**[Service Date March 18, 2011]**

March 18, 2011

**NOTICE OF STAFF RECOMMENDATION FOR FUEL SURCHARGES,**

**OPPORTUNITY TO FILE WRITTEN COMMENTS,**

**AND OPEN MEETING**

**(Set for 9:30 a.m., Thursday, April 14, 2011)**

RE: Fuel Surcharge Inquiry

 Docket T-101661

TO: REGULATED SOLID WASTE COMPANIES

This Notice is provided to advise companies of the Staff’s recommendation to the commission, that companies can file additional written comments, which are due **April 1, 2011**, and that the commission will consider this matter at the April 14, 2011, open meeting.

**SUMMARY**

The commission opened an inquiry in Docket T-101661 to consider whether to adopt, by rule, methods for determining the circumstances under which it will permit solid waste companies to impose a surcharge for fuel costs, and the methods of calculating any such fuel surcharge. The commission held two workshops attended by representatives from four solid waste companies and the Washington Refuse and Recycling Association.

Order 04 in Docket A-042090 clarifies that solid waste companies should continue to be able to file for temporary fuel surcharges under the procedures and requirements currently applicable to those companies for as long as Order 02 remains in effect, now scheduled to expire May 2, 2011.

After considering written comments and the discussions at the two stakeholder meetings, staff recommends the commission:

1. Eliminate the current fuel surcharge methodology for solid waste companies effective May 2, 2011, as scheduled.
2. Allow solid waste companies to implement deferred accounting for fuel expense. Staff proposes a methodology in this notice and further recommends the commission phase in deferred accounting. No company will be required to implement deferred accounting. However, the temporary fuel surcharge methodology will expire with the effective date of each company’s scheduled deferred accounting phase in effective date.
3. Establish deferred accounting for fuel expense by separate order for each company, similar to what the commission has done for recyclable materials commodity credits and revenue sharing.
4. Allow solid waste companies to continue using a revised fuel surcharge methodology, explained in this notice, on a temporary basis, to expire on the staff’s recommended scheduled effective date for the company to implement deferred accounting. No commission order is required to implement this methodology.
5. Any company can file a proposed rate change using any other methodology. Those filings must comply with the commission’s rules and regulations. Staff believes that WAC 480-07-505(1)(d) defines any such filings as a general rate case and those filings must comply with WAC 480-07-520, filing requirements.

**BACKGROUND**

Fuel expense for each company varies as a percent of total revenue for each service provided and as a percent of total company revenue.

**Table 1**

 **Fuel Expense: Percent of Total Revenue and Profit[[1]](#footnote-1)**



Some of that variation results from disparate prices that companies pay for services. Many costs (e.g. disposal fees, taxes, labor, etc.) are higher in western Washington than in eastern Washington. The commission uses the Lurito-Gallagher (LG) methodology to calculate a company’s revenue requirement to set rates. The current LG version is based upon 1988 financial data, and was adopted in 1991. The LG model provides additional profit for increased expenses, but it is less sensitive to increases in expense than to increases in investment. The effects of these changes in the LG model are not intuitive and generally need to be analyzed by changing input data and recording the output for later analysis. In many respects, the LG model is a black box and underscores the need for the commission to review whether the LG model is still appropriate for the purpose of establishing revenue requirement.

Fuel expense is related to the type of fuel used (gasoline, diesel, CNG, electric), units consumed (gallons, cubic feet, watts) and unit price. As companies upgrade fleets with vehicles that use alternate fuels, the relationships become more complex.

**CURRENT METHODOLOGY**

Staff believes the current fuel surcharge methodology is flawed in the following respects.

* It is not a surcharge. A surcharge is intended to address a significant change in a significant cost element, not otherwise offset by other factors, over a short period of time. Some solid waste companies have been filing surcharges on a regular basis. For example, Skamania County Sanitary Service, Inc., filed 55 monthly fuel surcharge supplements over a period of 64 months.
* It allows companies that have not filed a rate case for at least six years to file increased rates based on fuel as a single item. The current method uses a base fuel price from the company’s most recent rate case, or calendar year 2004, whichever is more recent. The 2004 western Index is $1.8734 per gallon and the 2004 eastern Index is $1.9274 per gallon.
* Companies file voluntarily. Companies are not required to file when fuel cost falls below the level that would require the company to provide customers a credit. Companies that filed rate cases using a test period at the height of the 2008 fuel spike argue that there has been inflation and other cost increases that offset the fall in fuel costs. Fuel surcharges are not a means to subsidize or offset cost increases for other expense components.
* There is no updating mechanism. Some companies can rely on fuel surcharges to provide additional revenue instead of filing a rate case.
* The surcharge is applied uniformly to all rates, even though fuel as a percent of total cost varies between different service classes (garbage, recycling, yard waste and drop box) and some rates do not directly consume fuel (e.g. late charges, restart fees, returned check charges, Item 230 Disposal Fees, Container Rent, etc.)

