client interviews and the documents reviewed to support the analysis.
- A review of current rate methodologies and structures as well as an alternate approach to establishing a rate surcharge that could alleviate the potential unintended consequences.

Attachment A provides the client interview templates, and Attachment B provides the surcharge analysis tool. Attachment C provides a review of current POA infrastructure and carrier operations.

Client Interviews and Document Review

1.1 Interviews

Between June 16th and 25th, 2021, HDR conducted interviews with shippers and carriers that use the POA. These interviews were conducted to ascertain general shipper reactions to overall upcoming price increases and how these interviewees would react to a disparate user surcharge. HDR also conducted these interviews to gauge the carriers' reactions about the proposed "cost causer cost payer" user surcharge structure. Attachment A provides the interview templates for the carriers and shippers. The responses are confidential and as such are not included in the report.

Interview participants were:

- Liner Carriers: TOTE and Matson
- Barge Carriers: Alaska Marine Lines
- Shippers: Costco (Store #10 and #63), Sysco, Albertsons, Carlile Transportation, and Continental Auto Group

HDR also interviewed the members of the MOA Finance Department—Travis Frisk, Chief Fiscal Officer (CFO), and Ross Risvold, Public Finance and Investments Division Manager—on July 14, 2021.

General points raised during the interviews included:

- TOTE is opposed to a uniform surcharge but does not have any issues with the proposed disparate surcharge.
- Matson anticipates that a disparate surcharge, where they pay the higher amount, will give TOTE an advantage and result in Matson losing business.
- Matson perceives that the proposed improvements are for public terminals at a public port with open access. They believe all cargo carriers should pay the same surcharge rate.
- Alaska Marine Lines plans on increasing rates in response to a surcharge on Matson and TOTE, which would maintain the same percentage price difference between them and Matson and TOTE. Their goal is to increase revenue and not necessarily market share.

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[7] Anderson, C., Grigalunas, T., and Opaluch, J. The Demand for Import Services at US Container Ports, *Maritime Economics & Logistics*, 2009 11(2).

- Shippers expect carriers to pass on the surcharge to shippers.
- Shippers will try to pass on the costs to consumers.
- If the surcharge is large enough, shippers will reallocate shipping options. They may use barges more often for less time-sensitive goods and increase the use of over-the-road truck transport (currently a minor use).
- Given a disparate surcharge, shippers primarily using TOTE do not expect to make any changes.
- Given a disparate surcharge, shippers using both TOTE and Matson will shift more business to TOTE if the surcharge on Matson is higher.
- Given a disparate surcharge, shippers primarily or exclusively using Matson may switch relatively less business to TOTE given long-term relationships, quality partnering, and relationships in other markets (e.g., Hawaii). However, they would likely move some business to TOTE if the surcharge on Matson is higher, even more so if the surcharge increase is significant.
- Shippers revisit contracts annually or biennially, so changing carriers is not difficult.

1.2 Document Review

HDR reviewed materials provided by POA, as well as other materials readily available on POA's website (https://www.portofalaska.com/), including:

- *Port of Alaska Modernization Program Financial Advisory Services Final Report* (Capstan Report), November 8, 2018
- POA Tariff Service Review presentation, December 6, 2019
- POA industrial park lease schedule, 2021
- Port of Alaska Replacement Cargo Terminals & Second Fuels Infrastructure Essential Features
- POA Petroleum and Cargo Surcharge presentation, April 2021
- POA Financial Statements, 2007 thorough 2020
- Container tonnage information (spreadsheet from the POA with TEU/tonnage counts, tonnage surcharge forecast, and TEU surcharge forecast)
- *Port of Alaska Modernization Program Comprehensive Plan of Finance*, October 7, 2020, and July 6, 2021
- POA 2022 Bond (PDF and Excel)
- *Port of Alaska Replacement Cargo Terminals & Second Fuel Infrastructure Essential Features*, March 22, 2021
- POA Tonnage Reports, 2011 through 2020
- POA Terminal Tariff No. 9, effective date January 1, 2020
- POA Factsheet
- *Port of Alaska Logistical and Economic Advantages Report*, October 2020

1.3 Rate Methodologies and Rate Structures

This section assesses the *Port of Alaska Modernization Program Comprehensive Plan of Finance*, dated July 6, 2021. Specifically, it assesses the financial plan for the Phase II cargo terminals. The objective of this assessment is to determine whether the current rate structure for recovering the cost of the Phase II cargo terminals:

- Is equitable, does not give a financial advantage to one POA user over another, and/or fairly distributes debt service coverage to all users who will benefit from the new infrastructure; and
- Does not have any negative unintended consequences for the future financial viability of the POA itself.

