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 1 BEFORE THE WASHINGTON

 2 UTILITIES AND TRANSPORTATION COMMISSION

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 5 Re Inquiry into Methods for ) DOCKET TG-131255

 Setting Rates for Solid )

 6 Waste Collection Companies )

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 TECHNICAL WORKSHOP, VOLUME I

 9

 Pages 1-73

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 October 8, 2019

13

 9:30 a.m.

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15 Washington Utilities and Transportation Commission

 621 Woodland Square Loop Southeast

16 Lacey, Washington 98503

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 1 A P P E A R A N C E S

 2

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 4 MARC TORRE, Sunshine and Disposal and Recycling

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 JOHN CHELMINIAK, Waste Management

12 JOHN LLOYD, Sunshine and Disposal and Recycling

 ANDREW KENEFICK, Waste Management

13 CLEVE TYLER, BRG (via Skype)

 PAUL DIVER, BRG (via Skype)

14 ROB WHITACKER, Associate Counsel, WRRA (via Skype)

 ANN LARUE, UTC (via Skype)

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 1 LACEY, WASHINGTON; OCTOBER 8, 2019

 2 9:30 A.M.

 3 --o0o--

 4 P R O C E E D I N G S

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 6 MR. KERMODE: So this is the technical

 7 workshop for the inquiry into methods for setting rates

 8 for solid waste and collection companies. It's

 9 TG-131255, and I want to thank everyone for coming in.

10 I think we've been waiting for this one for a while as

11 far as getting to the point where we can actually talk

12 technical.

13 If you remember in the original comments,

14 we -- the few that we got said, well, we don't know what

15 we're commenting about because you haven't provided

16 anything, which was a valid answer. So we've gotten to

17 the point now where we actually have material we can

18 bring forward and discuss it.

19 So most everybody knows, my name's Danny

20 Kermode, and I'm the assistant director of Water and

21 Transportation. I'll be trying to facilitate this

22 discussion.

23 Couple of housekeeping things. First of

24 all, we have a court reporter actually recording what

25 we're talking about so that the Commissioners actually

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 1 have a paper copy of what the discussion is and

 2 hopefully have a better understanding versus going

 3 through recordings and trying to find stock numbers so

 4 you can hear what the discussion is. So in that we have

 5 a court reporter, if you could say your name before --

 6 before you make your comment.

 7 You'll notice the tables have no

 8 microphones. They're up there, and they're supposed to

 9 be -- so far they've worked really well, so we shouldn't

10 have any problems with turning on and off mics. Just be

11 aware that they're there.

12 Also, bathrooms are right across the -- the

13 hall here. The handle appears to be locked. It's not

14 locked, just push, and you'll go in. The little green

15 light there. So I don't want somebody stuck out there

16 and not being able to do anything.

17 So first thing I want to do is probably

18 start with Weldon, and we'll go around the room and have

19 introductions.

20 MR. BURTON: Weldon Burton, CPA.

21 MS. CAMPBELL: Sara Campbell, Sanitary

22 Service Company.

23 MR. TORRE: Marc Torre, Sunshine Disposal &

24 Recycling.

25 MR. WILEY: David Wiley, Williams Kastner.

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 1 MS. GARLAND: Heather Garland, Waste

 2 Connections.

 3 MR. JOYCE: Kevin Joyce, Waste Connections.

 4 MR. VASCONI: Marc Vasconi, I'm the director

 5 of regulatory services here at the UTC.

 6 MR. FUKANO: Harry Fukano, Assistant

 7 Attorney General.

 8 MR. SHARBONO: Benjamin Sharbono, Water and

 9 Transportation.

10 MR. KERMODE: Danny Kermode, assistant

11 director of Water and Transportation.

12 MR. YOUNG: Mike Young with Water and

13 Transportation.

14 MR. CHARLE DIETRICH: Charle Dietrich, Basin

15 Disposal.

16 MR. DARRICK DIETRICH: Darrick Dietrich,

17 Basin Disposal.

18 MR. SEVALL: Scott Sevall, Regulatory

19 Services.

20 MS. VAN METER: Tiffany Van Meter, Water and

21 Transportation.

22 MS. WALDRAM: Lindsay Waldram, Waste

23 Connections. Sorry.

24 MR. WONDERLICK: I'm Joe Wonderlick with

25 Waste Connections.

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 1 MR. LOVAAS: Brad Lovaas, Washington Refuse

 2 and Recycling Association.