There has been continuing controversy over the last 15 years regarding the solid waste fuel surcharge mechanism regarding:

* Sharing risk between the company and the customer. The current methodology uses a one percent of total revenue threshold or “dead band”. Companies are allowed to recover the amount of fuel increase that exceeds the “dead band”. The “dead band” increases the amount that the price of fuel would need to increase for a company to become eligible to file a fuel surcharge. Companies want to eliminate, or at least decrease, the one percent threshold, which would allow companies to qualify for more frequent, higher fuel surcharges, and earn more revenue and higher profits.
* The method used to calculate a company’s fuel expense relationship. The current methodology calculates a company’s fuel expense relationship by dividing fuel expense by the company’s total revenue. Total revenue includes disposal fees and taxes. Some company’s (primarily operating in western Washington) want to eliminate disposal fees and taxes from this calculation to “normalize” the effect of high-cost disposal fees and taxes in western Washington and low-cost disposal fees and taxes in eastern Washington. Eliminating either disposal fees or taxes from the calculation would lower “adjusted revenue”, thereby increasing the percentage relationship of fuel to the adjusted revenue, and, absent any change in the one percent “dead band”, allow companies to qualify for more frequent, higher fuel surcharges and earn more revenue and profits.
* Filing frequency. The current methodology requires companies to file fuel surcharges that match the company’s billing cycle. The following is a summary of current billing practices:

**Table 2**

**Company Billing Cycle**



Staff believes monthly changes are too frequent and distort the effect of fuel price fluctuations. Multiple month periods capture both increases and decreases. A six-month period would level out fuel fluctuations and require fewer resources for the company to file changes and for staff to review the filings.

* Using an index instead of individual fuel costs, especially for smaller company’s operating in more rural areas.

The current methodology also has suffered from numerous administrative problems which require staff resources to correct:

* Companies file more frequently than their billing cycle allows. A company that bills every two months qualifies for a surcharge every two months, yet some companies continue to file monthly.
* Continuing errors with tariff publication regarding supplement numbers, revision numbers, effective dates and application of the surcharge to customers based upon billing cycles frequently require staff to contact the company to file corrections and replacement tariff pages.

**INDUSTRY PROPOSALS**

Industry representatives proposed to maintain the current index methodology with the following changes:

* Eliminate, or decrease, the one percent of revenue threshold.

Staff Response: Staff continues to believe the current one percent threshold, “dead band”, is appropriate. The threshold shares risk between the company and customers. With no threshold, the company bears little, or no, risk. Risk is the basis for reward. With no risk, the company should earn no reward on fuel expense. That would transform the current fuel surcharge methodology, which was designed to provide companies relief from large changes in fuel prices (so-called “spikes”), into a fuel expense guarantee methodology.

* Eliminate disposal fees and taxes from the calculation of fuel expense as a percent of revenue.

Staff Response: Staff disagrees. The current methodology calculates a company’s fuel expense relationship by dividing fuel expense by the company’s total revenue. Total revenue includes disposal fees and taxes. Some company’s (primarily operating in western Washington) want to eliminate disposal fees and taxes from this calculation to “normalize” the effect of high-cost disposal fees and taxes in western Washington and low-cost disposal fees and taxes in eastern Washington. Eliminating either disposal fees or taxes from the calculation would lower “adjusted revenue”, thereby increasing the percentage relationship of fuel to the adjusted revenue, and, absent any change in the one percent “dead band”, allow companies to qualify for more frequent, higher fuel surcharges and earn more revenue and profits.

Disposal fees are an integral part of a solid waste company’s business and financial structure. Companies earn a profit on disposal fees. All other things being equal, companies should prefer to pay higher disposal fees because that will earn higher profits for the company. The following table shows the relationship of disposal fees for several solid waste companies – small and large, western and eastern.

**Table 3**

**Disposal Fees: Percent of Total Revenue and Profit**[[2]](#footnote-2)



* Do not require a rate case more recent than five years.