This assessment examines these issues from a risk perspective and includes a conduct scenario, or what-if analysis, to highlight/illustrate potential implications for the consumer, shippers, the terminal operators/carriers, and the POA.

1.3.1 Plan of Finance for the Phase II – Cargo Terminals

Table 1 provides a high-level overview of the *Port of Alaska Modernization Program Comprehensive Plan of Finance* for Phase II – Cargo Terminals (supporting details can be found in the July 6, 2021, document).

Table 1. Summary of Plan of Finance for Phase II – Cargo Terminals

Category	Terminal 1	Terminal 2	Total
Infrastructure Owner	POA	POA	–
Terminal Operator/Leaseholder	Matson	TOTE	–
Cost of New Infrastructure ($M)	$672.0	$275.3	$947.3
Non-debt Funds to Pay for New Infrastructure ($M)	$142.9	$85.8	$228.7
Debt Funds to Pay for New Infrastructure ($M)	$529.1	$189.5	$718.6

To recover the costs of the new infrastructure, the Plan of Finance has employed a “cost causer cost payer” approach in which the debt service related to the costs for new infrastructure at each terminal would be recovered by a surcharge per ton at each terminal. The rationale for this approach is cited as incentivizing low construction costs at each terminal:

> *The Municipality is actively engaged with the two current users, who have very different infrastructure requirements, in planning the construction of two separate and distinct terminals, and it seems logical to charge the respective initial users the respective amount for the cost of financing the respective terminal. We believe this “cost causer cost payer” approach gives each current user the incentive to keep the cost of construction as low as possible.*[8]

The resulting proposed surcharges from the Plan of Finance are many times greater than the POA’s current average effective tariff per ton (wharfage fee only) and are significantly different for cargo moved at each terminal (see Figure 1).

[8] Memorandum dated July 6, 2021, to Travis Frisk, CFO, from Ross Risvold, Public Finance and Investments Division Manager, regarding *Port of Alaska Modernization Program Comprehensive Plan of Finance*, page 5 of 10.

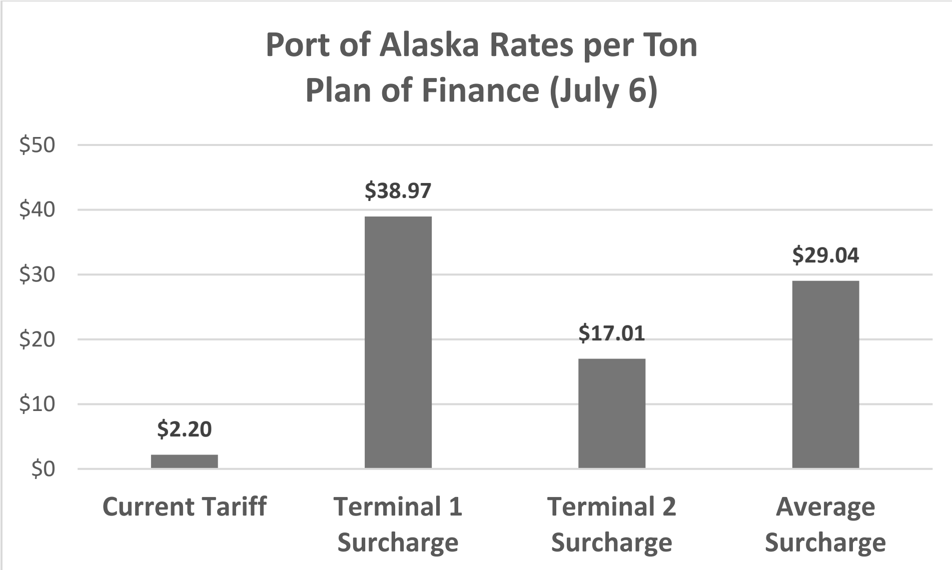

Figure 1. Summary of Port of Alaska Rates per Ton
Source: Comprehensive Plan of Finance, July 6, 2021

The situation proposed in the Plan of Finance is quite unique even among other similar Jones Act Ports. The proposed surcharge for cargo moved at Terminal 1 (Matson) is more than twice as high as the proposed surcharge for cargo moved at Terminal 2 (TOTE). The average surcharge is more than 13 times higher than the existing tariff (wharfage fees only). Such dramatic increases in a port's tariff-related charges are uncommon.

1.3.2 Potential Behavioral Responses to a Port's Price Changes – Cargo Terminals

When a carrier, shipper, or consumer faces price changes for a good or service they demand, they may choose to alter their behavior to mitigate the impact of that price change. Given the materiality of the significant price increases associated with the planned new surcharges at the POA, it is anticipated that there will be a behavioral response. In addition, the differential nature of the surcharges on cargo—depending upon what terminal the cargo is shipped through—likely will have additional behavioral implications. The potential impacts identified and discussed in this study are derived from two primary sources:

- Basic economic theory concerning price increases and substitution to other service providers; and
- Interviews with carriers and shippers.