 3 MR. CHELMINIAK: John Chelminiak, Waste

 4 Management.

 5 MR. LLOYD: John Lloyd with Sunshine

 6 Disposal & Recycling.

 7 MR. KENEFICK: Andrew Kenefick, Waste

 8 Management.

 9 MR. KERMODE: I'm going to try -- can

10 anybody on Skype hear us or respond?

11 MR. TYLER: We do have Cleve Tyler from BRG.

12 MR. KERMODE: Great.

13 MR. DIVER: And Paul Diver from BRG.

14 MR. KERMODE: Anyone else?

15 MR. WHITTAKER: This is Rob Whittaker

16 listening in.

17 MS. LARUE: This is Ann LaRue from UTC.

18 THE COURT REPORTER: I couldn't hear that.

19 MR. KERMODE: Ann -- Ann LaRue, UTC.

20 Okay. So far so good, guys. So this is --

21 I hope everybody picked up some agendas and matrix over

22 here. This is the -- the agenda what we're going to be

23 looking at. Initially, we're going to have a discussion

24 of the purpose of the workshop and review of -- a light

25 review of the Staff recommendation. It's been out since

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 1 January. I think most people have it -- have already

 2 reviewed it. I find the -- the key point will be the

 3 presentation by WRRA. Cleve and Paul will be doing that

 4 over Skype. We have a fallback if the Skype doesn't

 5 quite work right.

 6 Once they're done, we'll go ahead and

 7 discuss the model attributes matrix. And what's

 8 important about the matrix is, we find this being

 9 what -- what we call a kind of the levers and dials of

10 the -- of the model, of the proposed model. These are

11 the things we turn and twist and change the numbers.

12 And so a lot of them we already have agreement on and

13 some we disagree on, and we're also going to look at if

14 there's any other observations that we should be

15 considering. Then we'll go on to next steps and the

16 process, general comments, and then we'll adjourn. I

17 think we'll make some pretty good headway. We've done a

18 lot of front-end work here, so I think the discussion

19 will be crisp and on point.

20 So -- so the purpose of the workshop, we

21 sent out a -- a notice in August announcing the -- the

22 workshop. We had to change the date. But the intent of

23 it was to discuss technical issues related to the Staff

24 recommendation at a technical level. When -- when we

25 have a general workshop, usually the Commissioners are

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 1 here and the -- we don't get into the -- the -- the

 2 detail of things. In this case, we're able to if

 3 somebody wants to discuss log-linear over natural log or

 4 log 10, we get to do that, versus the Commission

 5 probably we wouldn't want to do that.

 6 We also want to highlight areas of agreement

 7 and disagreement in the workshop. That's a big point,

 8 and we want, once again, to get it on the record so when

 9 the Commissioners look at it, they have a crisp, clear

10 understanding of where we agree and where we disagree.

11 We also want to allow discussion of

12 alter- -- alternative approaches or concepts. So we're

13 not pinned in by my report or by what Cleve might come

14 up with. If -- if there's other avenues that you think

15 is important to get on the record, I -- I think this is

16 the place to get it said, and then we actually have that

17 to present to the Commission.

18 So review of the Staff recommendation. Back

19 in January 16, we released the recommendation on the

20 methodology for deriving operating ratio for solid waste

21 haulers. It's after what -- what was it, five, six

22 years of -- of hard work and a couple dead ends, but I

23 think we finally got a framework to work from.

24 What's unique about this report is it

25 computes recommendation, it computes return on

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 1 investment before income tax and interest. In contrast,

 2 Lurito-Gallagher has -- has input income tax and

 3 interest and takes it all the way down to net income.

 4 We use the seven-year data set, Lurito-Gallagher used a

 5 ten. So we have a little shorter period, which is

 6 really a -- and we'll talk about it -- a little

 7 compromise between how quickly the model can react to

 8 economic implementses [sic] and the stability of the

 9 number.