Staff Response: Staff disagrees. Immediately after a rate case, staff has a high degree of confidence that the rates are fair, just, reasonable and sufficient. That confidence decreases as time passes. A rate case typically uses data that is about a year old. For example, a three-year old rate case is based on four-year old operations of the test period.

Fuel surcharges are a simplified method to change rates with no consideration of need, no consideration of other factors that might offset the need for additional revenue, and no burden to demonstrate that the resulting rates are fair, just, reasonable, and sufficient.

The length of time since the last rate case is not the issue. The issue is whether or not there have been changes in the company’s operations. Some companies may operate in a very stable market, with very constant operating characteristics. However, as the length of time since the last rate case increases, changes are more likely, and the rate case data and operations are less representative of current operations: Newer vehicles may have greater capacity and get better fuel mileage, number of customers change, etc.

If the commission adopts a threshold time period since a company’s last rate case, staff recommends that it be used only as a guideline and that it be three years, not five years.

The industry generally opposes deferred accounting. The commission received written comments from Waste Management on January 19, 2011, which stated that Waste Management does not support using a deferred accounting methodology and that its deferred accounting pilot program was cumbersome and demanding, caused a great deal of confusion and was challenging to administer. The comments identified the following issues:

1. For one thing, Waste Management operates under nine different tariffs, and having just one division utilizing a line-item for fuel made it difficult for customer service representatives to field questions about rates.

Staff Response: Waste Management can use deferred accounting for all of its divisions.

1. Also, because it is deferred, customers had a difficult time understanding the pricing: they could see price fluctuations at the gas pump, but since the fuel item lagged behind the actual prices, the customers were confused.

Staff Response: Waste Management’s pilot program used a twelve-month time period, staff’s proposal uses a six-month time period. The time lag is unavoidable in any true-up or surcharge methodology, and is exacerbated by multiple-month billing cycles. For example, over a six-month period (e.g. January – June), customers in the third billing group of a company with a three-month billing cycle (one month in arrears, current month, and one month in advance) would receive bills in August and November under the current surcharge methodology, but only one bill in October under staff’s proposed deferred methodology.

1. Administering a deferred accounting methodology would impose resource burdens.

Staff Response: Staff agrees that the deferred accounting process will require more resources. Deferred accounting is also the only methodology that will protect the company, by ensuring that the company recovers all of its fuel expenses, and customers, by ensuring that they pay what they should. Costs to administer the program will be offset, in whole or part, by cost savings resulting from eliminating profit on fuel expense.

1. If it were adopted for the solid waste industry, to start the process all companies would have to file a general rate request to back out the fuel from its current tariff rates.

Staff Response: No. Staff’s proposed methodology allows a one-time adjustment to fuel expense to start the program. See Attachment A. The spreadsheet requires just two selections from drop down menus; the company name and the proposed effective date.

1. Commission Staff would be inundated with filings.

Staff Response: Staff believes that we could process all of the deferred accounting start-up filings in one month. However, that would also require staff to process all of the true-up filings in one month, and that would strain staff resources. Staff proposes to phase in the deferred accounting process to manage the timing of true-up filings. See Attachment B. Of course any company can petition the commission at any time to approve deferred accounting.

1. Then, on an annual basis companies would have to file again, similar to the current handling of the recycling commodity credit/debit except that fuel filings would need to be submitted as general rate filing.

Staff Response: Staff proposes a six-month true-up instead of a twelve-month true-up that was in effect for the Waste Management pilot program. Staff proposes to phase in the deferred accounting process to manage the timing of true-up filings. See Attachment B. Staff expects the fuel true-up will be very similar to the current process to adjust the recyclable commodity credit/debit, and we do not expect that it will require significant resources from companies or staff. The true-up would be filed in compliance with the deferred accounting order, not a general rate case under WAC 480-07-520 filing requirements.

1. We submit that establishing a sharing mechanism would require far more sophisticated measurements of total fuel costs and projections for future fuel prices.

Staff Response: Staff does not propose a sharing mechanism because our proposal eliminates the company’s profit on fuel expense. The company will recover all of its fuel expense.

1. It would require a substantial dedication of private and public sector resources to implement.

Staff Response: Staff does not expect this process would require a substantial resource requirement by companies or staff. Although Waste Management reported that the pilot program was labor intensive, the district office did not explicitly track costs associated with the pilot program and, after the pilot program was completed, the company did not make any accounting adjustments to eliminate the costs associated with the pilot program as a nonrecurring expense. Staff encourages companies to provide additional information regarding any expected additional costs associated with deferred accounting. All, or a portion of, additional costs would be offset by savings resulting from removing the profit associated with fuel expense.