In general, it is anticipated that all businesses in the supply chain will attempt to pass on any price increases to their respective customers:

- The POA, through surcharges, will pass on most of the cost of the PAMP to the carriers Matson and TOTE. The full Phase II PAMP development costs are expected to be partially subsidized and reduced through other sources such as state and federal grants.
- The cargo carriers will attempt to pass on these surcharges to their customers (i.e., shippers). Carriers may temporarily absorb some of these surcharges themselves if they believe doing so will weaken their competitive position.

  Given the material difference in proposed surcharges for the two carriers, it is more likely that the low surcharge carrier may be able to pass on the full amount of the surcharge to most of their existing customers[9]. Given the competitive advantage of the low surcharge, the higher surcharge carrier may be less able to pass on the full amount of the surcharge in efforts to retain cargo volume from existing customers.

- Assuming cargo carriers attempt to pass on the surcharges, shippers will face a material change/price shock in:
  - The price for cargo shipped through the POA; and
  - The relative price differential between the two carriers operating at the POA.

  Faced with a price increase for shipping, some shippers may decide to ship via an alternate means to reduce costs, such as:
  - By barge (Alaska Marine Lines) to other close non-POA terminals for bulky, not time-sensitive goods; and,
  - By road or air for more time-sensitive goods.

  For the cargo shipped through the POA, shippers currently shipping with Matson may consider mitigating the price increases by shipping with the carrier (TOTE) with the lower surcharge (lower by $21.96 per ton), if feasible.

  In the end, no matter how they attempt to mitigate any price increases, shippers will attempt to pass on any additional transportation costs to their end customers (i.e., consumers).
- The consumer, facing higher prices for goods, may decide to reduce their consumption or purchase lower value goods.

It is anticipated that the material increases in the overall rates charged by the POA will have an impact:

- It will make other modes of transportation (i.e., barge, air, road) more competitive. It is probable that some amount of cargo will shift away from the POA due to the overall price increase. Through the interview process, shippers indicated a willingness to explore alternative transportation options if faced with a significant price shock. Any switch to an alternative (e.g., barge, air, road) will decrease cargo handled at the POA, and will result in a direct revenue loss to the POA from the existing tariffs and proposed surcharges.
- To the extent rates end up being passed on to the end consumer, the potential exists for consumer demand to be dampened. Any decrease in consumer demand would result in less cargo being shipped through the POA and commensurate revenue losses. It is not anticipated that this impact will pose a material financial risk to the POA since based on economics and interviews with shippers the demand is price inelastic (see Background).

The significant difference in the surcharges outlined in the Plan of Finance likely will result in shippers that currently use the high surcharge carrier to shift to the low surcharge carrier. Whether this shift in cargo will occur and to what degree is unknowable. However, through the interview process, shippers did indicate the willingness and ability to shift cargo carriers if the price differential was material. Some shift in cargo is expected.

Regarding the potential financial risk to the POA, the Plan of Finance, including the specific surcharge levels required to service the debt, is based on 2020 tonnage levels at each respective terminal. Any shift in tonnage from the high surcharge terminal to the low surcharge terminal would result in a surcharge revenue loss to the POA of $21.96 per ton. The lower revenues would result in a lower debt

[9] Theoretically, it is possible that a profit maximization strategy for the low surcharge carrier would be to increase their rates by the surcharge they are faced with plus some portion of the rate differential with the high surcharge carrier. This is highly dependent on the degree to which other competitive shipping alternatives exist.

service coverage than the required 1.35 times coverage outlined in the Plan of Finance. While it is unknown how much cargo could shift from Terminal 1 (Matson) to Terminal 2 (TOTE) through scenario or what-if analysis, impacts on POA finances can be assessed. Table 2 provides the impact of potential shifts from the high surcharge carrier to the low surcharge carrier. Every 5 percent shift in cargo would result in an annual $1 million revenue surcharge loss.

Table 2. Impact of a Shift in Cargo Tonnage from the High Surcharge to Low Surcharge Carrier (assumes no capacity constraints)

Percent shift from High Surcharge Carrier to Low Surcharge Carrier	Change in Surcharge Revenues ($M)	Percent Change in POA Surcharge Revenues	Implied Debt Service Coverage Ratio from Surcharges
0%	$0.0	0%	1.35
5%	-$1.0	-2.1%	1.32
10%	-$2.0	-4.1%	1.29
15%	-$3.0	-6.2%	1.27

If a shift of cargo did occur and a revenue loss was experienced, the POA would have to reset the surcharges to ensure 1.35 times coverage to offset any revenue shortfall and cover debt service. Based on the rate setting approach in the Plan of Finance, the surcharge at Terminal 1 would be increased further, the surcharge at Terminal 2 would be reduced, and the surcharge differential between the two terminals would increase, exacerbating the situation and increasing the financial risk to the POA.