10 It recognizes leverage of risk. As a

11 company comes [sic] more leveraged, theoretically they

12 become riskier and theoretically, they should get a

13 higher return on equity. Lurito-Gallagher did not

14 recognize that. You -- the more you leverage, your

15 equity returns stays the same. If you have a high

16 equity component, the equity level stay -- return stays

17 the same, and I would suggest that's contrary to

18 financial reality and theory. So -- so this model

19 recognizes that higher your leverage, the higher the

20 risk.

21 Updated financial data from comparable

22 companies. That was valid when the report came out, and

23 we have once again updated. Luckily, I -- you know, one

24 thing I always say about -- about the industry we work

25 in, it -- it's -- it's a -- it's like a flower opening.

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 1 It's -- it moves slowly and -- and so things don't

 2 rapidly -- we don't have a volatile type of industry.

 3 So as we move forward, I think it's -- it's a nice

 4 smooth effect that we can have some security as long as

 5 we have a -- a structure that supports the nonvola- --

 6 volatility of the industry itself.

 7 The data -- the report also recommends

 8 updating the data at least every three years, but no

 9 more than five, and that's something else we can talk

10 about. This -- we -- we talked about there's factual

11 issues that we can abate and try to find answers to.

12 Then there's policy issues. And this I

13 would suggest is a policy issue, to what extent does the

14 Commission and industry want updated data. And --

15 and -- and that's, you know, under the environment of

16 cost being involved to update it.

17 So that -- like I said, I wanted that to be

18 fairly quick because I think we've -- we've done it on a

19 number of workshops already and gone through it.

20 So is there any questions on the purpose of

21 the workshop or the report itself before we move on to

22 the indus- -- WRRA's response to it?

23 Okay. Paul? Hello, Paul?

24 MR. TYLER: Hi, this is -- yeah, it's Cleve

25 Tyler and -- and Paul Diver. I don't know how we share

0011

 1 here, so we --

 2 MR. KERMODE: Okay. I'm going to -- I -- I

 3 was taught -- I was taught this yesterday, so make

 4 presenter. So I'm making you a presenter, I think I can

 5 make Paul -- yep, I can make both of you presenters.

 6 Now, how do I transfer control?

 7 MR. TYLER: Probably by just -- I think I

 8 just have to accept being a presenter.

 9 MR. KERMODE: Oh, okay. Okay. Let's see

10 what happens. Look at that. Well done.

11 MR. TYLER: Can you hold on just a moment?

12 It says that I'm presenting, but you can't see my screen

13 as -- yet?

14 MR. KERMODE: It says presentation is

15 paused.

16 MR. TYLER: Ah. Well, let me -- let me stop

17 presenting and then try this again.

18 MR. KERMODE: Apparently you should feel

19 free to start.

20 MR. KENEFICK: Maybe if you make just one of

21 them a presenter, whoever's controlling the PowerPoint.

22 MR. KERMODE: Yeah, but who do you -- I'm

23 going to try -- something's going on.

24 MR. TYLER: Yeah, maybe you should try --

25 MR. KERMODE: Or, you know, Cleve -- well,

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 1 you would know --

 2 MR. TYLER: Can you see my screen now? You

 3 may see my screen now.

 4 MR. KENEFICK: Yep, good.

 5 MR. TYLER: Okay. Okay. Do you see the

 6 full -- do you see my screen?

 7 MR. KERMODE: Now, as a fallback, I got your

 8 PowerPoint ready to go.

 9 MR. TYLER: Right.

10 MR. KENEFICK: I'm just wondering if both of

11 them being presenters, then they might be competing with

12 their screens.

13 MR. KERMODE: I'm going to make -- who --

14 who has the presentation?

15 MR. TYLER: Why -- why don't you try making

16 Paul the presenter?

17 MR. KERMODE: Okay.

18 MR. TYLER: His -- his computer seems to be

19 working getting into Skype better than mine did.

20 MR. KERMODE: Okay.

21 MR. TYLER: And let's see if it works that

22 way.

23 MR. KERMODE: There it is. Okay. So Paul

24 is the pre- -- sole presenter now.

