

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**WASTE CONTROL, INC.,**

**Respondent.**

**DOCKET TG-140560**

**INITIAL BRIEF ON BEHALF OF COMMISSION STAFF**

**November 7, 2014**

**ROBERT W. FERGUSON  
Attorney General**

**BRETT P. SHEARER  
Assistant Attorney General  
Office of the Attorney General  
Utilities & Transportation Division**

**1400 S Evergreen Park Drive S.W.  
P.O. Box 40128  
Olympia, WA 98504-0128  
(360) 664-1187**

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## I. INTRODUCTION

### A. Background

1 Waste Control, Inc. (“WCI” or “Company”) seeks to increase its revenues from solid waste collection by approximately \$510,000, or 12.9 percent.<sup>1</sup> Commission Staff (“Staff”) proposes an increase in annual revenues of approximately \$340,000, or 8.6 percent.

2 Following the Company’s rebuttal testimony on August 20, 2014, Staff and the Company (collectively “Parties”) reached a partial settlement agreement. The Parties’ proposed settlement resolves 11 of the 15 contested issues. This brief presents Staff’s position and arguments for the following four issues still in dispute:

1. Shared Utilities Expense, Adjustment R-6D. The Parties disagree as to the appropriate amount of shared utilities expense to allocate to WCI.
2. Affiliate Land Rents, Adjustment R-6E. The Parties agree on a general methodology for calculating affiliate land rent transactions but disagree as to the appropriate values for capital structure, cost of debt, cost of equity, and allocation of depreciation and average net investment.
3. Rate Case Expenses, Adjustments P-2 and P-3. The Parties disagree as to the amount of rate case costs that should be included in rates and the appropriate amortization period.
4. Investigation Fees. The Parties disagree as to whether the Commission should require WCI to pay Staff’s investigation fees, and, if so, should the Commission allow the Company to recover the investigation fees from ratepayers.

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<sup>1</sup> WCI’s initial filing on April 3, 2014, requested approximately \$543,000 in additional annual revenue. The Company’s rebuttal testimony filed on August 20, 2014, reduced the proposed additional annual revenue to approximately \$497,000. Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 53, Table 2 (August 20, 2014). WCI’s response to Bench Request 1 proposed additional annual revenue of approximately \$510,000. *See* WCI Response to Bench Request 1, October 21, 2014.

## B. Updates to Staff's Recommendation

3           Based on WCI's rebuttal testimony on August 20, 2014, and supporting information provided later, Staff supports three specific updates to its prior testimony filed on July 18, 2014. Staff's updates are based on new factual information supporting the inclusion or exclusion of specific figures in specific calculations; Staff's rationale and underlying methodology have not changed. Given that Staff supports these updates on the basis of new factual information provided by the Company, it is a better and more expedient use of the Commission's time and resources if Staff acknowledges its recommended updates in briefing and points to the reasons/support in the evidentiary record.

### 1. Three-factor allocator.

4           First, Staff supports an update to its three-factor allocator. The updated three-factor allocator impacts Shared Utilities Expense, Adjustment R-6D, and that portion of Affiliate Land Rents, Adjustment R-6E that allocates depreciation costs and average net investment.<sup>2</sup>

5           In its Testimony in Support of Partial Settlement on October 13, 2014, Staff recommended updates to its three-factor allocator for Adjustment R-6G, Property Tax Expense.<sup>3</sup> Those same updates and their supporting rationale continue to apply. Staff's update removes affiliate West Coast Paper Fiber, Inc. ("WCPF") from its calculation and adjusted affiliate Waste Control Recycling, Inc.'s ("WCR") gross revenues by subtracting the cost of recycled materials.<sup>4</sup> Staff also independently removed pass-through revenues

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<sup>2</sup> *Infra* Section II. Shared Utilities Expense, Adjustment R-6D, pp. 4-11 and Section III. Affiliate Land Rents, Adjustment R-6E, subsection E. Allocation of Depreciation and Average Net Investment, pp. 20-21.

<sup>3</sup> Testimony of Melissa Cheesman in Support of Proposed Partial Settlement Agreement, Docket TG-140560, p. 18, lines 16-18 and p. 21, lines 10-22 (October 13, 2014).

<sup>4</sup> Testimony of Melissa Cheesman in Support of Proposed Partial Settlement Agreement, Docket TG-140560, p. 18, lines 16-18 and p. 21, lines 10-15 (October 13, 2014).



from its three-factor allocator for Waste Control Equipment, Inc. (“WCE”), and WCI.<sup>5</sup>

Based on the Company’s rebuttal testimony and exhibits, Staff’s recommendation to the Commission now includes these changes. Staff’s current recommendation is also reflected in Staff’s response to Bench Request 1.

**2. Including origination fees in the cost of debt for HBI.**

6 Second, Staff supports amortizing loan origination fees over the life of the debt and adding those amortized, annual amounts to Heirborne Investments I, LLC’s (“HBI”) cost of debt. Staff otherwise maintains its position of pricing HBI’s debt at the actual, company-wide cost of debt readily observable in HBI’s financial statements. An update to HBI’s cost of debt impacts the cost of debt portion of Affiliate Land Rents, Adjustment R-6E.<sup>6</sup>

Amortizing origination fees adds 27 basis points to HBI’s cost of debt. Staff’s proposed update changes its previous recommendation from 1.93 percent to 2.2 percent. Based on the Company’s rebuttal testimony and exhibits, Staff’s recommendation to the Commission now includes this change. Staff’s current recommendation is also reflected in Staff’s response to Bench Request 1.

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<sup>5</sup> Pass through revenues refer to material costs for WCR and disposal fees for WCE and WCI, all of which are offset dollar-for-dollar in expenses. *See* Testimony of Melissa Cheesman in Support of Partial Settlement Agreement, p. 18, lines 16-19 and p. 21, lines 10-22 (October 13, 2014).

<sup>6</sup> *Infra* Section III. Affiliate Land Rents, subsection C. Cost of Debt, pp. 16-18.

**3. Addition of new truck shop facility placed into service after the test year.**

7 Staff recommends the Commission include the Company's new truck shop facility placed into service since the end of the test year.<sup>7</sup> Including the new truck shop facility impacts Affiliate Land Rents, Adjustment R-6E.<sup>8</sup>

8 As described in Staff's testimony in support of partial settlement, Staff did not previously include the truck shop facility in its analysis because the Company did not include it in the general rate filing and did not inform Staff that WCI had placed the facility into service.<sup>9</sup> After reviewing the Company's rebuttal testimony, and subsequent supporting documentation, Staff believes the new truck shop facility is used and useful.<sup>10</sup> Staff's recommendation to the Commission now includes this change.

**II. SHARED UTILITIES EXPENSE, ADJUSTMENT R-6D**

**A. Overview**

9 The Parties' dispute over Shared Utilities Expense, Adjustment R-6D, stems from WCI's relationship with its affiliates. WCI and its affiliates share common personnel, equipment, and facilities. Staff and the Company disagree as to the appropriate allocation of utilities expenses tied to those shared resources. Staff recommends the Commission allocate \$13,975 of shared utilities expenses to WCI's operations.<sup>11</sup> The Company proposes to allocate \$28,926 in utilities expenses to WCI.<sup>12</sup>

<sup>7</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_\_ (JD-41T), p. 19, lines 5-7; Davis Rebuttal, Exhibit No. \_\_\_ (JD-44)

<sup>8</sup> *Infra* Section III. Affiliate Land Rents, Adjustment R-6E, pp.10-21.

<sup>9</sup> Testimony of Melissa Cheesman in Support of Proposed Partial Settlement Agreement, Docket TG-140560, p. 21, lines 3-9 (October 13, 2014).