The results highlighted above only reflects potential shifts in cargo from the high surcharge carrier to the low surcharge carrier. We have also developed a Surcharge Analysis Tool that can be useful in exploring the impact of other potential effects such as a shift in cargo away from POA to other modes, a decrease in overall consumer demand and combinations of these various factors. We have documented some other scenarios in Attachment B and have provided as a Deliverable the Surcharge Analysis Tool in MS Excel format that allows the POA to input a variety of scenarios to assess the impact on revenues and debt service of various behavioral responses.

1.3.3 Plan of Finance Review Conclusion

Implementation of the surcharges outlined in the Plan of Finance is expected to result in a shift of cargo from Terminal 1 (high surcharge) to Terminal 2 (low surcharge), which could result in a financial risk to the POA. If this risk does materialize, the surcharge-related revenues for the POA may be insufficient to achieve the required level of debt service coverage to cover the PAMP Phase II costs.

The core analysis and conclusions related to the rate plan are not impacted by:

- The capital cost of the Phase II cargo terminals development assuming their relative costs remain consistent.
- The level of project funds from other sources (e.g., general tariff increases, additional grants); or
- The amount of funds from debt versus operating revenues to finance the phase II cargo terminals.

Any reduction in capital costs and/or any increase in other funding for the Phase II Cargo terminals will lower the magnitude of the per ton surcharge regardless of the approach to establishing the surcharges.[10] However, these types of impacts do not influence the assessment of whether a particular rate plan gives a financial advantage to one port user over another which is the prime focus of this analysis. Matson still loses business to TOTE and consequently surcharge revenues would continue to be below projections.

Another rate structure/method approach was reviewed in which the payback period for Matson is stretched out beyond that of TOTE (e.g., 10 more years). This approach would yield similar negative financial risk results to the POA. The difference between the proposed surcharges is so great that adding a few years to Matson's payback period would not materially lower the surcharge to them in the years where both Matson and TOTE are paying the surcharge. Consequently, the course of the effects remains and the adverse impact to POA surcharge revenues would not be much different. Additionally, if the surcharge model allows one terminal to pay off their debt (i.e., when TOTE is no longer paying a surcharge), Matson will be at a greater competitive disadvantage and will not be meeting the surcharge revenues projected by the MOA.

1.4 Alternate Approach to Establishing Surcharges for Phase II – Cargo Terminals

To mitigate the potential financial risk related to the Plan of Finance for Phase II – Cargo Terminals (discussed in Section 1.3), an alternate approach to cost recovery should be considered:

- Establish a single uniform surcharge per ton rate to recover the costs of all "essential" PAMP investments to deal with continued deteriorated berths and ensure POA resiliency with respect to seismic events and harsh winter conditions. This method is typically how ports recover infrastructure investment costs. This surcharge would be applied equally to all cargo moved at Terminals 1 and 2, regardless of carrier (noting that Matson and TOTE are not necessarily guaranteed to be the only carriers at POA in the future).
- Any improvements to Terminals 1 and 2 that relate to specific customizations (e.g., mobile, portable infrastructure such as cranes or ramps) as prescribed by the current leaseholders (and agreed to by the POA) can be the responsibility of the user. The POA and the leaseholder(s) could negotiate terms and conditions where the leaseholder would fund these improvements on their own. Or alternatively, financed through the Port with an agreed upon cost of capital plus all related procurement and installation costs recovered through the lease.

Such an approach could mitigate/moderate the financial risk to the POA associated with material differentials in the surcharges between its two carriers.

Conclusions

HDR reviewed the proposed rate surcharge structure in the Plan of Finance for funding Phase II of the PAMP. The proposed rate structure imposes a differential surcharge on Matson and TOTE, with the former paying a substantially higher share per ton of cargo moved. This rate structure is expected to have several unintended negative consequences. It will shift market share to TOTE and in doing so will not only have an adverse effect on POA revenues (TOTE pays less per cargo moved) but also in

[10] For example, adding a common area fee to all the tenants within the boundary of the POA district (e.g., gate fees for trucks, petroleum terminal users, etc.) would lower the total surcharge required from Matson and TOTE. Similarly, operational efficiencies (e.g., shared facilities or optimizing schedules) may provide the opportunity for reduced capital costs thus lowering the total surcharge required from these carriers. Note, this is from an economic and operational perspective as to possible ways to increase revenues or lower capital costs and is not based on an engineering review.

maintaining its debt service coverage ratio required for servicing the debt. If the POA then imposes additional surcharges on Matson to make up this shortfall, this can subsequently lead to unstable financial consequences where Matson loses more market share to TOTE and the POA loses additional surcharge revenue with every subsequent rate increase.