25 MR. DIVER: Can people see my screen?

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 1 MR. KERMODE: Yes.

 2 MR. TYLER: Okay. And -- and here's an

 3 interesting question, can you see our faces or are we

 4 not video -- we're not -- there's no video --

 5 UNIDENTIFIED SPEAKER: You should have

 6 shaved this morning.

 7 MR. KENEFICK: We cannot see you.

 8 MR. CHELMINIAK: No, we can't.

 9 MR. TYLER: Thank you, Mr. Kermode, for this

10 opportunity --

11 MR. KERMODE: Ah, just a minute.

12 MR. TYLER: I'm sorry?

13 MR. KERMODE: Oh, just a minute. There you

14 go. Okay. Go ahead.

15 MR. TYLER: Okay. Yeah, well, thank you for

16 the opportunity to present. This is Cleve Tyler at

17 Berkeley Research Group. As -- we've spoken a number of

18 times before. I've spoken, I think, to some of the

19 other individuals in this room. And those of you who I

20 haven't met before, you know, I'm -- I look forward to

21 showing [sic] with you our current thinking about the

22 issues here.

23 So today, we're going to address the -- some

24 of the methodological issues associated with the current

25 LG and the proposed DuPont method. And we're especially

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 1 going to focus on the regression analyses that feed into

 2 the models, either the LG or the -- or the DuPont. We

 3 will be filing comments in a -- or I expect we'll be --

 4 we'll be filing comments in a few weeks. In there,

 5 there'll be a lot more detail about what we have to say

 6 today, and there will probably be collaboration as well

 7 with the ones to -- with the ones today.

 8 Okay. There are our names and the inquiry.

 9 Okay. So I think the idea here is, we -- we wanted to

10 take a very principle approach to thinking about these

11 issues. We -- we know that the emphasis for a lot of

12 this is that the LG uses data from many, many years ago

13 stretching back to the late '60s into the late 1970s,

14 and -- and the thinking is, is that data is pretty

15 antiquated at this point, and that it makes a lot of

16 sense to use more recent information.

17 But beyond that, we -- we also recognize

18 that we're seeking a method that will be updated going

19 forward as -- as Mr. Kermode pointed out. And so to

20 that end, we -- we want to have a method where the data

21 can, on an ongoing basis, be updated so that in ten, 15,

22 20 years from now, these issues don't have to be

23 revisited again. It's a [inaudible] issue of -- of

24 updating with more recent data at that point in time.

25 So in -- in our view, it -- it makes sense

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 1 to lay out some ideas, some principles upon which we

 2 would base some of our decisions here, some of our

 3 recommendations. We want to keep a logic-based

 4 approach, something that is understandable so that when

 5 anyone looks at any of the specific levers or decision

 6 points, it's clear what is chosen and the rationale for

 7 that decision. We -- we want to use standard approaches

 8 for the dealing with -- with the analytical decisions

 9 that arise and that we consider. We want those

10 approaches to be reliable, we want them to be replicated

11 and to -- to ensure accuracy, of course. And then we

12 also want precise documentation about each step of the

13 process so that -- so that there's no subject --

14 subjectivity that is introduced at future points in

15 time.

16 And then I also wanted to point out that the

17 results that come out of the regression analysis can be

18 put into either the LG or the -- or the DuPont model as

19 proposed or potentially some other -- other model that

20 takes into account the relationship between at the

21 turnover and -- and profit margins. So this -- this

22 commentary isn't necessarily just about one -- one or

23 the other, but really focuses on that regression

24 analysis. And -- and we expect that we'll have more to

25 say about the LG and the DuPont in particular in the

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 1 comments in a few weeks. But this particular

 2 presentation is going to focus on the -- on the

 3 regression part of the analysis.

 4 So one thing that I think it makes sense to

 5 address is the idea that -- and -- and this is something

 6 that is discussed in the January proposal, I've also

 7 seen it in other places like the Bell study from a

 8 number of years ago, the idea that the -- the older data

 9 is not appropriate anymore because that data was from a

10 high inflation period, and we're now in -- in a

11 prolonged low inflation period, and so the -- so the

12 data just isn't relevant any longer. And -- and I

13 want -- wanted to address that because there's sort of a

14 premonition that, well, that means that -- that profit

15 margins must come down because of this issue.