<sup>10</sup> *Id.*

<sup>11</sup> Staff's testimony on July 18, 2014, recommended an allocation of \$11,857 in utilities expense to WCI. The change is due to updates in Staff's three-factor allocator. For further explanation, please see *supra* Section I. Introduction, subsection B. Updates to Staff's Recommendation, pp. 2-4

<sup>12</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_\_ (JD-41T), p. 13, lines 2-4 (August 20, 2014).

10

Staff's recommendation stems from a straightforward and transparent allocation based on WCI's and its affiliates' adjusted revenues, book value of fixed assets, and number of employees.<sup>13</sup> The combination of these three factors is a reasonable indicator of the size and scope of each affiliate entity's operations relative to WCI and one another.<sup>14</sup> In turn, the relative size and scope of each entity's operations reasonably estimates the proportional costs each entity places on common resources such as shared personnel, equipment, and facilities. Therefore, Staff's proposed calculation assigns shared utilities expense in a fair, transparent manner that is consistent with the regulatory principle of cost causation.

11

WCI appears to simultaneously argue in favor of several different, mutually exclusive proposals. First, in its direct testimony, the Company proposed to allocate shared utilities expense based on the number of affiliates sharing a facility; for example, if three affiliates share space, WCI advocated a one-third (1/3) allocation of shared utilities expenses for each entity without any further analysis.<sup>15</sup> In rebuttal testimony, the Company advocates the use of another, unspecified allocation methodology apparently based on square footage; however, WCI does not propose a narrative of its methodology, supporting data and calculations, or even the resulting allocator.<sup>16</sup> Lastly, WCI appears to argue in favor of using a modified version of Staff's allocation methodology that includes WCR's utilities expenses from non-shared facilities.<sup>17</sup>

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<sup>13</sup> Cheesman, Exhibit No. \_\_ (MC-1T), pp. 16-17.

<sup>14</sup> *Id.*

<sup>15</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 18, lines 3-9 (July 18, 2014).

<sup>16</sup> See Rebuttal Testimony of Layne Demas, Exhibit No. \_\_ (LD-1T), at pp. 7-8; Rebuttal Testimony of Jackie Davis, Exhibit No. \_\_ (JD-41T), pp. 11-13.

<sup>17</sup> See Rebuttal Testimony of Jackie Davis, Exhibit No. \_\_ (JD-41T), p. 11:21-22 and p. 12:25 through p. 13:4 (August 20, 2014). Ms. Davis's rebuttal testimony also argues for removal of one affiliate entirely and removal of another affiliate's pass through costs/revenues in Staff's three-factor allocation, both of which Staff largely supported in its testimony in support of partial settlement. See *supra* Section I. Introduction, subsection B. Updates to Staff's Recommendation, pp. 2-4.

## **B. Staff's Recommendation is Fair and Reasonable**

### **1. Fundamental principles and Commission precedent.**

12 Generally-accepted, fundamental accounting principles dictate that shared costs should be allocated based on cost-drivers.<sup>18</sup> Allocation factors should reasonably attempt to allocate costs to the entities and operations generating those costs.<sup>19</sup> When expenses cannot be directly assigned, Commission precedent also supports allocating expenses based on the principles of cost causation and avoidance of cross-subsidies.<sup>20</sup> Only Staff's testimony applies these principles and precedent in its recommendation to the Commission.

### **2. Staff's recommendation reasonably estimates costs.**

13 Staff bases its three-factor allocator on each affiliate's average percentage of its relative number of employees, adjusted revenue, and fixed asset book value.<sup>21</sup> Staff does not propose allocating on the basis of any single factor.<sup>22</sup> The combination of three-factors provides a reasonable and accurate estimate of each entity's relative size and impact on common resources.

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<sup>18</sup> Every legitimate textbook or treatise on ratemaking includes discussion about the basic fairness of using cost causation principles as a primary factor in determining fair and reasonable cost allocations and rates. *See, e.g.*, LEONARD SAUL GOODMAN, *THE PROCESS OF RATEMAKING*, Vol. I, pp. 37-388 and 420-422 (1988); CHARLES F. PHILLIPS, JR., *THE REGULATION OF PUBLIC UTILITIES* 227, 434-436 (1993).

<sup>19</sup> *See* GOODMAN at 374.

<sup>20</sup> Nearly every docket before the Commission contains some allocation on the basis of cost causation/avoiding cross subsidies. For representative examples across regulated industries, *see e.g. WUTC v. American Water Resources, Inc.*, Dockets UW-980072, UW-980258, UW-980265 (consolidated), Sixth Supplemental Order (Jan. 21, 1999); *In the Matter of the Petition of Puget Sound Energy, Inc., and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 and UG-121705, Order 09 at p. 16 (December 12, 2013); *King County Department of Public Works, Solid Waste Division v. Seattle Disposal Company, Rabanco Ltd., d/b/a Eastside Disposal and Container Hauling*, Docket TG-940411, Third Supplemental Order (Final) at pp. 14-20, (Sept. 14, 1994).

<sup>21</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-1T), pp. 16-17 (July 18, 2014).

<sup>22</sup> *Id.*

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WCI's rebuttal testimony expressly recognizes that number of employees is useful as an allocator for certain shared overhead costs.<sup>23</sup> Utilities Expense incurred through the use of shared facilities qualifies as a "shared overhead cost." The Company's rationale also applies to revenues and book value of fixed assets. For net book value of fixed assets, the aggregate book value of an entity's assets suggests the size of its operation and amount of its investments, which indicate that entity's role in contributing to common overhead costs. Similarly, the amount of revenues is indicative of each entity's level of activity and the corresponding amount of time and costs placed on shared resources.

**3. Staff's recommendation consistent with accepted allocators in other regulated industries.**

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It is important to note that Staff's proposal is consistent with the Commission's generally accepted allocation methodologies. Multi-state utilities under the Commission's jurisdiction allocate certain shared costs partially on the basis of fixed asset book value.<sup>24</sup> Those same multi-state utilities also include the number of customers and specific cost data in calculating allocation factors.<sup>25</sup> Although WCI did not maintain detailed customer or cost tracking data, Staff relied on the number of employees and revenues as analogous factors. The number of employees correlates to the number of customers served, and cost data necessarily derives from revenues. Thus, Staff's recommended three-factor allocator is as consistent as possible with Commission-accepted allocation methodologies in other regulated industries.

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<sup>23</sup> Rebuttal Testimony of Layne Demas, Exhibit No. \_\_\_ (LD-1T), bottom of p. 7 (August 20, 2014).

<sup>24</sup> See *WUTC v. Avista Corp. d/b/a Avista Utilities*, Docket UE-140188/UG-140189 (consolidated), Direct Testimony of Liz Andrews, pp. 93-99; *WUTC v. PacifiCorp*, Docket UE-061546, Order 08 (Final Order) ¶ 43 (June 21, 2007) (adopting PacifiCorp's WCA allocation methodology). See also *WUTC v. PacifiCorp*, Docket UE-061546, Direct Testimony of William R. Griffith, Exhibit No. \_\_\_ (WRG-4) (October 3, 2006).

<sup>25</sup> See *supra* footnote 24, above.

**4. WCI and its affiliates are sufficiently similar for reasonable comparison.**

16 The Company's argument that WCI and its affiliate entities are so disparate as to render any comparison or allocation unfair and unreasonable is without merit.<sup>26</sup> WCI's owner states in his direct testimony that there are "five *related* solid waste collection/recycling reclamation and transfer/disposal-related entities operating at our Longview facility" (emphasis added).<sup>27</sup> Staff recognizes distinctions between the various businesses, but agrees with the Company's co-owner that common ownership, management, equipment use, facilities, personnel, financing, and geographic locations demonstrate that WCI and its affiliates are closely related.<sup>28</sup> Given the commonalities, WCI and its various affiliates cannot possibly be so disparate as to render comparisons unreasonable.