A uniform surcharge on cargo moved would eliminate these unintended adverse consequences. However, this will need to be balanced carefully against policy and political considerations that are outside of the scope of this report.

That being said, the logical justification for a disparate surcharge is not strong. These are POA’s terminals; neither Matson nor TOTE are terminal operators. These are general cargo terminals serving all Alaskans and it is the Alaskan consumer who will end up paying for this infrastructure as the carriers will pass on the surcharge to them. Thus, this is not really an issue of paying for someone else’s infrastructure. The consumers will bear the burden of doing so.

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Attachment A

Interview Templates

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Interview Template for Carriers (Matson and TOTE)

1. What are your operational schedules? Transit time to mainland, port time, inland transit time, time at dock?

2. What are the primary limitations at the docks in Anchorage and in the mainland ports?

3. Please discuss the types of containerized and wheeled cargo you handle (both inbound and outbound).

4. What are your connecting ports and where is the international cargo cleared?

5. Do you expect volumes to grow, remain the same, or decrease?

6. Is there anything unique about your services, or is this a purely commodity business where you compete with (Matson/TOTE) for the same container and cargo business?

7. Other than (Matson/TOTE), do you have other competitors that serve the market? Do you view Alaska Marine Lines as a current or potential competitor?

8. Does any other carrier make use of the Port of Alaska (POA) facilities at your terminal?

9. Recognizing the condition of the current infrastructure, what are you plans if the POA docks are no longer in a condition where they can be used regularly?

10. What are your biggest concerns regarding your use of the POA?

11. As you are aware, the POA is considering a surcharge on cargo to service debt on the Port of Alaska Modernization Program. We'd like to ask you a few questions concerning how this will affect your business.

    a. Overall, what are your thoughts on a proposed surcharge, and how does it affect your current business and investments plans for operating at the POA?

    b. Do you have any concerns with respect to the magnitude of the surcharge?

    c. How will you factor the surcharge into your operations? Do you intend to pass on these costs to the shippers that contract with you?

    d. How do you think your customers will react to the change in pricing?

    e. How do you think this will affect your competitive position versus (Matson/TOTE)?

    f. Do you see any other alternatives for structuring the surcharge(s)?

Interview Template for Shippers

1. Please discuss the types of containerized cargo you import and export.

2. Do you use Matson, TOTE, or both? Or do use someone else?

3. Is there anything specialized about your cargo that led you to choose (Mason/TOTE), or was your decision based on price or prior business relationships?

4. Would you be willing to share your origin and destination pathway and the approximate O/D cost to you? (Information will remain confidential).

5. As you are aware, the Port of Alaska (POA) is considering a surcharge on cargo handled by Matson and TOTE to service debt on the Port of Alaska Modernization Program. We'd like to ask you a few questions concerning how this will affect your business.

    a. How much volume do you ship annually?

    b. How significant are transportation costs now in relation to your cost of goods sold?

    c. How much does relative pricing currently affect your choice of carrier?

    d. How sensitive are you to changes in transportation costs?

    e. In relation to the new surcharge(s), do you expect the costs to get passed on to you? If so, will that affect the amount of cargo you ship? If so,

        i. Could that impact your choice of carrier?

        ii. Will that affect the amount of cargo you receive/ship?

    f. Hypothetically, if one carrier increased their rates more than the other following the surcharge, how likely would you be to switch carriers based on this price increase?

    g. How large of an increase would it take to switch carriers?

    h. Hypothetically, let's assume that you chose the least costly carrier (noted above) as your prime carrier choice. Let's also assume that other shippers react the same way, and that this leads to a lack of available slots on their service from Tacoma, which results in the inability for you to timely ship all your cargo with that carrier.

        i. Would you use the higher cost carrier for the remainder of your shipping needs?

        ii. Would you opt for delays in your supply chain rather than use the higher cost carrier?

        iii. Would you reach out to another provider not paying the surcharge?

        iv. Would you reduce the amount of cargo you shipped?

Is there anything else you'd like to add?

Interview Template for Alaska Marine Lines

1. You currently offer twice weekly service from Seattle to Anchorage but do not use the Port of Alaska (POA).

    a. How do your landside connections for shippers compare to the POA?

    b. How many twenty-foot equivalent units (TEUs) can your barge service handle?

2. Where is most of your cargo coming from? Going to?

    a. Do you view Matson and TOTE as competing for the same business?

    b. What has been your volume trends?

    c. Are you anticipating expanding service?