16 So one of the things that -- that I started

17 looking around and doing some research into the economic

18 literature, well, has anyone actually addressed this

19 before and -- and it -- it doesn't take very long to go

20 to Google and start typing in return on equity,

21 inflation, profit margin, and DuPont. And an article

22 was written -- it's about 20 years old now -- by Frank

23 Riley, who was at the University of Notre Dame at the

24 time, who -- who analyzed the impact of inflation on ROV

25 growth and stock prices using the DuPont model. And --

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 1 and he -- he wasn't doing anything more really than

 2 looking at some correlations over time and -- and

 3 assessing how these things move together and change in

 4 the context of the DuPont model.

 5 But -- but I thought one of the things that

 6 stood out to me about that was that he wasn't really

 7 finding any strong correlation between profit margins

 8 and inflation. In fact, he -- he found a negative .1

 9 correlation. So -- so we thought, well, you know, it --

10 it might make sense to look here as well to see, you

11 know, what does, you know, our data show for the

12 transportation industry.

13 So one of the things that we did is if you

14 take the rule for SIC codes that is expressed in the

15 January proposal, now, this is before any exclusion of

16 SIC codes or anything like that, and then you convert

17 the information, this is from Compustat, and it goes

18 back over a period of 51 years. So we go back to the

19 beginning of the LG time frame that is used, and -- and

20 you convert that information into one data point per

21 year, and -- and you start looking at what -- what does

22 this relationship look like.

23 And -- and you don't really see any

24 correlation. We calculated a correlation of .05. You

25 can see that there's a couple of years that have

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 1 relatively high profit margins over 14 percent, and --

 2 and those are into very low inflation years. You -- you

 3 also see some high profit margins and relatively high

 4 inflations years. So -- so there's just not much of

 5 a -- a correlation here that we see.

 6 Now, if you -- if you also -- if -- if you

 7 were to then look at -- at the turnover and inflation,

 8 here we see in the transportation industry a negative

 9 correlation. And, you know, one -- one might think,

10 well, high -- you -- you know, in high inflation period

11 may be, you know, revenues increase faster than -- than

12 investments would in terms of how, you know, those are

13 reported, and so maybe you would see something like a

14 positive relationship here, but, in fact, there's a

15 negative relationship.

16 Now, interestingly, the Riley paper that I

17 mentioned a few minutes ago actually does find a

18 positive correlation of about, you know, point -- .44 or

19 so. So -- or whatever that number is in that paper, but

20 so they -- they actually find something a little

21 different than -- than we do for this industry over this

22 time frame. But I think the point here is it's not so

23 much how these correlations work, I -- I think that what

24 matters -- yeah, there we go. So I think what -- what

25 really matters is the idea that -- that I think it does

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 1 make sense to update the methodologies with more recent

 2 data, because the economic realities of firms and the

 3 industry do change over time. You know, it -- it -- it

 4 may be the case that this industry is flower, so to

 5 speak, but flowers do move and change and grow. And --

 6 and so it does make sense to update.

 7 And also the economic environment changes as

 8 well. A moment ago we were talking about the inflation

 9 and the impact that might have on profit margins and --

10 and also earnings. And if you -- if you think about

11 businesses here and if we're trying to find comparable

12 companies for those that we -- you know, waste companies

13 in Washington State. Well, companies tend to like low

14 inflation environments. When you have inflation, you

15 see your costs going up. You don't know whether those

16 costs are specific to your firm or to your industry or

17 where you have very limited information about that,

18 there's so much uncertainty, it's unclear how many of

19 those cost increases can be passed on in the form of

20 price increases to your -- your customers. And so firms

21 in a -- in an inflationary environment, their margins

22 could take a hit for those reasons.