**C. Absence of any Reasonable Alternative to Staff's Proposal**

17 Staff's proposal is the only reasonable allocation methodology in the record of this proceeding. The Company's three proposals are either unsupported, not actually provided at all, or contravene fundamental accounting principles and Commission precedent. As a result, WCI has not met its evidentiary burden and the Commission should adopt Staff's recommendation to allocate \$13,975 of shared utilities expense to WCI.

**1. Allocation by number of entities sharing a facility.**

18 The Company's initial proposal of a "one divided by three" allocation does not reflect, or even attempt to estimate relevant cost drivers. The Commission should reject WCI's initial proposal for that reason alone. The proposal is overly-simplistic, unsupported,

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<sup>26</sup> See Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 10, lines 15-24, p. 12, lines 12-21 (August 20, 2014); Rebuttal Testimony of Layne Demas, Exhibit No. \_\_ (LD-1T), p. 7, lines 8-10 (August 20, 2014).

<sup>27</sup> Direct Testimony of Joe Willis, Exhibit No. \_\_ (JW-1T), p. 7, lines 9-14 (April 3, 2014).

<sup>28</sup> See Willis, Exhibit No. \_\_ (JW-1T), pp. 2-4; Exhibit No. \_\_ (JW-3) (description of affiliate entities); Exhibit No. \_\_ (JW-4); Rebuttal Testimony of Joe Willis, Exhibit No. \_\_ (JW-7) (August 20, 2014). See also Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 16, lines 14-15, Exhibit No. \_\_ (MC-3), pp. 1-4.

and unreasonable given the Commission's precedent supporting allocations on the basis of cost.

**2. Square footage.**

19 Ms. Davis's rebuttal testimony articulates a preference for a square footage allocator but fails to provide a calculation or the allocator.<sup>29</sup> Consequently, WCI has not met its evidentiary burden to support a square footage allocator. The Commission cannot rely on a stated preference without supporting data or even a specific request to allocate an expense in a certain manner. A short reference to a data request in the previously-dismissed docket does not provide a record on which the Commission could or should adopt such a proposal.<sup>30</sup> Thus, the Commission should reject WCI's apparent proposal for a square footage allocator.<sup>31</sup>

**3. Adopt the results of Commission's three-factor with modifications.**

20 Ms. Davis goes on to propose that the Commission should adopt the results of Staff's methodology with three modifications. First, WCI argues that affiliate WCR's obligation should be adjusted to include \$59,215 in utility bills paid for non-shared facilities.<sup>32</sup> Second, affiliate WCPF should be removed from the calculations.<sup>33</sup> Third, WCR's materials costs should be removed from the revenue portion of Staff's three-factor allocation because those costs are matched dollar-for-dollar in revenues.<sup>34</sup>

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<sup>29</sup> See Rebuttal Testimony of Jackie Davis, Exhibit No. \_\_\_ (JD-41T), pp. 11-12 (August 20, 2014).

<sup>30</sup> *Id.* at 12. Staff disputes that the referenced data request response contains the suggested data or evidentiary support.

<sup>31</sup> Staff maintains that square footage allocations are not feasible in this case because the Parties are disputing costs associated with *shared* spaces and resources. It is not possible to allocate square footage for the same physical space, people, and equipment.

<sup>32</sup> Rebuttal Testimony of Jackie Davis, Exhibit No. \_\_\_ (JD-41T), pp. 12-13 (August 20, 2014).

<sup>33</sup> *Id.* at 13.

<sup>34</sup> *Id.* at 13.

21 Staff's updated proposal largely accepts Ms. Davis's second and third modifications, excluding WCPF completely and removing WCR's materials costs.<sup>35</sup> In order to ensure accounting consistency, Staff's recommendation additionally removes pass through revenues associated with WCI and WCE.<sup>36</sup>

22 The Commission should reject Ms. Davis's proposal to adjust WCR's allocation of utilities expense. There is simply nothing in the record documenting or supporting the Company's proposal to include utilities expense for non-shared facilities or why adjusting only WCR's gross revenues results in a reasonable and fair allocation. WCI's proposal fails to meet the required evidentiary burden.

23 In addition, WCR's claimed \$59,215 in utilities payments appear to relate to non-shared facilities in which WCR conducts non-regulated activity.<sup>37</sup> Thus, the rebuttal testimony of Ms. Davis seeks to reduce WCR's allocation of costs for shared facilities on the basis of WCR's payments relating to non-shared facilities.<sup>38</sup>

24 Fundamental accounting principles dictate that direct costs should be directly assigned rather than allocated.<sup>39</sup> Commission precedent also reflects a preference for direct assignment of costs where feasible.<sup>40</sup> The entire purpose of an allocation is to fairly allocate common, indirect costs. Therefore, by definition, allocation for common costs should apply only to common, indirect costs such as shared facilities. The Commission should continue

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<sup>35</sup> See *supra* Section I. Introduction, subsection B. Updates to Staff's Recommendation, pp. 2-4.

<sup>36</sup> See *supra* Section I. Introduction, subsection B. Updates to Staff's Recommendation, pp. 2-4

<sup>37</sup> *Id.*; see Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 12, lines 10-17 (August 20, 2014) ("cost of aggregate facility utilities" and "utility costs for that portion are, in fact, not shared").

<sup>38</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 12, lines 10-17, 25 (August 20, 2014).

<sup>39</sup> Every credible ratemaking textbook or treatise includes discussion of both cost-based rates and the assignment of direct costs. See e.g. JAMES C. BONBRIGHT ET. AL., PRINCIPLES OF PUBLIC UTILITY RATES, pp. 109-120 (2d. edition 1988); LEONARD SAUL GOODMAN, THE PROCESS OF RATEMAKING, Vol. I pp. 378-79, 364-65, 440 (1988); CHARLES F. PHILLIPS, JR., THE REGULATION OF PUBLIC UTILITIES, pp. 225, 435-37 (1993)

<sup>40</sup> *WUTC v. American Water Resources, Inc.*, Docket UW-980072, UW-980258, UW-980265, UW-980076 (consolidated), Sixth Supplemental Order (Final), at p. 15 (Jan. 21, 1999).



to adhere to basic accounting principles and reject the Company's proposal to reduce an affiliate's portion of common, indirect expenses based on payment of its unrelated, direct costs.

### III. AFFILIATE LAND RENTS

25           The Parties' dispute over Affiliate Land Rents, Restating Adjustment R-6E, stems from WCI's relationship with its affiliates. WCI leases its premises from affiliated landlords Heirborne Investments I, LLC ("HBI") and Heirborne Investments II, LLC ("HBII").<sup>41</sup> WCI shares its leased premises with affiliates WCR and WCE. Staff recommends the Commission allow WCI to include \$85,217 of its affiliate lease payments in rates. WCI proposes to include \$164,303 of the affiliate lease payments in the Company's results of operations.<sup>42</sup>

#### A. Fundamental Principles and Overview

26           WCI's lease payments to HBI and HBII are affiliate interest transactions under RCW 81.16.010. Under the terms of RCW 81.16.030, the Commission may disallow payments to an affiliate interest in whole or in part if those payments are unreasonable.<sup>43</sup> The Commission determines reasonableness by pricing affiliate transactions at the lower of cost or market.<sup>44</sup> "Market" is simply the market price for a similar good or service; "cost" is the underlying cost of the good or service plus a reasonable return, or "cost-plus-return."

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<sup>41</sup> WCI and its affiliate landlords, Heirborne Investments I, LLC and Heirborne Investments II, LLC share 100% common ownership. Direct Testimony of Joe Willis, Exhibit No. \_\_ (JW-1T), pp. 2-4 (April 3, 2014).