3. As you are aware, the POA is considering a surcharge on cargo handled by Matson and TOTE to service debt on the Port of Alaska Modernization Program. We'd like to ask you a few questions concerning how this will affect your business:

    a. Do you think some shippers would use your services instead of Matson or TOTE?

    b. Do you plan on adding barge service frequency or using larger barges in the future?

4. If either Matson or TOTE reduced current service levels, would you add extra capacity to try to win business?

5. Do you think that this is a business opportunity for you?

6. Is there anything else you would like to add?

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Attachment B

Surcharge Analysis Tool

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The Surcharge Analysis Tool is a scenario analysis tool to explore the potential impact on the Port of Alaska (POA) as a result of surcharges to be implemented at Terminals 1 and 2 to recover the costs of the Port of Alaska Modernization Program related to Phase II – Cargo Terminals. This tool presents both the change in revenue and debt service coverage ratio under user-defined scenario inputs relative to a baseline that reflects the *Port of Alaska Modernization Program Comprehensive Plan of Finance*, dated July 6, 2021, for Phase II – Cargo Terminals. Additionally, this tool reports the results for cargo activities at each terminal: Terminal 1 (Matson) and Terminal 2 (TOTE).

Limitations:

- The Surcharge Analysis Tool is a “what-if” tool that reports potential impacts of implementing surcharges on cargo at the Cargo Terminals based on user-defined inputs. The actual impact of implementing the surcharge is unknowable and will ultimately be determined by the behavior of the consumers of goods, suppliers, the carriers operating at the Cargo Terminals, and other carriers competing for the same cargo.
- The impacts measured with the Surcharge Analysis Tool are “first order” effects and do not consider future potential surcharge modifications should the POA face a shortfall in the total surcharge revenues that are necessary to achieve a debt service coverage ratio of 1.35.

The Surcharge Analysis Tool allows the user to assess potential changes to POA surcharge revenues and debt service coverage (for Phase II – Cargo Terminals) from three market outcomes post surcharge implementation. In particular, the user can input specific assumptions related to the following potential impacts:

- The percent of cargo volume that could shift from Terminal 1 to Terminal 2 due to the lower surcharge (note, the user can also select no shift);
- The percent of cargo volume that shifts away from the POA Cargo Terminals 1 and 2 due to the increase in POA’s rates to competitive alternatives (e.g., barge, road, air); and
- A decrease in the demand for goods in the Alaska economy due to the higher transportation costs (from the surcharges) that are passed on to consumers and businesses.

For illustration purposes, three what-if scenarios are provided:

- Scenario 1: 15 percent of Terminal 1 cargo shifts to Terminal 2 due to the surcharge differential (see Figure B-1).
- Scenario 2: 10 percent of Terminal 1 cargo shifts to Terminal 2 due to the surcharge differential; 5 percent of Terminals 1 and 2 cargo shift from the POA to competitive alternatives; and total Alaska consumer and business consumption is reduced by 2 percent (see Figure B-2).
- Scenario 3: No cargo shifts from Terminal 1 to Terminal 2 due to the surcharge differential; 10 percent of Terminals 1 and 2 cargo shift from the POA to competitive alternatives; and total Alaska consumer and business consumption is reduced by 4 percent (see Figure B-3).

Limitations:

- These scenario inputs are not a forecast of what is expected to occur. Rather, these inputs are designed to illustrate the potential impact on POA surcharge revenues and debt service coverage ratio under different assumptions.

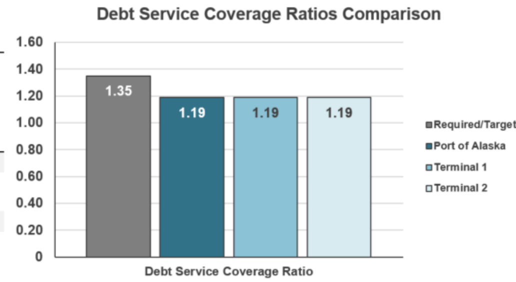
Surcharge Analysis Tool

Review Scenario Inputs

Financial Results

Port of Alaska	Base Results	Scenario Results	Change in Results	% Change in Results
Revenue from Cargo Surcharges ($M)	$47.7 M	$42.0 M	-$5.7 M	-12.0%
Debt Service Coverage Ratio	1.35	1.19	-0.16	

Change in Results by Terminal	Base Results	Scenario Results	Change in Results	% Change in Results
Terminal 1				
Revenue from Cargo Surcharges ($M)	$35.1 M	$30.9 M	-$4.2 M	-12.0%
Debt Service Coverage Ratio	1.35	1.19	-0.16	
Terminal 2				
Revenue from Cargo Surcharges ($M)	$12.6 M	$11.1 M	-$1.5 M	-12.0%
Debt Service Coverage Ratio	1.35	1.19	-0.16	