23 But -- but the overall point here is that I

24 think it's difficult to -- to anticipate ahead of time

25 what sort of changes we would expect to see in terms of

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 1 margins or earnings for companies when you -- you apply

 2 the model. So it -- so I think's it's -- it's sort of

 3 better not to -- not to -- not to assume automatically,

 4 okay, the margins are going to go down or they're going

 5 to go up. I think -- I think this is where we let the

 6 data speak to us, and -- and if we have a good method,

 7 then, you know, the results will tell us what has

 8 happened.

 9 So now I wanted to address the selection of

10 companies in the regression methodology. The January

11 proposal uses not just that data from 2010 to 2016,

12 and -- and that -- that I think was a fine choice at the

13 time. The issue, it turns out, is that Compustat has

14 been discontinued by -- by S&P. So on a go-forward

15 basis, that's not going to work. So the sort of,

16 quote/unquote, replacement for Compustat is Capital IQ.

17 It's also by S&P, and so we think that -- that

18 represents a fine data set to use going forward.

19 There -- there are some advantages to

20 Capital IQ over Compustat. One of them is that it

21 provides for a more granular breakdown of some of the

22 SIC codes. So to the extent that we're applying --

23 we're applying a rule to certain SIC codes, that gives

24 us a little bit of -- of a better breakdown of

25 companies. It also includes results for some private

0021

 1 companies, which is nice, given that some of the -- the

 2 regulated companies here are -- are private.

 3 Now, in -- in doing this, in putting the

 4 methodology together and describing the methodology,

 5 we -- we think it important to have instructions, for

 6 instance, describing the downloading of data. This --

 7 this is something where we through this process looking

 8 at the Compustat data, it -- it's not as straightforward

 9 as you would think. There's a number of choices that

10 are made. There are ways in which Compustat was

11 handling restatements, for instance, that would require

12 some working with the data to get to the right results

13 that -- that would be needed.

14 And so -- so there -- there -- there should

15 be a description of precisely what is done, but I don't

16 think it should stop there. I think there should also

17 be descriptions of principles used for, you know, why

18 are certain selections made in the downloading of the

19 data, because data sets do change. S&P may change the

20 ways in which data can be filtered, the data that's

21 available. And if those change -- sorts of changes

22 happen going forward, as you would expect they would,

23 that will give the -- the future a guide for how to

24 handle those sorts of things. We -- we can't anticipate

25 everything that might happen, but if there are

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 1 principles that are likely to address various scenarios

 2 in the future, that's certainly preferable.

 3 So when it comes to the specific selection

 4 of SIC codes, the January proposal says that it should

 5 include companies that load, transport, and deliver

 6 without changing or converting what is transported. So

 7 overall, I think that's a pretty reasonable way of

 8 thinking about a set of comparable companies. You know,

 9 it -- it -- it may be the case where we're doing this on

10 a sort of a code-by-code basis. So you're kind of

11 getting a whole group in at one point in time. The

12 Capital IQ and Compustat data have SIC codes in those

13 data sets. They -- they do not have, for instance, any

14 ICS codes, but, you know, that could change in the

15 future. Maybe SIC codes fall by the wayside and -- and

16 other sorts of codes are used. If that's the case, then

17 this rule could be applied to those codes also.

18 As we were looking at this, looking at some

19 of the companies that -- that come in with this sort of

20 definition, one of the things that struck us was that

21 the conversion or changing or converting maybe is not

22 quite accurate in the sense that you think about the

23 waste collection industry, you know, waste is collected

24 and it's oftentimes contacted, you know, right in the

25 truck, right? So there technically you have something

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 1 that is changed or converted, maybe not very much as

 2 compacting, but it is changed. And so is it really

 3 right to include that sort of thing in the definition.

 4 You know, not quite sure, so maybe we can get a little

 5 more precise with the -- with the definition, but -- but

 6 I think that the overall kind of direction of -- of that

 7 definition does -- does make sense.

 8 One thing we've considered here was, well,

 9 you know, maybe this can get a little bit more precise.

10 You know, maybe we could look at some -- at companies

11 that -- that transport using vehicles, for instance.

12 That would essentially remove some of the water supply

13 and pipeline companies from the equation. And so

14 that -- that might represent a -- an alternative that --

15 that the Commission would want to consider. And -- and

16 so we'll -- you know, we'll address that also in -- in

17 some more detail in our comments in a few weeks.

