

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND) DOCKET TG-131794
TRANSPORTATION COMMISSION,)
)
Complainant,)
)
v.)
)
WASTE CONTROL, INC., G-101,)
)
Respondent.)

**PREFILED DIRECT TESTIMONY
OF JACQUELINE G. DAVIS,
G.L. BOOTH, J.G. DAVIS & ASSOCIATES, PLLC
OF FEBRUARY 18, 2014**

1 **I. IDENTIFICATION OF WITNESS**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND ROLE AT**
3 **BOOTH, DAVIS & ASSOCIATES, PLLC.**

4 A. My name is Jackie G. Davis. My business address is 1516 Hudson Avenue, Suite 201,
5 Longview, Washington, 98632. I am an owner/shareholder in G.L. Booth, J.G. Davis
6 & Associates, PLLC. I am testifying on behalf of Waste Control, Inc. (“WCI,”
7 “Company” or “Waste Control”).

8 **Q. PLEASE PROVIDE A BRIEF BACKGROUND OF YOUR EDUCATIONAL**
9 **AND ACCOUNTING EXPERIENCE AND FAMILIARITY WITH WASTE**
10 **CONTROL, INC.**

11 A. I will have been with my current firm for 20 years in August of this year. I received my
12 Bachelor of Science degree from Oregon State University in 1992. Just after
13 graduation, I was employed by Moss Adams, a large regional accounting firm before
14 moving to Longview and assuming a position with GL Booth & Associates CPA firm
15 which eventually became known as Booth, Davis. Prior to becoming a partner, I was
16 the Audit Manager for the firm for five years, and have been the Audit Partner for our
17 firm since becoming partner in 2003. My job focus has recently been transitioning and
18 is directed more and more to consulting projects and tax planning, largely because we
19 have significant depth now in our audit department. Our firm has represented Waste
20 Control since before my arrival and has also long worked with the Willis family (Waste
21 Control’s owners) including its current principals, Joe and Kevin Willis, and their
22 parent predecessors, in addition to the corporation, Waste Control. Our firm has also
23 represented other regulated industry companies, including telecommunication and
24 commercial ferry companies, and we thus have some significant experience dealing
25 with WUTC ratemaking and the Uniform System of Accounts (“USOA”). In addition,
my partner, Gerrie Booth, has been involved in WUTC rate filings for well over 20

1 years and has worked closely with the current regulatory audit section predecessors
2 including Robert Colbo, Nicki Johnson and Layne Demas.

3 **Q. DO YOU HAVE GENERAL COST ACCOUNTING AUDIT EXPERIENCE?**

4 A. Absolutely. As an entry level CPA, then Audit Manager and now Audit Partner, I have
5 spent over two decades auditing revenue and expenses of business entities and am quite
6 familiar with particular audit theories, doctrines, alternative methodologies and
7 protocols in reviewing the results of operations of both non-regulated and regulated
8 entities, including generally accepted accounting standards promulgated by the AICPA
9 (“American Institute of Certified Public Accountants”), and generally accepted
10 accounting principles promulgated by the Financial Accounting Standards Board (the
11 “FASB”).

12 **II. PURPOSE OF YOUR TESTIMONY**

13 **Q. COULD YOU JUST BRIEFLY SUMMARIZE WHAT THE PURPOSE OF
14 YOUR TESTIMONY IS IN THIS PROCEEDING?**

15 A. Certainly. As the Company’s lead outside accountant on this general rate filing, I am
16 its primary witness on financial and accounting issues relating to the underlying general
17 rate case. My colleague, Mary Spencer, and I have been closely involved in the case
18 since its preparation and filing late last summer and early fall and have been the
19 subsequent leads in responding to Staff data requests, contacts and site visits since then.
20 As such, I will address in my testimony the post-filing review phase and the audit issues
21 leading up to the suspension of the case and the apparent impasse between the
22 Company and Staff in December, 2013 which brings us to the present adjudication.

23 **III. SUMMARY AND DISCUSSION OF PARTIES’ DISAGREEMENTS
24 ON SUSPENSION OF CASE IN LATE NOVEMBER/IMPASSE IN DECEMBER**

25 **Q. DOES YOUR AUDIT BACKGROUND AND INVOLVEMENT IN THIS CASE
TO DATE GUIDE ANY OF YOUR POSITIONS/PERSPECTIVE ON THE
CURRENT FILING AND ITS POSTURE?**

1
2 A. It unquestionably does and sharpens my particular concerns with some of the proposed
3 accounting treatments employed by the Staff, at least in the initial phase of this
4 proceeding leading up to the December impasse for this general rate case approximately
5 four years after the last general rate increase granted to WCI in 2009.

6 **Q. COULD YOU CHARACTERIZE HOW THE CURRENT CASE STATUS**
7 **MIGHT NOW DIFFER PROCEDURALLY FROM THE POSTURE OF OTHER**
8 **RATE CASES YOUR FIRM HAS HANDLED?**

9 A. Yes, our firm, as noted, has had previous experience in filing WUTC general rate cases
10 for Waste Control and a commercial ferry company. In those cases, you would file
11 your case 45 or 30 days or more, respectively, before the desired effective date
12 accompanied by the revised tariff pages and supporting workpapers, as here, and be
13 subject to audit and review by the regulatory accounting Staff prior to resolving the
14 Company and Staff positions. Then, at either company-filed or, more typically, Staff-
15 company-negotiated rate levels, the case would go before the Commissioners at the
16 regular Open Meeting just prior to the effective date, where the Commissioners
17 formally act upon the general rate case proposal allowing it to go into effect by
18 operation of law or issuing a written order.

19 **Q. IN THE COURSE OF THE POST-FILING INTERVAL WAS WASTE**
20 **CONTROL'S CURRENTLY-FILED CASE SUBJECT TO THAT**
21 **ESTABLISHED PRACTICE?**

22 A. Yes, to the extent that Waste Control's general rate filing was subject to extensive pre-
23 suspension audit review in this matter.