<sup>42</sup> Refer to WCI's Response to Bench Request 1 (October 21, 2014).

<sup>43</sup> RCW 81.16.030.

<sup>44</sup> *WUTC v. Bremerton-Kitsap Airporter*, Docket TC-001846, Fifth Supplemental Order (Final), p. 14, ¶ 36 (August 2, 2002).

27 The Commission has previously endorsed a cost-plus-return methodology for affiliate lease payments.<sup>45</sup> The Commission's previously-accepted cost-plus-return calculation relies on capital structure, cost of debt, cost of equity, and allocation of depreciation and average net investment. Staff and WCI disagree as to the appropriate values for all of these terms.

28 As described in the testimony of Ms. Melissa Cheesman, each of Staff's recommended values in the cost-plus-return calculation is based on reasonable estimates of the underlying cost to the affiliate.<sup>46</sup> Conversely, the Company's proposal and recommended values are unsupported, inconsistent with previous Commission treatment, and contravene regulatory accounting principles.

## **B. Capital Structure**

### **1. Commission should use the actual, company-wide capital structures for HBI and HBII.**

29 Staff recommends the Commission use the actual, company-wide capital structures of the affiliate landlords, HBI and HBII, in calculating fair and reasonable affiliate land rents. Based on December 31, 2013, balance sheets, HBI's actual capital structure is 93.7 percent debt and 6.3 percent equity, and HBII's actual capital structure is 53.8 percent debt and 46.2 percent equity.<sup>47</sup> Staff's recommendation is appropriate for several reasons.

30 First, and most important from a regulatory policy perspective, Staff's recommendation for a company-wide, consolidated capital structure removes HBI's and HBII's ability to manipulate debt and equity levels between non-regulated and regulated

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<sup>45</sup> *WUTC v. Bremerton-Kitsap Airporter, Inc.*, Docket TC-001846, Fifth Supplemental Order (Final), pp. 14-15 and Appendix C (August 2, 2002).

<sup>46</sup> See Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), pp. 18-23 (July 18, 2014).

<sup>47</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 20, line 21, through p. 21, line 3 (July 18, 2014).

facilities. Use of an asset-specific capital structure, as WCI proposes, would allow an entity to shift equity to assets associated with regulated operations while shifting debt to assets associated with non-regulated operations.<sup>48</sup> Under such a scenario, an entity could manipulate asset-specific capital structures to increase affiliate lease payments with no increase in actual risk to the entity or corresponding benefit to ratepayers. Therefore, asset-specific capital structures allow for and incent cross subsidies, which violates the reasonableness standard in RCW Chapter 81.16 and Commission precedent.

31 Staff's concern is not entirely speculative. Indeed, although *all* of the affiliate entities' assets secure HBI's and HBII's debts,<sup>49</sup> WCI argues in this proceeding that the vast majority of HBI and HBII debt is associated *only* with non-regulated operations.<sup>50</sup> At the same time, WCI's testimony states that the majority of HBI's and HBII's assets associated with regulated operations hold little or no debt.<sup>51</sup> WCI's proposal uses affiliate transactions to allocate debt to non-regulated operations and equity to regulated operations. WCI's proposal demonstrates the merits of Staff's concerns. Use of an asset-specific capital structure incentivizes regulated companies to manipulate debt ratios through affiliate transactions with no corresponding change in risk profile or benefits to ratepayers.

32 Second, a company-wide capital structure is appropriate in this case because all of HBI's and HBII's facilities, including those leased to WCI, secure all of HBI's and HBII's

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<sup>48</sup> For example, if the Commission were to allow returns on the basis of asset-specific capital structures, an entity could simply borrow capital against non-regulated assets to pay off debt associated with regulated assets.

<sup>49</sup> Rebuttal Testimony of Joe Willis, Exhibit No. \_\_ (JW-7), p. 2 (August 20, 2014); Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 20 footnote 19, and Exhibit No. \_\_ (MC-3), pp. 1-4 (July 18, 2014).

<sup>50</sup> See Direct Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-1T), p. 4, lines 22-25, p. 9, line 21 through p. 10, line 3 (April 3, 2014); see also Rebuttal Testimony of Jackie Davis, Exhibit No. \_\_ (JD-41T), pp. 14-16, and Exhibit No. \_\_ (JD-43T) (August 20, 2014) (proposed land rents calculation); Rebuttal Testimony of Joe Willis, Exhibit No. \_\_ (JW-7T), p. 2 ("each of the entities . . . are guarantors"). See also Cheesman, Exhibit No. \_\_ (MC-1T), p. 20, lines 3-4

<sup>51</sup> See Rebuttal Testimony of Layne Demas, Exhibit No. \_\_ (LD-1T), p. 4.

debts.<sup>52</sup> Therefore, for all practical and economic purposes, HBI and HBII's facilities are encumbered and carrying a pro rata share of the companies' debts.<sup>53</sup> There is simply no economic difference between pledging assets as security for a bond and mortgaging those assets directly. The Commission should reject the Company's false distinction. Regardless of the Commission's preference for a company-wide or asset-specific capital structure, a fair calculation of each facility's capital structure in this case must reflect the Company's overall debt ratios.

33 Third, Staff's testimony points out that HBI's and HBII's company-wide capital structures reflect those companies' actual risk profiles and costs of capital.<sup>54</sup> The actual risk profiles and cost of capital are necessarily the appropriate figures when calculating cost-plus-return.<sup>55</sup> An asset-specific capital structure is not indicative of an entity's risk profile and thus cannot be used to calculate an accurate cost of capital or adequate return. An asset-specific capital structure is particularly inadequate where the underlying assets are old and no longer reflective of the ownership entity's financial position.

## 2. Commission Precedent in BKA.

34 WCI supports its proposal on the basis of the Commission's final order in Docket TC-001846, *WUTC v. Bremerton-Kitsap Airporter* ("BKA").<sup>56</sup> However, the Commission's order in BKA does not mandate, or even expressly support, an asset-specific capital

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<sup>52</sup> The revenues and assets of the operating affiliates, including WCI, WCE, and WCR guarantee HBI's and HBII's debts. Rebuttal Testimony of Joe Willis, Exhibit No. \_\_\_ (JW-7), p. 2 (August 20, 2014). See also Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-1T), p. 20 footnote 19 and Exhibit No. \_\_\_ (MC-3), pp. 1-4 (July 18, 2014).

<sup>53</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-3) (July 18, 2014).

<sup>54</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-1T), p. 20, lines 1-3.

<sup>55</sup> *Id.*

<sup>56</sup> *WUTC v. Bremerton-Kitsap Airporter, Inc.*, Docket TC-001846, Fifth Supplemental Order (Final Order), pp. 14-15 and Appendix C, (August 2, 2002).

structure for calculating appropriate affiliate lease payments.<sup>57</sup> The Commission simply never addressed whether an asset-specific capital structure is appropriate to calculate allowable affiliate land rents. At the very least, the Commission did not address whether asset specific capital structures should apply universally to all affiliate rent transactions.

35 Both a plain reading of the Commission's order in BKA and a brief examination of the underlying facts support Staff's position that BKA does not require the use of an asset-specific capital structure in affiliate rent transactions. First, neither the Commission's order nor any documentation in the record leading up to the Commission's decision requires or even discusses an asset-specific capital structure.<sup>58</sup> Second, the present situation between WCI and its affiliates is distinguishable from the BKA case. The record in BKA indicates that the regulated entity and its owner did not have multiple facilities, affiliate entities, non-regulated operations, the potential for cross subsidies, or present any other regulatory concern that the owner would or could manipulate capital structure to inflate affiliate lease payments.<sup>59</sup> In a scenario with one facility, one owner, and one business, cross subsidies are not possible and an asset-specific capital structure cannot raise questions of reasonableness under RCW 81.16.030.