1. Furthermore, the Commissioners expressed concern in our Sno -King filing because a deferred accounting methodology removes any direct incentive for the company to manage its fuel expense.

Staff Response: Staff agrees that is a concern..

1. At the time, they noted that using a single-issue cost-adjustment is acceptable when the cost at issue is a significant portion of overall costs and the utility's ability to manage the cost is limited, but since fuel costs are less than five percent of total revenues for solid waste collection companies, the incentive to manage costs when a deferred accounting mechanism is available is diminished.

Staff Response: Deferred accounting for an expense that represents a small percentage of total revenue is unusual. However, accounting is also the only methodology that will protect both the company, by ensuring that the company recovers all of its fuel expenses, and customers, by ensuring that they pay what they should. The commission currently uses a deferred accounting methodology for recyclable commodity revenues, which are similar in size to fuel expense. Also, deferred accounting will fully address price volatility and eliminate company’s, staff’s and customer’s concerns regarding criteria and implementation of fuel surcharge methodologies, current and staff’s temporary revised method.

1. Perhaps the most telling point is that Waste Management had the unique experience of implementing a deferred accounting method for fuel prices through a pilot program, and if we had thought it worked we would not have reverted to normal rate design in our compliance filing.

Staff Response: Each company needs to determine what best serves its business needs.

**STAFF RECOMMENDATION – DEFFERRED ACCOUNTING**

Staff recommends that the commission allow solid waste companies to implement deferred accounting for fuel expense. Recent unrest threatening oil supplies and increasing demand caused by global economic recovery demonstrate that fuel prices, if anything, are likely to increase and become more volatile. Deferral is the only methodology that protects the companies and customers by ensuring that companies recover actual expenses and that customers pay what they should.

To limit the application of surcharges, other methods require artificial conditions such as: Shared risk, use of a “dead band”, using an index instead of actual price, frequency of filings, whether or not to include disposal fees and taxes to calculate the percentage relationship of fuel to revenue, how much of an increase is significant enough to warrant a surcharge, how to define a fuel “spike”, should the surcharge methodology include credits when fuel prices drop, etc. All of these issues have been discussed and debated for years. Deferral eliminates all of these conditions, discussions and debates.

Because deferral guarantees recovery, the company bears no risk. Because there is no risk, staff recommends that the company not earn any profit on fuel expenses and the commission should remove fuel expense from the LG calculation of the company’s revenue requirement, which includes profit, and add the fuel expense back to the revised calculated revenue requirement.

Staff further recommends that the commission:

* Establish deferred accounting for each company, by separate order, in each company’s next rate case.
* Embed test period fuel expense in rates and use a percentage of revenue adjustment to rates, similar to the current fuel surcharge methodology, to make changes related to fuel expense.
* Allow adjustments not more frequent than every six months. However, a company could choose a longer filing period.
* Implement deferred accounting using actual data within a rate case. If there is no pending rate case, use a one-time fuel adjustment, which would be the company’s Base Fuel Period Index divided by the most recent three-month average index.
* Phase in deferred accounting over the next twelve months to spread out the work load and allow companies to continue charging a fuel surcharge as set forth in the following section.

See Attachment A for a description of staff’s proposed starting deferred accounting and Attachment B for the proposed phase in time schedule.

**TEMPORARY INDEX FUEL SURCHARGE**

Staff recommends that the commission allow companies to continue using a revised version of the current monthly fuel indexed surcharge methodology until they have the opportunity to implement deferred accounting according to the proposed schedule in Attachment B. The revised indexed fuel surcharge methodology changes the current indexed fuel surcharge as follows (changes identified with underline):

* The surcharge adjustment would be mandatory for decreases. The current methodology is voluntary. Referring to Attachment C, note that current and revised methodologies result in a fuel credit (.32 percent) for Murrey’s Disposal Co., Inc. d/b/a Olympic Disposal.
* Base Period Revenue is defined as (1) last rate case or (2) most recent disposal fee rate case. The current methodology uses only last rate case revenue.
* Base Fuel Cost is defined as (1) the average annual fuel cost from the company’s last rate case or (2) twelve-month index average from six months previous, whichever is greater. The purpose of the six-month time lag is to allow the company six months to prepare and file a rate case based on fuel costs for the previous twelve months. If the company has not filed a rate case, we assume that the company does not need additional revenue for the twelve-month period and the fuel costs were acceptable. For example, a filing with an April 1, 2011, effective date would use an alternate base fuel cost for the twelve months ending September 2010, leaving six months to prepare and file a rate case to become effective April 1, 2011. The current methodology uses only the average annual fuel cost from the company’s last rate case.