24 **Q. COULD YOU CHARACTERIZE THE AUDIT PROCESS TO DATE,**
25 **BRIEFLY?**

26 A. Yes, starting on September 19, 2013, when we were initially contacted by Brett Shearer
27 who was then assisting primary Staff auditor, Melissa Cheesman on this audit, our

1 office responded to nine (9) informal data requests containing 79 individual questions
2 some of which contained multiple subparts, received and initiated countless telephone
3 calls and emails in follow up, hosted, (along with Joe Willis), a 1 ½ day site visit on
4 November 7 and 8, 2013 from Ms. Cheesman who was also accompanied by Ann
5 LaRue of Staff for those visits, photocopied and/or scanned each individual expense
6 invoice (totaling many hundreds) in the test year (which staff requested to retain versus
7 simply reviewing during the site visit), and also dealt directly by phone and email with
8 Mr. Brett Shearer, as the other analyst on the Staff with Ms. Cheesman and Ms. LaRue,
9 answering questions on the general rate case through the audit. In addition, Joe Willis
10 and I met in person with Staff including Mr. Gene Eckhardt and respective counsel in
11 Olympia in mid-December in attempts to resolve this filing. As should be obvious
12 then, this rate case has received substantial time and attention from the Company and
13 our office since its official filing on September 23, 2013 and the Commission Staff has
14 reviewed that original general rate case in depth since that time.

15 **Q. IN GENERAL TERMS, COULD YOU ALSO PLEASE DESCRIBE THE**
16 **REASONS WHY THE COMPANY AND THE STAFF HAVE UNTIL NOW**
17 **BEEN UNABLE TO COME TO AGREEMENT ON THIS FILING FROM**
YOUR PERSPECTIVE?

18 A. Yes, at least as of the third week in December, there were a number of material issues
19 still in dispute after the audit and informal discovery phase which I would characterize
20 as follows:

21 1. Allowable rent expense in the regulated entity for various affiliate rent
22 transactions. As will be expanded upon below, the capital structure currently used by
23 Staff for this analysis is the capital structure of the entire affiliated entity versus an asset
24 specific capital structure or that of the regulated Company alone we contend should be
25 used for any reasonable outcome. Capital structure as applied under the Staff's

1 approach we believe is inconsistent with the return allowed under the Lurito-Gallagher
2 modified generating ratio ratemaking approach adopted by the Commission to set
3 regulated solid waste collection rates.

4 2. Some affiliated entity rental operating costs for real property and equipment are
5 disallowed without explanation, including, but not limited to, insurance, taxes and
6 maintenance.

7 3. Staff-imputed interest rates on debt instruments related to the Company's
8 affiliated rent transactions.

9 4. Rate of return on equity in the applied capital structure of rented assets used by
10 the regulated Company.

11 5. Appropriate allowance of the capital structure derived by the Lurito-Gallagher
12 ratemaking methodology rather than the depreciated per books valuation that the
13 Company initially filed in its September 23 submission which would now enable the
14 maximum debt/equity ratio allowed by Lurito-Gallagher for regulated solid waste
15 collection companies.

16 6. Allowance of all rate case and general advisory professional fee costs for Waste
17 Control, Inc. in the Company's adjusted rate base amortized over four years.

18 7. Allowance of overtime paid in the test period as opposed to costs for overtime
19 normalized over a four-year period.

20 8. Allowance of a payroll increase for cost of living adjustments effective 7/1/14
21 which is a "known and measurable" increase.

22 **Q. HAVE YOU ASSIGNED AN EXHIBIT NUMBER TO THE ORIGINAL RATE**
23 **FILING?**

24
25

1 A. Yes. The underlying general rate case as docketed in this matter under No. TG-131794
2 we are here designating as Exhibit JD-2. That exhibit was filed electronically and with
3 paper copies, pursuant to rule, in September.

4 **Q. HAVE YOU ALSO PREPARED AN EXHIBIT, JD-3, WHICH REFLECTS/
5 HIGHLIGHTS THE MATERIAL ACCOUNTING ADJUSTMENTS YOU
6 BELIEVE ARE CURRENTLY CONTESTED BETWEEN THE PARTIES?**

7 A. Yes. I have prepared and attach, as Exhibit JD-3A, a Company adjusted pro forma
8 results of operations which, in bold type and references, sets forth our proposed
9 adjustments for costs and/or revenues attributable to those particular disputed issues or
10 items.

11 **Q. DOES EXHIBIT JD-3 ALSO INCLUDE OTHER ACCOUNTING ITEMS THAT
12 MAY BE PRESENTLY IN DISPUTE WITH THE STAFF?**

13 A. Of course it could, but we await the Staff's filing of March 28, 2014 to learn what
14 additional items, if any, they are currently disputing in the Company's pro forma
15 statement of operations and overall revenue requirement amount that divide us.

16 **Q. IN ADDITION, IN EXHIBIT JD-3, HAVE YOU PREPARED A REVISED
17 COMPUTATION OF THE OVERALL REVENUE REQUIRED DERIVED BY
18 THE LURITO-GALLAGHER RATEMAKING FORMULA?**

19 A. Yes, that is attached and identified as Exhibit JD-3B.

20 **Q. DOES THAT REFLECT CHANGES TO THE PROPOSED REVENUE
21 REQUIREMENT FROM THAT CALCULATED IN THE ORIGINAL RATE
22 FILING SET FORTH IN EXHIBIT JD-2?**

23 A. Yes. The revised Lurito-Gallagher formula revenue requirement derived by the
24 Company is \$483,542 v. approximately \$392,000 as initially filed.