18 So the next couple of pages here just lay

19 out all the SIC codes that are broadly in the four

20 thousand or -- or the one digit four industry, which

21 includes all transportation companies.

22 And then we have three columns over here.

23 The first column is labeled "Staff Used SICs." So these

24 are the codes that were used in the January proposal.

25 This takes into account those that were excluded,

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 1 which -- which we'll talk about in -- in a moment.

 2 The second column would be a list of the SIC

 3 codes. If it says yes there, where if you just by the

 4 definition from the January proposal, which SIC codes

 5 would -- would come into the equation. One -- one thing

 6 I'll point out, by the way, about the Staff used SICs,

 7 you'll see a few in there that say implicitly, that is

 8 because in the Compustat data, the SIC codes were not

 9 broken out as finely as they are in Capital IQ. We --

10 we were looking at the Capital IQ available codes here,

11 and so these couple that say implicitly here mean that

12 in Compustat, all of those SICs were really rolled up

13 into the two digit 4100 category, but later were broken

14 out. So that's what -- that's what that means.

15 Now, the alternative, BRG alternative there,

16 is if you were to add the additional criteria that

17 companies would primarily transport with the use of

18 vehicles, then you would see those codes, you get a

19 little bit more restrictive set of codes than the other

20 two, but -- but, again, might be something to think

21 about.

22 So the first you'll see maybe the big

23 distinctions here are the way rail is handled in the

24 January proposal, but if that's excluded, and there's

25 a -- there's a lot of agreements here, but then you'll

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 1 see with water transportation that in both the Staff

 2 rule SICs and the BRG alternatives, those would -- those

 3 would come in.

 4 So here's the second sheet. The codes go

 5 on. Again, more -- more list of water codes there,

 6 everyone has their transport in on the -- some of the

 7 other things, a lot of them are all, you know, noes.

 8 And so we have one more sheet here, the rest

 9 of the SIC codes, and we'll -- we'll look at a few more

10 of these distinctions in a moment. You'll see the

11 natural gas transmissions in the pipeline SIC codes come

12 into the January proposal also would fall under

13 the -- the rule that is offered in the January proposal.

14 But of course, the use of vehicles, and so then we

15 included in the -- the alternative that one might

16 consider.

17 So here's a few pie charts that show the --

18 a breakdown of companies. One thing to be aware of is

19 that in the January proposal, it may be a bit -- bit

20 weighted towards the pipeline companies. That's the

21 sort of big part of the pie chart here. And -- and so

22 that -- that's, you know, important to know. This

23 doesn't have the number of observations, we'll also look

24 at that -- well, we will include that in our comments in

25 a few weeks so you could look at it both ways.

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 1 If you were to take the Staff-proposed rule

 2 and not exclude SIC codes, then they're not quite as

 3 heavily weighted. This is where you would bring in the

 4 rail and the water transportation as well.

 5 And then in the next slide, this the --

 6 the -- if you were to look at the vehicles, this is a

 7 bit more -- you know, this -- this -- this is a bit more

 8 diversified. You have the, you know, sort of waste

 9 refuse companies, they're -- they're in that -- the

10 4900s. And then, of course, you have the water

11 transportation, which is the orange there, you have air

12 transportation, and then the trucking in here as well.

13 So a bit more diversified, but, again, an alternative

14 and something to be aware of when thinking about what

15 SIC code is what.

16 So the January proposal excluded some SIC

17 codes that described some that were sort of obviously

18 different presumably than the [inaudible] definition,

19 but yet were deemed not to be appropriate. And then --

20 and then there was a use of -- of Chow test to

21 specifically look at the certain codes that might not be

22 appropriate. This is something we thought about here

23 for -- for quite a while now and debated. And we -- we

24 think that it makes a lot of sense to -- to make sure we

25 have a good logical definition for the comparable

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 1 companies that are going to come into the analysis. And

 2 then once those companies are in, to not have any

 3 further rules for excluding companies.