Fixed Scenarios

Scenarios	Definition	Switch	Impact: Volume Reduction – Terminal 1	Terminal 2	Total
1	The percent of cargo volume that could shift from Terminal 1 to Terminal 2 due to a lower surcharge rate (the user can also select no shift)	on	-		
2	The percent of cargo volume that shifts from the Port of Alaska Cargo Terminals 1 & 2 due to the increase in Port of Alaska rates to competitive alternatives (e.g., barge, over the road, air cargo)	on	-10.0%	-10.0%	
3	A decrease in the demand for goods in the Alaska economy due to the higher transportation costs (from the surcharges) that are passed on to consumer and business consumption	on			-4.0%

Figure B-1. Scenario 1 Results

Note: Debt service coverage ratios are presented by terminal to illustrate potential shortfalls or excesses at individual terminals in relation to the terminal's ability to generate revenues sufficient to cover the costs of "Funds from Debt to Pay for New Infrastructure" at each terminal. A specific debt offering for each terminal is not included.

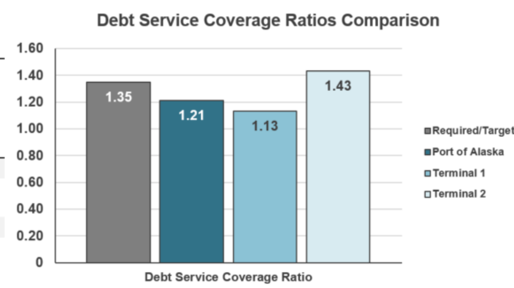
Surcharge Analysis Tool

Review Scenario Inputs

Financial Results

Port of Alaska	Base Results	Scenario Results	Change in Results	% Change in Results
Revenue from Cargo Surcharges ($M)	$47.7 M	$42.9 M	-$4.8 M	-10.1%
Debt Service Coverage Ratio	1.35	1.21	-0.14	

Change in Results by Terminal	Base Results	Scenario Results	Change in Results	% Change in Results
Terminal 1				
Revenue from Cargo Surcharges ($M)	$35.1 M	$29.5 M	-$5.6 M	-16.0%
Debt Service Coverage Ratio	1.35	1.13	-0.22	
Terminal 2				
Revenue from Cargo Surcharges ($M)	$12.6 M	$13.4 M	$0.8 M	+6.2%
Debt Service Coverage Ratio	1.35	1.43	+0.08	



Fixed Scenarios

Scenarios	Definition	Switch	Impact: Volume Reduction – Terminal 1	Terminal 2	Total
1	The percent of cargo volume that could shift from Terminal 1 to Terminal 2 due to a lower surcharge rate (the user can also select no shift)	on	-10.0%		
2	The percent of cargo volume that shifts from the Port of Alaska Cargo Terminals 1 & 2 due to the increase in Port of Alaska rates to competitive alternatives (e.g., barge, over the road, air cargo)	on	-5.0%	-5.0%	
3	A decrease in the demand for goods in the Alaska economy due to the higher transportation costs (from the surcharges) that are passed on to consumer and business consumption	on			-2.0%

Figure B-2. Scenario 2 Results

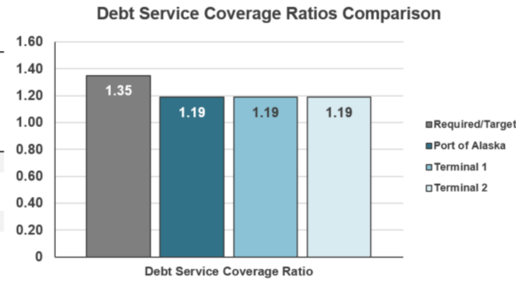
Surcharge Analysis Tool

Review Scenario Inputs

Financial Results

Port of Alaska	Base Results	Scenario Results	Change in Results	% Change in Results
Revenue from Cargo Surcharges ($M)	$47.7 M	$42.0 M	-$5.7 M	-12.0%
Debt Service Coverage Ratio	1.35	1.19	-0.16	

Change in Results by Terminal	Base Results	Scenario Results	Change in Results	% Change in Results
Terminal 1				
Revenue from Cargo Surcharges ($M)	$35.1 M	$30.9 M	-$4.2 M	-12.0%
Debt Service Coverage Ratio	1.35	1.19	-0.16	
Terminal 2				
Revenue from Cargo Surcharges ($M)	$12.6 M	$11.1 M	-$1.5 M	-12.0%
Debt Service Coverage Ratio	1.35	1.19	-0.16	