25 **Q. IN GENERAL TERMS WHY IS THERE NOW THE DISCREPANCY IN THE
REGULATED REVENUE REQUIREMENT CALCULATED BY THE
COMPANY?**

1 A. Most significantly, that devolves from capital structure adjustments made by the
2 Company. First, we adjusted the debt to equity ratio of the Company after the filing, on
3 October 11, 2013, when we discovered an error on our end of the prior period equity
4 computation. Next, in early December, we notified Staff that the debt to equity ratio
5 should be further adjusted to reflect the USOA regulatory accounting method of
6 calculating asset net book value rather than the GAAP per books method according to
7 which we had filed. This, as will be explained in more detail below, increases the
8 equity ratio of the Company's capital structure to 60% and lowers the debt to 40%.

9 **Q. COULD YOU EXPLAIN HOW EXHIBIT JD-4 REFLECTS THESE VARIOUS**
10 **ADJUSTMENTS?**

11 A. Yes. Because the USOA and Commission-regulated ratemaking requires plant and
12 equipment to be depreciated over a larger life and impute a salvage value in contrast to
13 the Company's methods used under GAAP, this necessarily results in less depreciation
14 expense being recognized in a rate case than the Company records on its books and
15 financial statements. Therefore, the equity calculation for the Company must be
16 adjusted to reflect the higher net book value of these assets due to the difference in
17 depreciation calculations.

18 **Q. DID THE REGULATORY UTILITY ACCOUNTING METHOD OF VALUING**
19 **DEPRECIATED ASSETS ACTUALLY ARRIVE AT PRECISELY A 60%**
EQUITY LEVEL FOR WCI HERE?

20 A. No, as seen in Exhibit JD-4, it actually reached a 64.13% equity level but we have
21 reduced it to the 60% maximum level here considered prudent by the Commission in its
22 prior Lurito-Gallagher methodology orders.

23 **Q. IN PRESENTING YOUR TESTIMONY HERE, COULD YOU NOW**
24 **ELABORATE ON THE COMPANY'S POSITION ON THE DISPUTED ITEMS**
YOU HAVE OUTLINED ABOVE?

25

1 A. Yes, and I will try to address these in the order previously listed and provide some
2 explanation and/or illustrative examples:

3 1. “Commingled” Regulated and Nonregulated Affiliate Capital Structures.

4 This particular issue is likely the most contentious in this rate filing at least as I and the
5 Company understand the position of the Staff to the point of case suspension. As noted
6 above, we believe it is not reasonable to apply, on an aggregate basis, the entire capital
7 structure of a non-regulated company simply due to the rental of an asset by the sister
8 regulated company. In this case, that treatment artificially inflates the debt component
9 of the return on investment ratio which Staff is using to calculate allowable rents for
10 commonly-used assets, for instance in our case, by imputing the capital structure of
11 Heirborne, Heirborne II or WCE (as the owner entity) onto several depreciated pieces
12 of unencumbered property rented and used by the regulated company.

13 **Q. CAN YOU DESCRIBE THIS MORE SPECIFICALLY?**

14 A. Yes, to understand this concern, it must be noted that when an asset is older and fully
15 depreciated, it necessarily yields a lesser return for ratemaking purposes. Thus,
16 unilaterally applying the capital structure of a higher-debt, non-regulated affiliate to a
17 rental asset owned by that affiliate such as a fully depreciated, older truck used by the
18 regulated company, will necessarily yield the most minimal return on that asset
19 available. (*See*, attached Exhibit JD-5 for illustration.) And that is precisely the
20 proposed ratemaking treatment afforded by Staff to the three spare trucks scheduled and
21 used by Waste Control, Inc. at issue in this general rate case proceeding now on
22 suspension.

23 **Q. DO YOU BELIEVE THIS IS AN INAPPROPRIATE TREATMENT OF THE**
24 **SPARE TRUCK ASSETS?**

25

1 A. Yes. It is unilateral and consistent only in its negative effect on the calculated return
2 for the regulated company. Either the asset-specific capital structure of the jointly
3 utilized/rented asset owned by the affiliate should be used, or the regulated company's
4 underlying capital structure should be applied. To instead isolate the rented asset and
5 apply its depreciated book value against the capital structure not of the regulated
6 company but that of the nonregulated affiliate owner, is contrary to established
7 principles of the Lurito-Gallagher methodology as we understand their application and
8 appears designed only to diminish the Company's overall revenue requirement.

9 **Q. ARE THERE OTHER IMPLICATIONS/COMPLICATIONS THAT YOU
10 PERCEIVE IN MIXING/COMMINGLING CAPITAL STRUCTURES OF
11 NONREGULATED ENTITIES WITH THAT OF THE REGULATED
12 COMPANY? DOES THAT ENTAIL INCLUSION OF DIFFERING METHODS
13 OF DEPRECIATION THAT NECESSARILY AFFECT THE RESULTS?**

14 A. Yes, in calculating allowable rent, the Staff apparently recalculated depreciation for the
15 nonregulated affiliate companies' assets using the Uniform System of Accounts
16 ("USOA") method but made no corresponding allowance or adjustment to increase
17 equity based on the GAAP method by which the nonregulated affiliates' depreciation is
18 calculated.

19 **Q. IS THERE ANY OTHER OBSERVABLE IMPACT OF MIXING CAPITAL
20 STRUCTURES OF REGULATED AND NONREGULATED AFFILIATES IN
21 THIS WAY?**

22 A. Yes, in using combined capital structures, the allowable rent for a depreciated asset will
23 change although the essential nature of the affiliated transaction is unchanged.

