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David W. Danner
Executive Director and Secretary
Washington Utilities and Transportation Commission
1300 South Evergreen Park Drive, SW
P.O. Box 47250
Olympia, WA 98504-7250

Re: TG-112162 – Recycling Revenue Sharing

Secretary Danner:

On behalf of Waste Management of Washington, Inc. ("WM" or "Company"), we are pleased to submit these comments about implementation of RCW 81.77.185 revenue sharing plans to the Washington Utilities and Transportation Commission ("the Commission"). The need for greater certainty in obtaining the Commission's approval on recycling commodity credit filings that incorporate revenue sharing is obvious, and we welcome the Commission's commitment to providing guidance on how to effectuate the legislation without triggering administrative litigation.

The Company's comments cover four topics that are implicated by revenue sharing. First is that recycling revenue plans present programs that are intended to increase recycling, and should not be evaluated only by reference to potentially meaningless objective criteria. We further submit that counties and collection companies should be permitted to design revenue sharing plans, and the Commission should refrain from constraining program activities and expenditures. Ironically, designing program activities that comprise the essence of a revenue sharing is seemingly the least controversial, but nonetheless the not without some questions on which the Commission's input would be welcome. Also, plan expenditures that the Counties determine are necessary to implement programs intended to increase recycling should be permitted. And finally, we reiterate our view that plan participants should be rewarded for efforts to increase recycling, although financial incentives for influencing indicators of increased quality and quantities of recyclable materials are

appropriate. The proper methods for financially incentivizing a regulated collection company's participation in revenue sharing programs has received perhaps the most attention and analysis, it is yet still an area of considerable ambiguity and risk.

WM at this point, however, offers limited observations because in many respects we have already told you what we think, and now we hope to learn more explicitly what the Commission believes. The Company has filed with the Commission extensive briefings and pleadings documenting WM's position on many of the questions presented in the past several years. At this point, we look forward to further dialogue outside of the confines of litigation to more explicitly articulate concepts and policies for implementation of revenue-sharing, and commend the Commission for undertaking a policy analysis now.

I. Recycling revenue plans present programs that are <u>intended</u> to increase recycling, and should not be evaluated only by reference to potentially meaningless objective criteria.

Although the statutory language requires that retained revenues be used "to increase recycling," the Commission should resist the trend of narrowing revenue sharing plans by measuring success only in terms of quantifiable measurements. Instead, it should recognize the breadth of the goal that was intended, and approve plans designed in good faith to influence the patterns of behavior that can contribute to increased quantities and qualities of diverted waste, and enhanced revenues from recyclable materials.

One reason is that the strict definition of "recycling" is not capable of being correlated to collection operations. Under the Solid Waste Management Act, the term is defined to mean, "transforming or remanufacturing waste materials into usable or marketable materials for use other than landfill disposal or incineration." RCW 70.95.030(18). In implementing regulations, the term is further embellished, and, "Recycling does not include collection, compacting, repackaging, and sorting for the purpose of transport." WAC 173-350-100.

Putting the revenue sharing legislation in the context of these definitions shows that collecting material from generators is just the first step in a process that culminates with a new product or application. To say that plan participants must "increase recycling" in order to use retained revenue is not credible. It is analogous to offering tax incentives to a property owner for filtering water from the spring on her ranch in the Cascade Mountains only if water quality in Puget Sound is improved. It's a good start, but the rancher cannot be held responsible for what ultimately happens.

Thus, increasing the amount of waste material that is transformed or remanufactured into usable or marketable materials for use other than landfill disposal or incineration is the only accurate way to measure whether recycling can be said to have "increased." That is the overall goal – but it is not an outcome that can be guaranteed by a revenue sharing program. Even if the amount of materials placed in recycling bins were doubled, it would not mean that "recycling" was increased. In fact, the collection of it is not within the legal definition of "recycling."

Furthermore, there are too many uncertainties outside of the control of program participants to justify assigning responsibility for actual increases in recycling, as that term is defined by statute, to the revenue sharing programs. The measure is inherently difficult to quantify simply because there are so many opportunities for complications and distortions of data between the ratepayers' premises and the ultimate markets. One customer may generate a greater amount of recyclable material, as measured by either the weight or the volume of materials placed in the container – and yet if the customer does not sort properly, that entire container may be unmarketable. Another customer may generate lots of high-grade materials – and yet if that load goes into a truck that contains contaminants, that entire load may be unmarketable.

Thus, quantifiable measures may be indications of a successful program, but they are not technically ever going to be capable of demonstrating an increase in the amount of materials being transformed into products. Instead, revenue sharing programs should be reviewed in the context of the overall goal of increasing the amount of material that is diverted from disposal and potentially turned into useful product.