Attachment C illustrates the difference between the current index fuel surcharge and the temporary, revised six-month “lagged” twelve-month index fuel surcharge.

**IMPLEMENTATION**

Because of the large number of companies, staff proposes the commission phase in deferred accounting. That will spread the work load of the transition and subsequent true-up filings throughout the year. Staff proposes to implement deferred accounting based upon a company’s Base Fuel Index. We believe that companies with the lowest Base Fuel Index would be most impacted by higher fuel prices, and that the commission should implement deferred accounting for those companies first.

A proposed phase in time schedule is set forth in Attachment B. The proposed schedule is an example that assumes all companies will implement deferred accounting. The actual schedule will be adjusted to account for companies that already have fuel surcharges in place that are affected by multiple billing cycles, account for companies that choose to not implement deferred accounting and account for companies that filed general rate cases or petitioned to implement deferred accounting. The total time of the phase in will depend upon the number of companies that choose to implement deferred accounting. For example, if only five companies choose to implement deferred accounting we will implement all of them in one month.

Staff will also schedule training workshops to meet with companies to explain the proposed methodology, record keeping requirements and filing requirements (data and timing) for periodic true-ups.

**WRITTEN COMMENTS**

Written comments addressing fuel surcharges as listed above must be filed with the Commission no later than 5:00 pm, **Friday, April 1, 2011.** The Commission requests that comments be provided in electronic format to enhance public access, for ease of providing comments, to reduce the need for paper copies, and to facilitate quotations from the comments. Comments may be submitted via the Commission’s Web portal ([www.utc.wa.gov/e-filing](http://www.utc.wa.gov/e-filing)) or by electronic mail to the Commission’s Records Center at records@utc.wa.gov. Please include:

* The docket number of this proceeding (T-101661)
* The commenting party’s name
* The title and date of the comment or comments

An alternative method for submitting comments is by mailing or delivering an electronic copy to the Commission’s Records Center on a 3-1/2 inch, IBM formatted, high-density disk, in .pdf Adobe Acrobat format or in .doc Word 97 or later format. Include all of the information requested above. The Commission will post on its web site all comments that are provided in electronic format. The web site is <http://www.utc.wa.gov/101661>.

If you are unable to file your comments electronically or to submit them on a disk, the Commission will always accept a paper document. Questions may be addressed to David Gomez at (360) 664-1240 or e-mail at dgomez@utc.wa.gov.

Your participation is welcomed via written comments. Information about the schedule and other aspects of the proceeding, including comments, will be posted on the commission’s web site as it becomes available. If you would like to receive further information on this proceeding you may 1) call the Commission’s Records Center at 360-664-1234, 2) e-mail the Commission at records@utc.wa.gov, or 3) mail written comments to the address below. When contacting the Commission, please refer to Docket T-101661 to ensure that you are placed on the appropriate service list. The Commission’s mailing address is:

Executive Director and Secretary

Washington Utilities and Transportation Commission

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**NOTICE**

**Persons filing comments will be included on the distribution list for future information about this proceeding. If you want to receive such information but do not want to comment now, you may notify the Executive Director and Secretary in one of the ways described above and ask to be included on the distribution list for Docket T-101661. If you do not file comments or request to be included on the distribution list, you might not receive further information about this proceeding.**

**OPEN MEETING CONSIDERATION**

The commission will consider Staff’s recommendation and the comments of interested parties at its regularly scheduled Open Meeting on April 14, 2011.

Sincerely,

DAVID W. DANNER

Executive Director and Secretary

**ATTACHMENT A** 

**ATTACHMENT B**

**IMPLEMENTATION SCHEDULE - CHRONOLOGICAL**



**ATTACHMENT B**

**IMPLEMENTATION SCHEDULE - ALPHABETICAL**

**ATTACHMENT C**

1. The calculations are taken from the company’s last rate case and comparing the LG result from the rate case and the LG calculation after removing fuel expenses. The difference in the revenue requirement is the fuel expense plus the profit component for fuel expense. [↑](#footnote-ref-1)
2. The calculations are taken from the company’s last rate case and comparing the LG result from the rate case and the LG calculation after removing disposal fee expenses. The difference in the revenue requirement is the disposal fee expense plus the profit component for disposal fee expense. [↑](#footnote-ref-2)