24 **Q. IS THERE AN EXAMPLE YOU COULD OFFER TO BETTER ILLUSTRATE
25 THIS POINT?**

26 A. Yes. For example, Heirborne recently issued a multi-million debt/bond obligation in
27 2006 for the primary purpose of constructing a transfer station to be operated for
28 Cowlitz County by Waste Control Recycling, Inc., also a nonregulated affiliate of

1 Waste Control, Inc. This obligation naturally caused Heirborne's debt/equity ratio to
2 skyrocket, despite its tangential relation to Waste Control, Inc. whose trucks are parked
3 under the transfer station's covered parking. Also, for impacts upon the allowed return
4 for rented assets and the effect of commingled capital structures, please see again
5 Exhibit JD-5.

6 **Q. HAS WASTE CONTROL, INC. EVER BEEN SUBJECT TO SUCH**
7 **TREATMENT IN ANY OF ITS PRIOR RATE CASES TO YOUR**
8 **KNOWLEDGE?**

9 A. No. The regulatory accounting Staff has never imposed or applied such a theory on
10 calculating return on rental equipment/spare trucks used by WCI that I have been able
11 to identify in any prior Staff memorandum recommending approval of negotiated rates
12 in past general rate cases of Waste Control, Inc.

13 **Q. DID YOU OBSERVE ANYTHING ELSE ABOUT THE STAFF TREATMENT**
14 **OF TRUCK RENTALS IN THE 2009 STAFF WORKPAPERS FOR THAT**
15 **GENERAL RATE CASE?**

16 A. Yes, in reviewing the truck rent workpapers for the 2009 rate case, attached as Exhibit
17 JD-6, I noticed the Staff did not even use a return on investment approach. Instead, the
18 Staff there examined the reasonableness of the associated expenses and the depreciation
19 and proposed an increase of \$16,405 to the Company's rent. The Company at that time
20 also rented three spare trucks which have all since been replaced with newer trucks.
21 Total rent paid during that test period for the 2009 rate case was \$30,000 and was raised
22 by Staff to \$46,405 and then reduced by \$1,500 for Kalama contract operations. Net
23 truck rent allowed in 2009 was \$44,905. In this present case, in contrast, Staff proposes
24 to allow only \$14,605. I don't understand how it is possible for the same rental
25 relationship to be treated so differently in consecutive rate cases and how Company
management will be able to plan for expenses in these circumstances.

1 **Q. WERE THERE ANY OTHER ISSUES IN THE 2009 RATE CASE**
2 **APPARENTLY RESURFACING HERE?**

3 A. Maybe so. In the last general rate case in 2009, Staff had also initially proposed a
4 “commingled” capital structure of nonregulated and regulated company debt to equity,
5 but was eventually dissuaded from imputing that into the Lurito-Gallagher ratemaking
6 formula calculation. The January 28, 2010 Staff memo in support of approval of the
7 negotiated revenue requirement in TG-091653 does not refer to or include any such
8 extraordinary debt structure asset analysis.

9 **Q. ARE YOU ALSO CONCERNED WITH SIMILAR/ANALOGOUS**
10 **ACCOUNTING TREATMENT BEING APPLIED TO RENTAL REAL ESTATE**
11 **USED BY WASTE CONTROL, INC. LEASED FROM NON-REGULATED**
12 **AFFILIATES?**

13 A. Yes. In fact, in the initial audit phase of this case, we have been sent four various
14 property rent calculations by Staff, each using a different methodology. The final
15 version proposed by Staff in December used the nonregulated affiliate entity’s entire
16 capital structure and for the first time we have seen in our experience, reduced the
17 allowed rate of return from the standard 15%. In fact, the Staff’s position in December,
18 2013 on suspension of this filing would have yielded the Company just \$32,362 total
19 for rental allowance for ratemaking purposes whereas, per books, the Company has
20 paid and been charged annual rents of \$120,000. In addition, for a newly-rented
21 warehouse, the Staff’s position results in allowable rent of only \$15,198 versus actual
22 charged rents of \$18,000. While we remain optimistic the Staff’s position on property
23 rentals will significantly move northward in their March 28 case filing after reassessing
24 what we believe to be some material initial omissions in that computation, we believe
25 that analogous capital structure imputations occurring on the spare rental truck
computations are also being applied to those rental real estate properties’ calculations.

1 As an example, the Company's office building which has been in service for thirty
2 years and is debt free diminishes in allowable rent amount in each workpaper variation
3 we received from Staff. Past rate case dispositions had been to allow a return on
4 investment at cost plus improvements for real property, but in this case, all real
5 properties are being recalculated at depreciated book value and then subjected to an
6 overall combined capital structure. (See Exhibit JD-7 attached for the Company's rent
7 calculations in comparison to the Staff calculations.)

8 **Q. IN THAT REGARD, HAVE YOU ALSO REVIEWED AND COMPARED THE**
9 **STAFF'S PREVIOUS PRO FORMA IN THE 2009 RATE CASE ON THE**
10 **RENTAL REAL ESTATE?**

11 A. Yes.

12 **Q. AND WHAT DOES IT ALLOW IN THE AGGREGATE FOR REAL ESTATE**
13 **RENTAL PAYMENTS IN RATES FOR WASTE CONTROL IN TG-091653?**

14 A. \$80,250 before the Kalama revenues are removed.

15 **Q. HAVE YOU PROVIDED A COPY OF THAT STAFF PRO FORMA TO OFFER**
16 **INTO THE RECORD HERE AS A REFERENCE?**

17 A. Yes, and it's identified as an attachment to my testimony as Exhibit JD-8.

18 **Q. HAVE THERE BEEN ANY CHANGES IN PROPERTIES LEASED OR**
19 **RENTAL PROPERTY OCCUPIED BY WASTE CONTROL, INC. SINCE**
20 **OCTOBER, 2009 AND IF SO, PLEASE EXPLAIN.**

21 A. Yes, one. The Company began leasing a warehouse to paint operating trucks and to
22 store some tools and equipment in 2011. Painting the trucks in-house is a more
23 economical way to operate for the Company and ratepayers. The warehouse is owned
24 by Heirborne II and is leased by Waste Control from it for \$1,500 per month. Also of
25 note is that the covered truck parking rented by Waste Control referred to above was
only in service for three months of the prior test period. All other rental properties are
unchanged since 2009. When adjusted for newly-rented properties, the overall rent

1 paid by WCI per books has increased from \$123,750 to \$138,000 over the past four
2 years which is less than 3% per year even though some of the properties have been
3 substantially improved during that time.