The Commission should acknowledge the aspirational goal of the legislation, and more affirmatively approve the use of retained revenues for programs and activities that are *intended* to increase recycling, but which may in fact fail to produce any tangible outcome. That aspirational objective of the statute is ignored if the focus is too narrowly made on metrics, especially because those standards may in fact not be measuring the right factor. It is not realistic to expect that every program will lead directly to an actual increase in "recycling," as the term is defined by law. The legislation frees revenues for plan participants to undertake activities that are put in place with reasonable and good faith expectations that the outcome will be – ultimately – to increase recycling. Unless it has reason to suspect the intentions of the parties, the Commission should approve programs designed in good faith by knowledgeable and earnest plan participants, instead of emphasizing the need for proof of potentially misleading benchmarks.

II. Counties and collection companies should be permitted to design revenue sharing plans, and the Commission should refrain from constraining program activities and expenditures.

The County personnel have experience in designing recycling programs, and expertise in evaluating what is effective and what is not. They know the local population, and they have institutional understanding of meaningful program components. The collection companies bring practical perspectives about customer behavior at the curbside, and about revenue-generating priorities at the markets. They observe the patterns of sorting and they track the correlation of processing and selling commodities. The Commission should defer to the solid waste departments of the local governments to determine the right mix of program activities intended to increase recycling in their jurisdiction.

In the absence of a blatantly inappropriate use of revenue, the Commission should therefore resist evaluating the merits of a plan presented to it. While the Commission's staff has considerable experience with solid waste collection programs, its area of authority and expertise is not with program design.

The Commission's scope of authority over economic regulation, however, is an important perspective. Its ability to assess the reasonableness of the expenditures made in the context of its ratemaking expertise complements the Counties' skill base. Auditing staff regularly reviews rate filings to verify that actual costs have been incurred, but County personnel does not typically have that kind of training or expertise. The Commission has familiarity with the kinds of expenditures presented by revenue sharing plans. It should verify that estimates are accurate and costs are appropriately allocated; but it should not second-guess program activities that are implemented under revenue-sharing plans designed by Counties in the context of substantiating expenditures for a past plan year, or in reviewing budgets for the next year.

Thus, it is not unreasonable for the Commission to require a participating company to project its expenses and revenues, if the plan is designed in a manner similar to the ones WM has implemented with its partner Counties in the past few years. Preparing a budget has been a positive exercise for both the Company and the local solid waste regulators. It has helped to anticipate the relative costs and weigh the benefits of various expenditures. Projecting expenses has resulted in modifications of initial plan activities, based on cost comparisons and revenue estimates. The Commission's ability to assure the general accuracy of projections is within its expertise and consistent with its statutory authorizations, and its review of budgets is appropriate

for plans that take the form of the ones recently used in Snohomish and King Counties.

When a budget is used for prospective plan periods, participants should not be rigidly tied to it, or be required to obtain Commission approval on modifications. If opportunities arise during the course of the plan year to invest in unanticipated activities, the plan participants should be permitted to pursue them. Some variation from a budget might be based on an affirmative choice of pursuing unanticipated opportunities, but even in the absence of those proactive modifications, variances can be expected. A budget is an approximation. There will inevitably be variations from projected revenues, and from estimated expenses. However, a prospective budget should not restrict eliminating, adding, or modifying plan activities and investments.

Whether a variance of either revenues or expenditures would require a formal modification might depend on the nature of the plan, but since a plan is only effective for twelve months, it is cumbersome to inject the time necessary for the Commission's further involvement. If it includes a mechanism for tracking variances from revenues and expenditures, then the Commission will be assured of having ability to review variations when the plan year has passed and a report is provided of how much revenue was actually generated, and how much was really spent. In that case, Commission approval of program adjustments should not be required.

III. Plan expenditures that the Counties determine are necessary to implement programs intended to increase recycling should be permitted.

Identifying all possible types of expenditures for revenue sharing plans would not yield a complete list. The programs to date have involved an enormous variety of activities and investments, and undoubtedly future plans will identify others currently unknown. The Commission has not suggested a desire to limit the nature of those expenditures, but a few specific types of uses of retained revenues have been the subject of some discussion.

The Commission has specifically queried whether annually recurring expenses are appropriate for revenue-sharing, or whether those program activities should be handled as recurring expenditures covered by the base recycling rates. There is no bright line answer to this question because it depends on the timing of the most recent general rate filing, the Counties' prioritization of a particular activity, and the Commission's policies regarding expenses that are not required by local laws.

Expenses that were not included in the pro forma for current tariff rates should legitimately be funded by retained revenues. Some of them may become so recurring that they are allowed in the rates when the next filing is made, but until that time paying for them with retained revenues is not obviously inconsistent with rate-making and revenue-sharing principles. Indeed, using retained revenue for revenue sharing activities potentially protects both the rate payer and the regulated company. Some years, where revenues are high, program expenditures may be unusually greater than normal, and setting rates based on those years would result in customers paying too much. Similarly, establishing a base recycling rate based on a test period that is leaner than most would result in under-earning. The mere fact that some program activities are recurring does not mean their expenses should be included in base rates.