Fixed Scenarios

Scenarios	Definition	Switch	Impact: Volume Reduction – Terminal 1	Impact: Volume Reduction – Terminal 2	Impact: Volume Reduction – Total
1	The percent of cargo volume that could shift from Terminal 1 to Terminal 2 due to a lower surcharge rate (the user can also select no shift)	on	-		
2	The percent of cargo volume that shifts from the Port of Alaska Cargo Terminals 1 & 2 due to the increase in Port of Alaska rates to competitive alternatives (e.g., barge, over the road, air cargo)	on	-10.0%	-10.0%	
3	A decrease in the demand for goods in the Alaska economy due to the higher transportation costs (from the surcharges) that are passed on to consumer and business consumption	on			-4.0%

Figure B-3. Scenario 3 Results

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Attachment C

Review of Current Port Infrastructure and Operations

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Assessment of Proposed Improvements

Through various engineering studies, the Port of Alaska (POA) has estimated that slightly more than $1 billion will be required to replace the existing dock structures to meet ongoing cargo handling requirements under Phase II of the Port of Alaska Modernization Program (PAMP). POA's facilities are subdivided into various terminals designated for handling different carriers and cargoes. This phasing includes demolition of existing dock structures in the near term, and new dock construction as well as dredging and demolition of remaining structures in the long term.

The plan, as presented, maintains continuity of operations in the current terminals until a new pier structure can be built in the place of Terminal 1. This includes the demolition of the existing pier, wharf, and buildings; shifting the administrative offices to a new location; reorienting the yard areas for cargo handling after the construction is complete; and then shifting the container operation to the new pier, apron, and wharf structure. This new structure would include the installation of new container cranes to handle ocean carrier requirements.

Subsequently, there would be the construction of ramps for vehicle operations, then the transfer of carrier operations from the current Terminal 2 (built in 1968, after the 1964 Earthquake) to the newly rebuilt Terminal 2, and then the demolition of the current Terminal 2. No dock is proposed, instead ramps on support structures connecting to vessels are proposed. Terminal 3 (built in 1973) is the newest dock, but it still requires extensive repair or replacement. Demolition of Terminal 3 is considered for the future but is not in the current plan. Reinforcement of Terminal 3 infrastructure may be an alternative in the future, which will provide the POA with alternative berthing since Terminal 2 will not have a cargo pier.

Container Operations

Matson uses U.S. flagged, built, and crewed vessels in one of the nation's most significant Jones Act trade, connecting the POA to Washington State ports (Seattle/Tacoma). Their current vessels, providing twice weekly service to POA's Terminal 2 (Anchorage) and Kodiak, as well as once weekly service to Dutch Harbor, include the *CV Matson Anchorage* (Figure C-1), *CV Matson Kodiak*, and *CV Matson Tacoma*. These vessels are 710 feet in length and carry 1,668 twenty-foot equivalent units (TEU) of containers, equivalent to 834 40-foot trailers. They handle various size units below and on deck. They also have a 2,500 TEU ship that can be used for service. These vessels are considered small in the worldwide classification of shipping.[11]

[11] Lloyd's Vessel Classification and IAMPE Ship Classification Data

Figure C-1. *CV Matson Anchorage*
Source: Matson

These vessels operate at an average draft of approximately 30 feet. The vessels breath (width) is slightly less than 78 feet across. The containers are stacked nine across and, on average, five high above the main deck.

Roll On Roll Off Operations

TOTE is the primary Roll On Roll Off (RORO) operator at the POA. Calling on Terminal 3, the company uses their Orca-class vessels for Alaskan service (Figure C-3), connecting to Tacoma, Washington. The vessels make two calls per week and are in port for approximately 10 hours. Their vessels handle approximately 1,000 to 1,400 moves per call, or approximately 100 moves per hour, of loads and empties trailer units. Approximately 98 percent of their Alaska cargo is handled in the POA.

The length of the Orca-class vessels is 839 feet, with a beam of 118 feet. Their maximum draft is 29.5 feet, and they have a carriage capacity of 600 40-foot trailers and auto capacity of 200 cars. Also U.S. flagged, crewed, and built, these vessels also are allowed in the Jones Act trade.[12] Most Orca-class vessels carry a mix of trailer sizes, automobiles, and other vehicles on each call.

TOTE, like Matson, uses upland property for handling and storing cargo. In the plan for rebuilding Terminal 2, the required new structures will include TOTE'S ramps connecting to the vessel built-on support structures provided by the POA (see Figure C-3). This would be a custom arrangement for TOTE vessels only. Once completed, their operation would be shifted from Terminal 3 to the new Terminal 2.

[12] The Jones Act is a maritime cabotage law that requires vessels moving cargo (and passengers) between U.S. ports must be handled on vessels that are U.S. Flag (registered in U.S.), U.S. crewed, and built in a U.S. shipyard.

Figure C-2. TOTE Orca-class Vessels
Source: TOTE