4 2. Inconsistent Treatment of Affiliated Operating Costs for Real Property and Equipment.

5 **Q. ARE THERE SIMILAR ISSUES OF APPARENT INCONSISTENT**
6 **TREATMENT OF RENTAL EQUIPMENT OPERATING COSTS IN THE**
7 **STAFF'S DISPOSITION OF THIS GENERAL RATE CASE FILING TO**
8 **DATE?**

9 A. Yes. The Staff has also treated various operating expenses for rental real estate and
10 operating equipment less than consistently in this case at least to the point of
11 suspension. In previous rate cases, for instance, operating expenses for the spare trucks
12 used by Waste Control for service when required have been fully allowed in rates. Up
13 until now in this case, however, various expenses for insurance, tires, repairs and
14 maintenance for the spare trucks have been disallowed. Currently, this disallowance on
15 truck operating costs amounts to approximately \$13,000.

16 **Q. ARE THERE ALSO SIMILAR ISSUES RELATED TO RENTAL PROPERTY**
17 **OPERATING EXPENSE?**

18 A. Yes. These disputed costs are \$5,507 as shown in Exhibit JD-7.

19 **Q. WHAT IS THE CURRENT AGGREGATE RENTAL DISALLOWANCE**
20 **RELATED TO RENTED ASSETS IN THIS RATE CASE?**

21 A. The amount in dispute related to rent expense in total is approximately \$100,000.
22 Again, this constitutes a highly significant and adverse variation to the Company in
23 rental expense allowance by Staff.

24 **Q. IN ADDITION TO THE MONETARY DISALLOWANCE, WHAT CONCERNS**
25 **DOES THE COMPANY HAVE ABOUT THE IMPACT OF DENIAL OF SPARE**
TRUCK AND REAL PROPERTY RENT EXPENSES?

1 A. While the amounts noted above obviously have a material effect on the Company's
2 revenue requirement in this filing, the greater impact for the Company in my view is on
3 the future use and role of spare trucks and rental properties in regulated operations. If
4 the Company lacks assurance that ordinary operating costs and appropriate depreciation
5 and return on investment for affiliate-owned real estate or spare trucks will be allowed
6 in the future, it will have to make future land and equipment purchasing decisions with
7 that in mind. The risk of subjective disallowance of previously-accepted, "known and
8 measurable" expenses for "standby" or "spare" operating equipment or current rental
9 properties owned by nonregulated affiliates and utilized by Waste Control, Inc. is thus
10 substantially higher. It might be advisable then to have the regulated company simply
11 purchase outright land and/or equipment and have the security of the cost recovery
12 rather than risk subsequent disallowance of regulated asset operating costs if they are
13 owned by nonregulated affiliates.
14
15

16 **Q. WHAT OTHER EFFECT WOULD YOU NOTE IF THIS PURCHASING**
17 **APPROACH IS ADOPTED BY MANAGEMENT?**

18 A. It discourages sharing operating equipment assets, primarily spare trucks, which
19 increase efficiency and lower operating costs to ratepayers. The Company's cost of
20 owning the spare trucks outright will lead to higher customer costs instead of sharing
21 this equipment burden with a related company.

22 3. Interest Rate Used in Debt Instrument Computation on Rental Properties.

23 **Q. WERE THERE ALSO STAFF ADJUSTMENTS TO THE DEBT**
24 **INSTRUMENTS CALCULATIONS ON RENTAL PROPERTIES THAT YOU**
25 **CHALLENGE?**

1 A. Yes. Instead of using the actual interest rate for the individual rental properties at issue
2 the Staff appears to have uniformly applied their isolated calculation of the bond
3 interest rate across the board to properties owned by Heirborne and rented by the
4 regulated Company. The instrument referred to above was issued by Heirborne for the
5 purpose of building the transfer station and is actually unrelated to most properties used
6 by the Company. The bond interest rate used by Staff actually is the lowest interest rate
7 assumed by any Waste Control companies on any extant mortgage obligation. The
8 Staff's calculated rate unfortunately is also much lower than the true effective rate of
9 the bond issue.

10 **Q. WHAT THEN OCCURS IN THE STAFF CALCULATION?**

11 A. Under this Staff calculation, the debt interest rate of return is then applied to 93% of the
12 net investment on all rental properties owned by Heirborne which are rented by Waste
13 Control, Inc. even though few of these properties were purchased with bond proceeds
14 and few of which properties carry any debt at all due to their age. Under the 2002
15 Bremerton-Kitsap Airpporter case final order formula apparently used by Staff in this
16 rate case, the allowed return on any financed portion of rented property is the recovery
17 of interest only. Thus, all Heirborne-rented properties are being calculated at this low
18 rate of return (last calculated at 2.18% by Staff) on 93% of the net book value of the
19 nonregulated Heirborne assets. Using this approximate 2% rate of return creates a huge
20 discrepancy in the allowable debt return compared to the equity return rate discussed
21 above and witnessed in the spare truck return example, Exhibit JD-5. This same effect
22 then will extend to the real property rentals.