The determination of whether certain program components should be repeated from year to year is one that the local regulators should be allowed to decide. To a certain extent, the suggestion that expenses from annually recurring activities should be subsumed into base recycling rates unfairly simplifies program components and disregards subtleties of implementation. Educational and informational outreach are particularly vulnerable because the activity description sounds repetitive unless the details of each communication are laid out.

If an outreach activity becomes standardized, then the Counties and the participating companies would have obvious motivation for having those expenses included in the rate base for the next tariff filing, and the ratepayers are in a sense protected by those incentives. The Counties have an incentive because doing so would free up more revenue for other program activities; and the companies would be guaranteed some return on those expenditures if they were incorporated into the rate base. The Commission should rely on these motivations and allow the plan participants to decide when a program cost should be incorporated into base rates.

Heretofore recovering expenses for annually recurring expenses like educational outreach in a general rate request has not been certain. The Commission has historically required there to be a legal obligation to perform, typically by way of the local solid waste management plan or implementing service level ordinances. Neither of these legal mandates are conducive to short-term planning, though. For example, imposing obligations for distributing materials to stimulate participation by particular customer demographics would not be appropriate for a five-year plan or a codified regulation. Even if any given revenue sharing activity were the appropriate subject of a local law, however, it would undermine the inherent flexibility and responsiveness that is called for with revenue-sharing programs to restrict them.

Regardless, if the Commission is now willing to permit expenses for program activities that are not mandated by solid waste management plans or by codes implementing those plans, it should clearly articulate that policy change.

Using funds for capital investments has been another specific expense called into question. WM and its partner Counties believe that using retained revenues for acquiring processing equipment at the materials recovery facility is within the scope of the revenue sharing legislation. Like collection, processing is itself not considered recycling – but it can have a significant impact on the quality of materials delivered to market, and thereby directly influence the volume of materials that are transformed into a useful product. There may be other sorts of equipment that could improve recycling programs. Using retained revenue for capital purchases may require a close tracking to ensure that the costs of those investments are removed from processing fees, but that should not be a reason to preclude the use of retained revenue for buying equipment to increase recycling.

IV. Plan participants should be rewarded for efforts to increase recycling, although financial incentives for influencing indicators of increased quality and quantities of recyclable materials are appropriate.

Rewarding regulated companies participating in revenue sharing plans has been perhaps the most controversial program expenditure. On this question, WM has repeatedly expressed its view that participating companies should be rewarded for diligently implementing revenue sharing programs, regardless of whether tangible metrics are achieved.

Prior to the enactment of the revenue-sharing legislation, the recycling commodity adjustment returned one-hundred percent of revenue to the customers, and there was nothing left over for regulated collection companies. Implementing the statute in a manner that forecloses any payment to the participating companies in some ways results in the same outcome. The regulated company gets to spend retained revenues, but it has no motivation for shopping and marketing the materials to get the greatest value. It might as well unload the material as quickly and cheaply as possible. Viewing revenue sharing programs in this manner effectively negates any meaningful change brought about from enactment of the legislation.

With regard to measurable criteria, WM has expressed its support for rewarding companies that produce objective evidence of a potential increase to recycling. Although these standards can only infer an increase to "recycling," nonetheless it is appropriate to compensate for results inferring an increase in the amount of

discarded material that is transformed or remanufactured into a useful product. Benchmarks such as a reduction in the quantity of material disposed, an increase in voluntary subscriptions, and other similar indicia of a successful program are legitimate bases for rewarding a participating company.

The Company urges the Commission to go beyond those objective indicia, however, and permit a performance incentive that is based solely on completing plan activities. Whether it be tied to revenue produced, or program expenditures, or some other reference, the willing and enthusiastic participation of regulated companies in revenue-sharing programs is dependent on allowing some sort of payment. Without it, the future of these programs is dubious.

V. Conclusion.

We commend the Commission for embarking on this policy initiative. Rulemaking is probably not appropriate for the questions involved in revenue sharing, but clear guidance can facilitate the ability to design plans and present filings with far less controversy.

Our last observation is that implementing revenue-sharing programs is problematic. Perhaps one of the most compelling problems on which Commission guidance is needed has to do with timing and mechanics of implementing revenue-sharing programs. The recycling commodity adjustment is by rule required for a twelve-month period, and using deferred accounting for its calculation compels the same time period for revenue sharing plans. Yet, it is difficult, and perhaps impossible to implement filings properly.

Under current Commission orders, the commodity price adjustment must be filed forty-five days prior to the effective date. This means the rate filing must be made prematurely, before the end of the plan period for which it is making an adjustment and prior to the commencement of the plan period for which it is effective. The plan participants do not have the benefit of data for the full twelve-month period, and are not yet able to evaluate program activities in order to design the next year's revenue sharing plan. At the same time, the Commission staff is presented with a rate filing without the companion plan. All parties are dissatisfied. The Counties, the Commission and the Companies should work together to resolve this dilemma.

We look forward to reviewing the comments of others stakeholders, and to further diaologue. Thank you for your consideration of our remarks, and obviously we are available and interested in answering questions and further the discussion.

Sincerely,

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