36 In contrast, HBI and HBII have several facilities, numerous affiliates, can manipulate capital structures for regulated and non-regulated facilities, their affiliates conduct non-regulated operations in the same or similar industries, and there is an inherent incentive to create cross subsidies between regulated and non-regulated entities. Therefore, using an asset-specific capital structure for HBI and HBII in this case does not establish a reasonable result or in any way alleviate the regulatory concerns over cross subsidies underlying RCW

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<sup>57</sup> See *id.*

<sup>58</sup> See *WUTC v. Bremerton-Kitsap Airporter, Inc.*, Docket TC-001846.

<sup>59</sup> See *WUTC v. Bremerton-Kitsap Airporter, Inc.*, Docket TC-001846.

81.16.030. Under any reasonable reading of the Commission's order, BKA does not mandate or support an asset-specific capital structure to calculate affiliate lease payments in this, or any other, case. The Commission reviews each case on its unique facts and surrounding circumstances, and a previous decision under one set of facts is not binding on the Commission in all situations.

### **3. WCI's alternative proposal.**

37 WCI alternatively proposes to use WCI's capital structure for calculating an affiliate lease payment.<sup>60</sup> Calculating an appropriate cost-plus-return on the basis of the tenant rather than the landlord violates basic accounting and common sense. Cost-plus-return is fundamentally tied to the entity that incurs the cost and receives the return (i.e. the landlord). WCI has not supported its novel proposal with any policy narrative, accounting or regulatory principle, or Commission precedent. Therefore, the Commission should reject WCI's alternative proposal to calculate an appropriate cost-plus-return on the basis of the tenant's financial structure.

## **C. Cost of Debt**

### **1. Overview.**

38 Staff recommends the Commission use HBI and HBII's actual costs of debt, 2.2 percent and 4.3 percent, respectively. WCI proposes an asset-specific cost of debt. The rebuttal testimony of Ms. Davis proposes an asset-specific<sup>61</sup> cost of debt of 2.635 percent for two of HBI properties, zero percent for the remaining HBI properties, and 5.27 percent for

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<sup>60</sup> See Prefiled Direct Testimony of Jacqueline G. Davis, Exhibit No. \_\_ (JD-1T), p. 4, lines 23-25 (February 18, 2014 – refiled April 3, 2014); Supplemental Testimony of Jacqueline G. Davis, Exhibit No. \_\_ (JD-\_\_T), p. 8, lines 23-25 (April 3, 2014); Supplemental Testimony of Jacqueline G. Davis, Exhibit No. \_\_ (JD-41T), p. 16, lines 10-12 (August 20, 2014).

<sup>61</sup> The mortgage rate for each specific facility. See Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-43) (August 20, 2014).

the HBII property.<sup>62</sup> Ms. Davis's proposal is based on apportioning a specific portion of HBI and HBII's debt obligations to facilities leased to WCI, and appears conditioned on Staff's acceptance of an asset-specific capital structure.<sup>63</sup>

**2. Fundamental principle.**

39 An entity's actual cost of debt is readily observable in financial statements.<sup>64</sup> Financial statements capture an entity's risk profile and financial obligations.<sup>65</sup> Thus, a company-wide cost of debt accurately reflects both the underlying costs and an appropriate return tied to an entity's level of risk.

**3. Staff's proposal is reasonable and consistent with Commission practice.**

40 Staff is unaware of any case in which the Commission evaluated an entity's cost of debt on an asset-by-asset basis. Such a process would require the Commission to examine debt levels for every truck, facility, and construction project. Not only is such an exercise time consuming and infeasible, but, absent a series of transactions or self-dealing to artificially inflate debt costs, the results are irrelevant. An entity's company-wide cost of debt will equal the weighted-average cost of debt of all individual projects. Staff's recommendation simply goes to the finish line and recommends the cost of debt readily observable on HBI's and HBII's financial statements as of December 31, 2013.<sup>66</sup>

41 Ms. Davis's rebuttal testimony proposes to allocate specific portions of HBI's and HBII's debts between regulated and non-regulated operations.<sup>67</sup> As Staff's testimony points

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<sup>62</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 21 (August 20, 2014).

<sup>63</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 21 (August 20, 2014).

<sup>64</sup> See e.g., STEPHEN A. ROSS, ET. AL., ESSENTIALS OF CORPORATE FINANCE 27-30, 367-73 (Fourth ed. 2004)

<sup>65</sup> *Id.* at 21-86.

<sup>66</sup> As described *supra* Section I. Introduction, subsection B. Updates to Staff's Recommendation, pp. 2-4, Staff supports amortizing the debt's origination fees over the life of the loan and including the annually amortized amount in the cost of debt for HBI.

<sup>67</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), Docket TG-140560, p. 21 (August 20, 2014).

out, and the Company's testimony expressly acknowledges, all of HBI's and HBII's facilities secure all of those companies' debts.<sup>68</sup> Ms. Davis's proposal to apportion or bifurcate specific debt obligations between buildings does not represent the economic reality that creditors hold equal claims on all of the borrowers' facilities. The cost of debt for each facility should reflect its owner's (i.e., HBI or HBII) actual, company-wide cost of debt. As a result, the Commission should accept Staff's recommendation and reject the Company's alternative proposals.

#### **D. Cost of Equity/Return on Equity (ROE)**

##### **1. Fundamental principles.**

42 The return on equity, or cost of equity, represents the return an investor demands in exchange for providing equity capital to a business.<sup>69</sup> The cost of equity is not static.<sup>70</sup> The Commission recognizes that capital markets are constantly changing.<sup>71</sup> A recent Commission order even reiterated the inadequacy of a discounted cash flow ("DCF") analysis that relied on historical, rather than forward looking, figures.<sup>72</sup> Only Staff's testimony and recommendation adhere to these fundamental principles of finance and Commission precedent.

##### **2. Staff's recommendation follows Commission precedent.**

43 Staff recommends DCF-based returns on equity of 12.5 percent for HBI and 13.1 percent for HBII. Ms. Cheesman's testimony relies on the earnings growth projections and

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<sup>68</sup> Rebuttal Testimony of Joe Willis, Exhibit No. \_\_ (JW-7), p. 2 (August 20, 2014). See also Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 20, footnote 19, and Exhibit No. \_\_ (MC-3), pp. 1-4 (July 18, 2014).

<sup>69</sup> E.g., CHARLES F. PHILLIPS JR., THE REGULATION OF PUBLIC UTILITIES, p. 394 (1993).

<sup>70</sup> *Id.* at 380 discussing judicial standards for cost of capital ("a fair return varies with investment opportunities, the location of a utility, the nature of the business and general economic conditions").

<sup>71</sup> *WUTC v. Pacific Power & Light Co.*, Docket UE-130043, Order 05 (Final Order), p. 8, ¶24 (December 4, 2013).

<sup>72</sup> *WUTC v. Pacific Power & Light Co.*, Docket UE-130043, Order 05 (Final Order), pp. 25-26, ¶65 (December 4, 2013).



dividend yields of publicly-traded real estate companies listed in ValueLine Investment Survey.<sup>73</sup> Following the Commission's principles supporting the temporal nature of the return on equity, Staff's analysis reflects current economic conditions and investors' current expectations for equity returns in the real estate industry.

**3. WCI's proposal is inconsistent with financial principles and the Company has failed to carry its evidentiary burden.**

44 WCI argues in its rebuttal testimony for a return on equity of 15 percent despite an admitted lack of quantitative analysis.<sup>74</sup> The Company offers no supporting calculation or rationale for its proposed ROE other than to note that the Commission previously allowed 15 percent in the 2002 BKA case,<sup>75</sup> HBI and HBII are small private companies, and a conclusory statement that 15 percent has "obviously been fair."<sup>76</sup> The Company also points to Dr. Lurito's testimony to the Commission in approximately 1990.<sup>77</sup> Given the Commission precedent that the cost of capital is dynamic, testimony and precedent from 12 and 25 years ago is of extremely limited value in assessing current costs of equity.