23 **Q. WHY DO YOU DISAGREE WITH THIS TREATMENT?**

24 A. As noted above, we believe this is unfair because most of those properties are debt free
25 and fully depreciated thus having a very small rate base upon which to apply this very

1 low rate of return. Furthermore, the Bremerton-Kitsap case used the asset specific debt
2 in its model for calculating allowable return. As we understand, Staff has refused to
3 accept that part of the ruling in our case to date. Additionally, bond financing is highly
4 complex. There are letters of credit, quarterly assessments of interest based on credit
5 ratings, required annual fees and a large amount of upfront fees which must be
6 amortized as financing costs over the life of the bond all of which increase its cost and
7 prevent a facile computation of the 2.18% stated interest rate the Staff has used.

8 **Q. HAVE ANY OF THESE BOND FINANCING COMPLEXITIES BEEN**
9 **CONSIDERED BY THE STAFF IN THEIR INTEREST RATE**
10 **CALCULATIONS TO DATE?**

11 A. To my knowledge, none of this appears to have been considered in the proposed
12 interest rate being used by Staff to this point. In contrast, we provided a calculation of
13 the bond rate to Staff for the portion of purchased assets actually financed by the bond
14 and used by Waste Control, Inc. (which again, is only the covered parking facility) and
15 it was apparently rejected. The result is highly detrimental to the Company in that its
16 aging operating assets are now treated as fully encumbered and only the most minimal
17 rental recovery is allowed. Finally, in the immediately prior rate case, a 15% return on
18 cost basis was allowed without any assessment of mortgage obligations related to the
19 properties.

20 **Q. WHAT IMPACT DOES THIS HAVE ON PROSPECTIVE BUSINESS**
21 **PLANNING?**

22 A. Clearly not a positive one. The effect of this treatment is apparently that Staff is now
23 changing policy midstream on a business that has always operated at a lower cost by
24 seeking efficiencies through shared operations. Had the owners known of this proposed
25 treatment of their properties, operations would likely have been restructured to separate
this part of their business from the affiliated companies so this would not be an issue.

1 Instead, they operated under the established ratemaking practice in assumption that
2 their rented properties and assets would be treated as if they were inside the regulated
3 company and reasonable costs would be allowed such as depreciation, routine operating
4 expenses and a return on investment.

5 **Q. IF THIS IN FACT IS TO BE STAFF AUDIT POLICY ON TREATMENT OF**
6 **ASSETS SHARED WITH NONREGULATED AFFILIATES, WHAT ARE**
7 **YOUR THOUGHTS?**

8 A. It would seem prudent and reasonable if such a change in allowable expenses for
9 regulated solid waste collection companies were to be considered and noticed to all
10 stakeholders by regulators with advance notice and opportunities to comment. I have
11 no knowledge about whether this practice/treatment has been applied to other regulated
12 solid waste collection companies' rate filings. In our case, the adjustments have come
13 on a piecemeal basis with yet another detrimental change appearing in each iteration of
14 the Staff's audit calculations.

15 4. ROE On Debt Instruments.

16 **Q. WHAT ABOUT RETURNS ON EQUITY ON RENTAL PROPERTIES?**

17 A. This was also an area of inexplicable adjustment by the Staff. Until mid-December,
18 2013, all the Staff worksheets/workpapers were using a 15% ROE ("return on equity")
19 for rental properties. Then, somehow, as the Company and Staff got close to final
20 discussions on the pro forma results of operations, that figure was unilaterally reduced
21 by Staff to 9.8% without explanation. Subsequent to that unilateral change, I have
22 learned that a ROE of 9.8% has recently been applied in some utility general rate case
23 orders and that the Transportation Regulatory Staff feels that that is now an appropriate
24 imputation for solid waste ratemaking as well.

25 **Q. DO YOU THINK ROE'S GENERALLY DERIVED IN UTILITY GENERAL**
RATE CASES ARE APPROPRIATE TO APPLY TO SOLID WASTE
GENERAL RATE CASES?

1
2 A. No. Since energy companies in Washington as I understand are regulated on a rate of
3 return (“ROR”) on rate base methodology and solid waste companies’ earnings are
4 regulated on a completely different, Lurito-Gallagher modified operating ratio basis,
5 and the solid waste industry experiences far greater capital turnover, I do not see how
6 an ROR methodology involving a 9.8% return on equity would either be fair or
7 reasonable. Waste Control has, in the past general rate cases that I have reviewed,
8 consistently received a 15% ROE. Various industries have standards for ROE based, of
9 course, on their capital requirements and operating risks. Sharing ROE rates across
10 industries is not something supported by any type of financial analysis norm of which I
11 am aware.

12 5. Per Books v. Regulatory Ratemaking Debt/Equity Ratio Capital Structure Derivations.

13 **Q. HAS THE STAFF APPROVED THE COMPANY RESUBMITTED DEBT-**
14 **EQUITY RATIO ESTABLISHED BY THE LURITO-GALLAGHER**
MODIFIED OPERATING RATIO METHODOLOGY?

15 A. No. As noted above, when the present rate case was submitted on September 23, 2013,
16 after an initial calculation error was found in October, we also inadvertently failed to
17 adjust the rate base asset valuations from the “per books” depreciated value under
18 GAAP to those derived under the Lurito-Gallagher ratemaking methodology. During
19 the late stages of the audit process prior to impasse in December, we discovered this
20 and recalculated the capital structure at the derived L-G maximum levels of 60%
21 equity/40% debt that are the appropriate computed amounts under Lurito-Gallagher and
22 provided the calculations to the Staff, but never learned whether or not it approved or
23 otherwise disagreed with that calculation in arriving at an overall recommended
24 revenue requirement.
25

1 **Q. TURNING AGAIN TO EXHIBIT JD-4, WHAT DOES IT REFLECT IN TERMS**
2 **OF THE ALLOWED RETURN UNDER LURITO-GALLAGHER?**

3 A. Well it shows that the “per books” GAAP debt to equity ratio of 44.21% v. 55.79% and
4 the revised Lurito-Gallagher calculation at 40/60 is a significant difference impacting
5 the Company’s allowed return. We therefore would ask that the Commission consider
6 the debt to equity capital structure as presented in Exhibit JD-4 at the appropriate 40%
7 debt/60% equity level which is the maximum deemed prudent under Lurito-Gallagher
8 by the Commission in past final orders addressing the methodology.

9 **Q. TO CLARIFY, WOULD THIS 40% DEBT 60% EQUITY LEVEL HAVE A**
10 **CORRESPONDING IMPACT ON THE PRO FORMA OVERALL REVENUE**
11 **REQUIREMENT?**

12 A. Yes, notwithstanding any other adjustment to the pro forma results of operations, I
13 calculate this would increase the overall revenue requirement by approximately
14 \$20,000 in addition to the increase identified on October 11, 2013 relative to the end of
15 period equity calculation error.

16 6. Professional Fee Rate Case Costs.

17 **Q. HAVE THE STAFF AND COMPANY COME TO ANY AGREEMENT ON THE**
18 **AGGREGATE AMOUNT OF LEGAL AND ACCOUNTING FEES FOR THE**
19 **PREPARATION, FILING AND PROSECUTION/LITIGATION OF THIS CASE**
20 **BEFORE THE COMMISSION?**

21 A. Not definitively at this time. While initially an amount of \$17,930 as amortized was
22 proposed to be allowed for professional time in November by the Staff, we have
23 subsequently submitted further invoice documentation but have not received an
24 acknowledgement by Staff that they would agree to recommend those additional fees be
25

1 allowed. The Company has obviously also incurred further professional fees since that
2 time.

3 **Q. HAD THE COMPANY AND STAFF AGREED ON ANY INTERVAL OVER**
4 **WHICH THOSE FEES AND COSTS WOULD BE AMORTIZED?**

5 A. I believe so to the extent that the Staff had tentatively accepted a four-year period over
6 which to propose normalizing those fees corresponding to our last general rate case
7 filing in 2009, but of course that awaits reaffirmation or challenge in their case filing in
8 March.

9 **Q. HAVE PROFESSIONAL FEES BEEN UNUSUALLY HIGH IN YOUR VIEW IN**
10 **THIS PARTICULAR GENERAL RATE CASE FOR WASTE CONTROL?**

11 A. Unquestionably and regrettably, yes. Our accounting fees for this general rate case are
12 over twice as high as the last case as of November, 2013 alone due to the voluminous
13 data requests, discovery, follow up work schedule preparation, telephone contacts, site
14 visits, meeting in Olympia, etc. that have all been previously referred to and which are
15 extremely time consuming, totaling 631.6 hours of accounting time alone through
16 January 31, 2014.

17 **Q. DO YOU ANTICIPATE THIS PATTERN WILL CONTINUE IN 2014?**

18 A. Unfortunately, yes. While accounting costs we anticipate will moderate, because this
19 case is now proceeding in a contested adjudicative mode, legal costs are increasing and
20 we are obviously incurring time in preparation of the Company's case presentation.
21

22 **Q. ARE YOU NOW HIGHLIGHTING ANY SPECIFIC INSTANCE OF STAFF**
23 **DISALLOWANCE OF RATE CASE COSTS BY LISTING THIS AS A**
24 **DISPUTED ACCOUNTING ISSUE?**

1 A. No, but we understand the Staff has indicated it may challenge the reasonableness of
2 the final total owing to the amount incurred by November and we are prepared to
3 defend by cross-examination and legal briefing the amount and need for the level of
4 rate case expenses in this filing which the Company has incurred which is \$91,369.90
5 for accounting costs and fees and \$34,651.35 for legal costs and fees billed through
6 January 31, 2014, as well as the accounting and legal fees to be incurred through final
7 Order.
8

9 **Q. HAVE YOU PREPARED AN EXHIBIT WHICH REFLECTS THOSE LEGAL
10 AND ACCOUNTING FEES BY MONTH SINCE THE START OF THIS CASE?**

11 A. Yes and it is identified here attached as Exhibit JD-9.

12 7. Labor and Overtime Allowance in Test Period.

13 **Q. ON THE BASIS OF A “NORMALIZATION” CONCEPT, DID THE COMPANY
14 DISAGREE WITH THE STAFF’S PROPOSED ADJUSTMENT TO LABOR
AND OVERTIME COSTS IN THE RATE CASE TEST PERIOD?**

15 A. Yes. In the July 1, 2012 through June 30, 2013 test period, the amount included in rates
16 for regulated company labor by the Company in its pro forma was \$793,444 plus two
17 cost of living pro forma adjustments for a total of \$804,904.
18

19 **Q. WHAT WERE THE TOTALS FOR CORRESPONDING FRINGE BENEFITS
20 IN THE TEST PERIOD?**

21 A. \$284,369.75 which also includes an incremental increase in fringe benefits and the cost
22 of living benefit increase to be implemented on July 1, 2014.

23 **Q. OF THE TOTAL LABOR FIGURE FOR LABOR, OVERTIME AND FRINGE
24 BENEFITS, HOW MUCH DID THE STAFF PROPOSE TO DISALLOW WHEN
THE PARTIES REACHED IMPASSE IN DECEMBER, 2013?**

25

1 A. As shown on the attached Exhibit JD-10, "Labor Analysis," the Company and the Staff
2 had, after initial discussion, agreed on removal of 3.2% of overall revenues for non-
3 regulated operations. The Company had thus calculated that test year labor including
4 overtime was \$828,203 which, after the 3.2% corresponding allocation to regulated
5 operating expenses by Staff is removed, amounted to \$804,904 total labor expense in
6 the test period.
7

8 **Q. DID THE STAFF AND THE COMPANY AGREE ON THAT AMOUNT AT
9 LEAST BY NEGOTIATION IMPASSE IN DECEMBER, 2013?**

10 A. No. At that point the Staff had disallowed \$28,830 of that test year labor charge.

11 **Q. WHAT IS YOUR UNDERSTANDING OF WHY THE STAFF HAD PROPOSED
12 A \$776,074 TEST YEAR LABOR EXPENSE VERSUS THE COMPANY
13 COMPUTATION (AFTER NON-REGULATED OPERATIONS REMOVAL) OF
14 \$804,904?**

15 A. My understanding of this reduction is that it is a similar attempt to "normalize" labor
16 expense over a four-year period instead of accepting the actual test year expense of
17 \$804,904.