45 WCI's testimony relies solely on historical capital costs. Commission precedent acknowledges and supports a dynamic cost of capital approach and constantly changing capital markets. Consequently, WCI's testimony fails to carry the requisite evidentiary burden to support a present-day 15 percent return on equity for HBI and HBII. Therefore,

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<sup>73</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-1T), p. 21, lines 12-17 and Exhibit No. \_\_\_ (MC-6), Schedule 4, R-6E (July 18, 2014).

<sup>74</sup> Rebuttal Testimony of Layne Demas, Exhibit No. \_\_\_ (LD-1T), p. 6, lines 15-16 (August 20, 2014).

<sup>75</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_\_ (JD-41T), p. 19, lines 15-16 (citing *WUTC v. Bremerton-Kitsap Airporter, Inc.*, Docket TC-001846, Fifth Supplemental Order (Final), Appendix C).

<sup>76</sup> *Id.*; Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_\_ (JD-41T), p 19, line15; *see also* Davis Rebuttal, Exhibit No. \_\_\_ (JD-43).

<sup>77</sup> Staff assumes that Mr. Demas's rebuttal testimony at page six refers to Dr. Lurito's testimony in *WUTC v. Sno-King Garbage Co.*, Dockets TG-900657/TG-900658 (consolidated), Fourth Supplemental Order (Final) (December 10, 1991), in which Dr. Lurito advocated for the continued use of the Lurito-Gallagher regression in solid waste ratemaking and an additional 75 basis points to be added to the ROE.

the Commission should reject WCI's proposal to impute a 15 percent ROE for its landlord affiliates and adopt Staff's recommendation.

## **E. Allocation of Depreciation and Average Net Investment**

### **1. Overview and fundamental principles.**

46 Depreciation and average net investment are legitimate components and are important to any cost-plus-return calculation.<sup>78</sup> It is necessary to allocate depreciation and average net investment among tenants because several of HBI's and HBII's facilities have multiple tenants and each tenant should be responsible for its proportional share of costs. Staff recommends its three-factor allocator for assigning costs whereas WCI proposes a one-third allocation. WCI has not provided a calculation or specific rationale for why one-third is an appropriate allocator.<sup>79</sup>

47 Under generally-accepted accounting principles, shared costs should be allocated based on cost-driving factors.<sup>80</sup> The regulatory goal is to assign expenses to the entities or operations that generate those expenses and avoid cross-subsidization between regulated and non-regulated operations.<sup>81</sup> The Commission supports allocating expenses on the basis of cost causation and avoidance of cross-subsidies.<sup>82</sup> Ms. Cheesman's testimony applies these regulatory and Commission-approved principles. WCI's recommendation does not adhere

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<sup>78</sup> Operating costs are not disputed in this case.

<sup>79</sup> See Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 17, lines 1-7 (August 20, 2014).

<sup>80</sup> Every legitimate textbook or treatise on ratemaking includes discussion about the basic fairness of using cost causation principles as a primary factor in determining fair and reasonable cost allocations and rates. *E.g.*, LEONARD SAUL GOODMAN, *THE PROCESS OF RATEMAKING*, Vol. I pp. 37-388 and 420-422 (1988); CHARLES F. PHILLIPS, JR., *THE REGULATION OF PUBLIC UTILITIES* 227, 434-436 (1993).

<sup>81</sup> See GOODMAN at 374.

<sup>82</sup> See *e.g.* *WUTC v. American Water Resources, Inc.*, Dockets UW-980072, UW-980258, UW-980265 (consolidated), Sixth Supplemental Order (Jan. 21, 1999); *In the Matter of the Petition of Puget Sound Energy, Inc., and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 and UG-121705, Order 09 at p. 16 (December 12, 2013); *King County Department of Public Works, Solid Waste Division v. Seattle Disposal Company, Rabanco Ltd., d/b/a Eastside Disposal and Container Hauling*, Docket TG-940411, Third Supplemental Order (Final) at pp. 14-20, (Sept. 14, 1994).

to the principle of cost causation, and the Company has not put forward information indicating that its proposal somehow estimates, or even attempts to estimate, each entity's impact on costs.

**2. Staff's proposal is reasonable and consistent with regulatory principles.**

48 Staff's three-factor allocator is the average percentage of each tenant's number of employees, fixed assets per book value, and revenues.<sup>83</sup> Staff's arguments in favor of its three-factor allocator here are the same as those described for Section II. Shared Utilities Expense, Adjustment R-6D and need not be repeated verbatim.<sup>84</sup> In principle, Staff's three-factor allocator is a reasonable estimate of each entity's relative size and scope of operations, which in turn reasonably estimates each entity's impact on common resources. Thus, Staff's allocation is consistent with basic fairness and regulatory accounting principles to assign expenses on the basis of cost causation. Staff's recommendation is also analogous to similar allocation factors accepted by the Commission.<sup>85</sup>

**3. WCI's proposal is not supported and ignores cost causation.**

49 The rebuttal testimony of Ms. Davis requests that the Commission allocate depreciation and average net investment by the number of entities sharing a facility.<sup>86</sup> The Company's proposal relies on its own statements of "reasonable" and "consistent."<sup>87</sup> WCI does not provide a supporting calculation or demonstrate anywhere in the record that such an allocation fairly corresponds to each entity's contribution to costs. Thus, the Commission should reject the Company's proposal as overly-simplistic, unsupported, and unreasonable

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<sup>83</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 19, lines 1-6 (July 18, 2014).

<sup>84</sup> See *supra* Section II. Shared Utilities Expense, Adjustment R-6D, pp. 4-11.

<sup>85</sup> See *supra* Section II. Shared Utilities Expense, Adjustment R-6D, subsection B.3. Staff's recommendation consistent with accepted allocators in other regulated industries, p. 7.

<sup>86</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 17, line 3.

<sup>87</sup> *Id.* at lines 2-4 and 7.

given general regulatory principles and the Commission's precedent supporting allocations on the basis of cost drivers.

#### IV. RATE CASE EXPENSES

##### A. Overview

50 WCI incurred significant costs over the course of its rate cases in dockets TG-131794 and TG-140560. The majority of the Company's rate case costs are payments to legal and accounting professionals. Staff has not reviewed rate case cost data beyond June 2014.<sup>88</sup>

51 Staff and the Company dispute both the allocation of rate case costs and the appropriate amortization period. Staff recommends the Commission allow the Company to recover 100 percent of costs associated with the informal auditing process in Docket TG-131794, 50 percent of the costs associated with the formal adjudicative proceeding in Docket TG-131794, and 50 percent of all costs associated with Docket TG-140560.<sup>89</sup> The Company proposes to recoup 100 percent of all rate case expenses associated with both dockets.<sup>90</sup> For an appropriate amortization, Staff proposes a minimum five years while WCI proposes four years.<sup>91</sup>

##### B. Procedural Background<sup>92</sup>

52 On September 23, 2013, WCI filed a general rate case that became Docket TG-131794. The Company and Staff then began the informal auditing process. The Parties did not agree on an appropriate revenue requirement. On December 24, 2013, the Commission

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<sup>88</sup> June 2014 data was the most recent data available at the time Staff filed its testimony. Staff did not revisit the analysis because WCI will update this information at the conclusion of the proceeding.

<sup>89</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 47, lines 1-6 (July 18, 2014).

<sup>90</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 45-47 (August 20, 2014).

<sup>91</sup> *Compare* Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 48, lines 2-3 *with* Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 47, lines 21-22.