18 **Q. DOES THE STAFF CALCULATION INCLUDE ANY ADJUSTMENT TO
19 OVERTIME AS YOU UNDERSTAND IT?**

20 A. Yes. The Staff requested payroll records for the past four years and calculated overtime
21 hours incurred over those years and applied the average hours to the test year.
22 Overtime above that amount was disallowed. This disallowance amount alone
23 approximated \$23,000.

24 **Q. CAN YOU BRIEFLY TOUCH UPON ANY PROBLEMS YOU HAVE WITH
25 THE STAFF'S APPROACH TO LABOR EXPENSE, PARTICULARLY AS
CONCERNS THE OVERTIME ELEMENT?**

1 A. Yes, the concept of “normalizing” overtime labor in the end seems somewhat
2 counterintuitive because overtime is by its nature historical and incurred in the test
3 period because of circumstances unique to that actual time period of operation.
4 Without obviously challenging the premise of normalization as a whole which we well
5 understand in regulated ratemaking, here again the Staff’s approach seems rather
6 selective and as I understand, predicated on a belief that the test year in question
7 involved “excessive” amounts of overtime.
8

9 **Q. AS TO THE LATTER POINT, DO YOU AGREE THE OVERTIME INCURRED**
10 **IN THE TEST YEAR WAS “EXCESSIVE?”**

11 A. No, for a number of reasons I don’t. First, the Company has incurred overtime in some
12 instances because it seeks to maintain efficiencies for labor expenses. Thus, when a
13 driver quits or is terminated, the Company does not always quickly move to replace
14 him/her in these post “Great Recession”-era times. Thus, overtime can be incurred by
15 the existing work force as a result of natural attrition. Secondly, there is a driver
16 shortage nationally that has been widely featured in the industry literature and
17 identifying and hiring qualified solid waste collection equipment drivers is not easy nor
18 are there always qualified, experienced applicants clamoring to be employed.
19 Moreover, because of recent economic hard times, many current workers actively
20 solicit overtime opportunities. Overtime actually acts to mitigate the increasingly high
21 cost of employee benefits like medical, dental, life insurance and retirement benefits
22 since those contributions are capped at finite levels for existing employees whereas a
23 new hire triggers additional incremental benefit costs. Finally, since the last rate case,
24 Company management is more focused on driver retention and has concluded in recent
25

1 years that retaining existing drivers and incentivizing them to stay with the Company
2 by offering opportunities to increase their compensation through overtime is preferable
3 to the costs of hiring, turnover and training of new employee drivers.

4 8. Allowance for the Cost of Living Increase Scheduled for 7/1/14.

5 **Q. WERE THERE DISAGREEMENTS AS WELL ABOUT ADJUSTING THE**
6 **LABOR EXPENSES FOR A MID-YEAR COST OF LIVING ALLOWANCE**
7 **(“COLA”)?**

8 A. An additional disagreement which divided the parties at suspension was allowance of
9 the annual cost of living adjustments that are provided by the Company to all their
10 employees on July 1 of each year. While the Staff did allow an adjustment for the
11 COLA one day after the test period ended on July 1, 2013, it did not accept the COLA
12 for July 1, 2014. While admittedly outside the test period, we had pro formaed a
13 “known and measurable” increase for the cost of living allowance adjustment for
14 July 1, 2014. At least in the late stages of negotiations in 2013, the Staff had refused
15 that adjustment, believing it was apparently too remote in time to be factored in.
16

17 **Q. WHY DO YOU DISAGREE WITH THE FAILURE TO PROVIDE A PRO**
18 **FORMA ADJUSTMENT HERE?**

19 A. Because the Company has historically always provided the cost of living allowance and
20 the Staff therefore has historic and consistent proof from the Company to justify this
21 adjustment. We are also now more than halfway to that point less than five months
22 away from this adjustment being effective, and during the course of this proceeding, we
23 can provide any additional corroboration that this COLA is in fact going to occur that
24 the Staff or Commission require.
25

1 **Q. WHAT IS YOUR CALCULATION OF THE AMOUNT OF LABOR EXPENSE**
2 **THAT SHOULD BE ADDED DUE TO THIS PRO FORMA ADJUSTMENT**
3 **FOR THE JULY 1, 2014 COLA?**

4 A. \$5,698.

5 **Q. IN SUMMARY, DO YOU HAVE ANYTHING ELSE TO ADD TO YOUR**
6 **TESTIMONY AT THIS JUNCTURE?**

7 A. No, except to say that I have attempted to depict, reconstruct and articulate all of the
8 accounting issues in dispute of which we were aware when the Company and Staff
9 reached impasse on or about December 19, 2013. Admittedly, the Staff might now
10 concur with the Company on some of these issues and we simply not be aware of that
11 due to this adjudication. I remain hopeful that the aggregate issues dividing us can be
12 bridged and that with the Staff's filing of their case in late March we may still reach a
13 stipulated revenue requirement figure and arrive at revised tariff pages reflecting same
14 to formally present to the Commission.

15 **Q. DOES THIS OTHERWISE CONCLUDE YOUR TESTIMONY AT THIS**
16 **POINT?**

17 A. Yes, it does.
18
19
20
21
22
23
24
25