<sup>92</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), pp. 2-4 (July 18, 2014).

issued a Notice of Prehearing Conference, which initiated the formal adjudicative process. On March 25, 2014, the Commission dismissed WCI's filing for failure to meet its evidentiary burden. The Company refiled its case on April 3, 2014, incorporating documents and testimony from the dismissed case, Docket TG-131794. WCI's refiled case became Docket TG-140560. The Parties then engaged in a series of discovery disputes which culminated in an Order to Compel to WCI and a Commission-ordered discovery conference. On July 18, 2014, Staff filed its testimony. On August 20, 2014, WCI filed rebuttal testimony that presented new information and subsequently filed additional support. On October 13, 2014, Staff and the Company filed a Partial Settlement Agreement and narratives in support of the partial settlement.

**C. Rate Case Costs Incurred between August 2013 and December 24, 2013 (Informal Audit Docket TG-131794)**

53 Staff and the Company recommend that the Commission allow WCI to recover all rate case costs associated with its initial filing up to the beginning of the formal adjudicative proceeding.

**D. Rate Case Costs Incurred between December 24, 2013, and March 25, 2014 (Formal Adjudicative Proceeding in Docket TG-131794)**

**1. Fundamental principles.**

54 The Commission has an obligation to set rates that are fair, just, reasonable, and sufficient.<sup>93</sup> The Commission's statutory responsibilities require it to balance both company and ratepayer interests.<sup>94</sup> Although WCI's shareholders are represented in this proceeding, WCI's ratepayers have no say or input on when the Company files a general rate case, the strategies employed, or the individuals involved in the process.

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<sup>93</sup> RCW 81.28.010.

<sup>94</sup> E.g., *POWER v. Utilities & Transp. Comm'n.*, 711 P.2d 319, 326 (Wash. 1985) (emphasis added).

Staff's testimony raises concern over a situation where shareholders have complete control over the decision-making process in a general rate proceeding, but can shift the consequences and obligations associated with their decisions to ratepayers.<sup>95</sup> Such a proposal results in "Heads, the Company wins. Tails, the ratepayers lose." Guaranteeing recovery of rate case costs regardless of the Company's actions and the merits of its positions allows and possibly incentivizes company shareholders to make inadequate filings, pursue illogical positions, and prolong rate cases. The Commission should reject any proposal that benefits shareholders in such a disproportionate and lopsided manner at the expense of ratepayer interests.

**2. WCI's shareholders managed the general rate filing and should retain some financial obligation for a failed rate case.**

55 WCI's shareholders managed the Company's actions in the formal adjudicative proceedings associated with TG-131794. Formal proceedings began with the notice of prehearing conference issued on December 24, 2014 and culminated with the case's dismissal on March 25, 2014.<sup>96</sup> The Commission dismissed WCI's filing in TG-131794 for the Company's failure to meet its evidentiary burden under the Commission's minimum filing standards.<sup>97</sup> The Commission's order expressly noted that the Company, not the Commission or Staff, was responsible for the dismissal.<sup>98</sup> Thus, it is WCI's shareholders and representatives who failed to follow the Commission rules and regulations, not

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<sup>95</sup> See Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-1T), pp. 48-49 (July 18, 2014)

<sup>96</sup> Staff's selection of December 24, 2014 through March 25, 2014, reflects the litigation schedule set by the Commission, not Staff. *WUTC v. Waste Control, Inc.*, Docket TG-131794, Notice of Prehearing Conference (Dec. 24, 2013). The Company began preparing its formal case, which was eventually dismissed, once the formal adjudicative process began on December 24, 2013. Consequently, the Company's arguments of arbitrariness in the date selections merit little or no consideration and should be rejected.

<sup>97</sup> *WUTC v. Waste Control, Inc.*, Docket TG-131794, Order 05, p. 7. ¶16 (March 25, 2014).

<sup>98</sup> *Id.* at p. 7 ¶18 ("the Company, not the Commission or Staff, is responsible . . . . The Company's failure to file a direct case that provides full support for its rate request necessarily results in dismissal of that case and rejection of the tariff filing.").

ratepayers. Ratepayers should not pay the entire cost of a failed general rate case for which they had no input or responsibility. WCI's shareholders should retain responsibility for a significant portion of rate case costs associated with the failed general rate case.

56 Staff's testimony does acknowledge that some of the Company's work associated with the formal adjudicative process in Docket TG-131794 became useful and relevant in Docket TG-140560.<sup>99</sup> Therefore, Staff recognizes that a portion of the TG-131794 formal adjudication rate case costs were legitimate and should be included in rates. In an effort to ensure consistency with the Commission's purpose to equally balance company and ratepayer interests, Staff's testimony recommends the Commission allow WCI to recover 50 percent of the rate case costs incurred from December 24, 2013 through March 25, 2014. The remaining 50 percent should be absorbed by shareholders.<sup>100</sup>

**E. Allocation of Rate Case Costs Incurred in Docket TG-140560<sup>101</sup>**

57 WCI bears a significant amount of responsibility for the delays and complexity associated with Docket TG-140560. A simple review of the record in this proceeding confirms Ms. Cheesman's testimony describing multiple sets of testimony, overlapping data, and numerous exhibits and workbooks. As Ms. Cheesman points out, most instances of Staff's delayed responses were the result of ongoing analysis and confusion over the multiple sets of overlapping and contradictory data.<sup>102</sup>

58 WCI is responsible for a significant portion of the Parties' prolonged discovery dispute over hardcodes and external links as well. Staff filed a motion to compel responses

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<sup>99</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 48 (July 18, 2014).

<sup>100</sup> Cheesman, Exhibit No. \_\_ (MC-1T), p. 47, lines 2-4, p. 48, lines 13-19.

<sup>101</sup> As noted *supra* Section IV. Rate Case Expenses, subsection A. Overview, p. 22, Staff has not reviewed rate case cost data beyond June 2014.

<sup>102</sup> Cheesman, Exhibit No. \_\_ (MC-1T), p. 57, lines 1-5. Staff's testimony also acknowledges that its substitution of counsel limited communications between the Parties at the end of May and first week of June, 2014. *Id.*

on June 12, 2014. The Commission ordered that WCI remove hardcodes or supply the appropriate external links documenting the Company's calculation.<sup>103</sup> The Commission order stated that the Company's argument for an exemption was "illogical."<sup>104</sup> After the discovery conference on July 11, 2014, WCI provided most of the hard code information within one business day.

59           WCI also bears significant responsibility for the length of this proceeding.<sup>105</sup> WCI filed a substantial amount of new information in its rebuttal testimony on August 20, 2014, and continued to file supporting information thereafter.<sup>106</sup> Prior to its rebuttal testimony and subsequent filings of supporting data, WCI simply had not provided adequate support or explanation for several of its proposed adjustments.<sup>107</sup>

60           Under any reasonable interpretation of fairness, ratepayers should not be required to pay 100 percent of rate case costs associated with a convoluted filing and an illogical position that contributed to substantial further litigation. Ms. Cheesman's testimony does recognize that a portion of the Company's filing and rate case preparation reflects legitimate costs and should be included in rates.<sup>108</sup> Staff again proposes the Commission maintain its position of balancing company and ratepayer interests by distributing an equal percentage of rate case costs to shareholders and ratepayers. Ratepayers should pay 50 percent of rate case

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<sup>103</sup> *WUTC v. Waste Control, Inc.*, Docket TG-140560, Order 05, pp. 8, ¶19 (July 2, 2014).

<sup>104</sup> *Id.* at p. 9, ¶20

<sup>105</sup> Testimony of Melissa Cheesman in Support of Proposed Partial Settlement Agreement, Docket TG-140560, p. 8, lines 7-15 (October 13, 2014).

<sup>106</sup> *See id.* at pp. 8-41 (describing new information the Company provided for each issue proposed for partial settlement). *See also* Rebuttal Testimony of Jacqueline Cheesman, Exhibit No. \_\_ (JD-41T) (August 20, 2014).

<sup>107</sup> Testimony of Melissa Cheesman in Support of Proposed Partial Settlement Agreement, Docket TG-140560, p. 8, lines 7-15 (October 13, 2014).

<sup>108</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), p. 49, lines 3-11 (July 18, 2014).



costs associated with Docket TG-140560 through rates with shareholders absorbing the remaining 50 percent.<sup>109</sup>

## **F. Amortization Period**

### **1. Fundamental principles and overview.**

61 Rate case costs should be amortized “over the period between expected occurrences or a reasonable period.”<sup>110</sup> Amortization periods used to normalize legal and accounting costs vary based on 1) the time between rate cases, 2) consideration of the magnitude of the cost claimed, and 3) the effect on rates.<sup>111</sup>

62 The Company argues for an amortization period of four years based on its dismissed filing in Docket TG-131794.<sup>112</sup> Staff contends that the Commission should base a reasonable amortization period on actual, non-dismissed filings.<sup>113</sup>

### **2. Staff’s recommendation reflects Commission standards and considerations.**

63 Staff’s testimony recommends a minimum five-year amortization period. Approximately 4.5 years passed between WCI’s general rate filing in 2009 and its most recent, non-dismissed filing in Docket TG-140560.<sup>114</sup> Approximately 5.2 years will pass between the effective date of WCI’s general rate filings in 2009 and the statutory effective date for Docket TG-140560.<sup>115</sup> The average of 4.5 and 5.2 is 4.9 years, which Staff rounded

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<sup>109</sup> Cheesman, Exhibit No. \_\_\_ (MC-1T), p. 49, lines 7-11 (July 18, 2014).

<sup>110</sup> *WUTC v. Bremerton Kitsap Airporter, Inc.*, Docket TC-001846, Fifth Supplemental Order, p. 11, ¶28 (August 2, 2002).

<sup>111</sup> *WUTC v. Bremerton Kitsap Airporter, Inc.*, Docket TC-001846, Fifth Supplemental Order, p. 10, ¶27 (August 2, 2002).

<sup>112</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_\_ (JD-41T), p. 47, lines 19-42.

<sup>113</sup> See Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-1T), pp. 47:20 through 48:3.

<sup>114</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-1T), pp. 47:20 through 48:3.

<sup>115</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_\_ (MC-1T), pp. 47:20 through 48:3.

up to five years. As Ms. Cheesman notes, Staff's recommendation reflects the Company's actual, non-dismissed filings and statutory effective dates.<sup>116</sup>

64 Staff's recommendation also considers the extraordinary magnitude of rate case costs in this case.<sup>117</sup> Rate case costs are non-recurring on an annual basis and the extraordinary amount in this case is not representative of the normal rate case costs associated with WCI's past filings. Therefore, five years is a conservative amortization period because WCI has not incurred such a significant amount of rate case costs in prior filings and should be unlikely to incur similar levels of rate case costs within five years.

65 In the rebuttal testimony of Ms. Davis, WCI proposes a four-year amortization period.<sup>118</sup> WCI's recommendation relies on the difference between the date the Company filed its general rate case in 2009 and the date the Company filed its general rate case in 2013 for Docket TG-131794.<sup>119</sup> The Company's proposal fails to recognize that the Commission dismissed WCI's filing in TG-131794.<sup>120</sup> The most recent filing that meets the minimum regulatory requirements is Docket TG-140560. WCI's rebuttal testimony also fails to consider the extraordinary magnitude of rate case costs in this proceeding and the potential effect on rates. At the very least, the Commission should base a minimum amortization period on legally adequate regulatory filings.

## V. INVESTIGATION FEES

### A. Fundamental Principles

66 "When the Commission decides it is necessary 'to investigate the books, account, practices and activities' of public service company to carry out its duties 'and the cost

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<sup>116</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), pp. 47:20 through 48:3.

<sup>117</sup> See Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), pp. 46-49.

<sup>118</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 47, lines 19-22.

<sup>119</sup> *Id.* at lines 21-23.

<sup>120</sup> *WUTC v. Waste Control, Inc.*, Docket TG-131794, Order 05, (March 25, 2014).

thereof to the commission exceeds in amount the ordinary regulatory fees paid by such public service company during the preceding calendar year,' RCW 81.20.020 directs the public service company to pay the expenses that are reasonably attributable to the investigation."<sup>121</sup> Under RCW 81.20.020, the Commission may only require a regulated company to pay investigation costs up to a maximum of one percent of that company's gross intrastate revenues.

**B. Staff's Recommendation Meets Statutory Standards**

67 Staff investigated the books and records of WCI on the basis of its obligation to review the Company's general rate filing and recommend rates that are fair, just, reasonable, and sufficient. Ms. Cheesman's testimony describes the extraordinary amount of time and resources Staff devoted to this investigation.<sup>122</sup> As of June 2014, Staff had devoted a combined \$84,305 to Dockets TG-131794 and TG-140560.<sup>123</sup> Although Staff has not revisited its analysis, Staff's costs have continued to increase in the four months since June 2014. To underscore the unusual nature of this filing, Staff notes that this is the only solid waste rate case litigation in more than 20 years.

68 WCI most recently paid \$18,732.55 in regulatory fees. Under the statutory directive in RCW 81.20.020, the Commission should require WCI to pay the cost of the Commission's investigation up to one percent of the Company's gross intrastate revenues, for a total assessment of \$43,818.82.

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<sup>121</sup> *WUTC v. Bremerton-Kitsap Airporter, Inc.*, Docket TC-001846, Third Supplemental Order (Initial Order), p. 21, ¶69 (April 15, 2014).

<sup>122</sup> Testimony of Melissa Cheesman, Exhibit No. \_\_ (MC-1T), pp. 55-56.

<sup>123</sup> *Id.* at p. 55, line 14.

**C. WCI'S Argument does not Refute Statutory Directive**

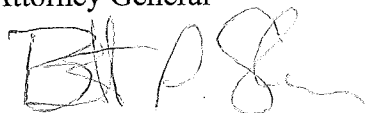
69

WCI's arguments of "piling on" do not refute RCW 81.20.020. The Company primarily argues that it is unaware of any other solid waste proceeding in which the Commission assessed investigation fees;<sup>124</sup> however, as the Company also notes in its testimony, the present docket is the first adjudicated solid waste general rate proceeding in over 20 years.<sup>125</sup> Therefore, the Company puts forward a precedential argument while at the same time acknowledging that the Commission could not have had the opportunity to assess investigation fees in a solid waste case during that time. By its own terms, the Company's argument is irrelevant and does not undermine the statutory directive in RCW 81.20.020. Thus, the Commission should adopt Staff's recommendation as consistent with RCW 81.20.020 and assess a \$43,818.82 fee on WCI. To ensure fairness to ratepayers, the Commission should not allow the Company to recoup investigation fees in rates.<sup>126</sup>

DATED this 7th day of November, 2014.

Respectfully submitted,

ROBERT W. FERGUSON  
Attorney General



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BRETT P. SHEARER  
Assistant Attorney General  
Counsel for Washington Utilities and  
Transportation Commission Staff

<sup>124</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 49, lines 8-11.

<sup>125</sup> Rebuttal Testimony of Jacqueline Davis, Exhibit No. \_\_ (JD-41T), p. 46, lines 5-6.

<sup>126</sup> The arguments for preventing WCI from recouping investigation fees in rates are the same as those to limit ratepayer obligations for rate case costs and need not be repeated verbatim. *See supra* Section IV. Rate Case Expenses, pp. 22-28.