 4 Now, and -- and we'll -- we'll talk about

 5 this a little bit more with respect to the Chow test,

 6 but, you know, keep in mind that there is an outlier

 7 method that is applied as well. So to the extent that

 8 there are observations that don't seem particularly

 9 normal, companies that are really outside the norm,

10 particular years that are very strange, those -- those

11 sorts of observations one would expect will get excluded

12 through an outlier method, which is probably a sort of a

13 better way to -- for finding out rather than throwing

14 out an entire SIC code.

15 Now, with respect to the Chow test itself, a

16 Chow test is a -- is a test that typically is used to

17 identify whether there is structural change in a data

18 set. So the way that I -- I've used it, the way that

19 I've seen it used, the way that I learned that it is

20 used typically relates to time series data where you

21 have a data through time and then at a certain point in

22 time, something changes. It could be some sort of

23 regime change, policy change, facts change, whatever it

24 is, and one wants to test whether that particular change

25 led to a difference in the relationship between

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 1 variables in a bottle.

 2 So one would look at the pre-period and then

 3 test to see whether -- whether in a regression the

 4 coefficients in that regression are different,

 5 specifically in the post period after the structural

 6 change compared to the pre-period. So -- so that's the

 7 way that a Chow test typically is used. Here it is --

 8 it has been proposed to be used as a way of taking a

 9 group of SIC codes, removing one SIC or for testing one

10 SIC code at a time versus the -- the remainder to see if

11 it is statistically different, if -- the relationships

12 are found to be different compared to the remainder, and

13 then doing that, you know, sort of one at a time all the

14 way around, and then those that are different are -- are

15 sort of removed.

16 The problem becomes that you don't know --

17 you don't have a stable base of when -- against what

18 you're comparing. So in a typical Chow test approach,

19 you have a pre-period and the pre-period doesn't change,

20 you -- you know what you're testing against, but if

21 you're testing against that STAT, which itself may be

22 changing because other SIC codes left in the base set

23 might themselves be excluded at a later point in time,

24 you're not testing against the stable base of SIC codes.

25 That may be suggestive you could use an

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 1 iterative approach and -- and you would, you know, test

 2 a -- one round and then take some out and then do a

 3 second round of testing. But then the problem becomes

 4 that if you -- as you remove some SIC codes and the

 5 order of which you remove them matter and it -- it might

 6 be the case that you remove a code early in the process

 7 and then later in the process it's no longer different

 8 from what remains. So -- so there's no guaranteeing

 9 whatsoever any process like this is going to actually

10 lead to a unique set of SIC codes, that -- that the

11 rules at which you -- you would remove them actually

12 matter -- matter quite a lot.

13 So -- so we think that it really leads to

14 sort of the circular logic and -- and -- and so, again,

15 it's -- it's really just sort of mixed application of

16 what the Chow test does, what it is meant to do. So

17 it's better to get the definition right to rely on the

18 outlier method that will be part of the process, and

19 then if you don't have the Chow test as part of the

20 methodology, that also really leads to a much more

21 straightforward method, removes some complexity from the

22 analysis, which would have some side benefits as well.

23 Yeah, so a couple of things with regard to

24 the -- the timing and the variable definition. So the

25 January proposal, it -- it uses seven years of data.

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 1 We've done some testing, we've looked at the use of five

 2 years, looked at the use of ten years. We think that

 3 the tradeoff described by -- by Mr. Kermode in the

 4 proposal is the right tradeoff, that -- that by using

 5 more recent information, your better path dreams or

 6 economic environment, economic conditions faced by the

 7 companies. If you get a longer time frame, you're --

 8 you're going to have sort of a more stable result over

 9 time. We see that in the data if you -- if you, you

10 know, really run in any model kind of back through time

11 and you look at the distribution of margins predicted by

12 the model over time, if you use five years, you get some

13 of the wider distribution, if you use seven, it gets

14 narrower, and if you use ten, it gets even narrower.

15 And so it seems to us as the -- the seven years is

16 probably, you know, probably a sweet spot here.

17 I -- I'll throw in one potential caveat

18 which is that the -- you know, if -- if -- if one were

19 to consider the -- the alternative, that's the

20 vehicle-based definition that does reduce the number of

21 companies and therefore the number of observations. And

22 so at that -- if that approach is taken, then -- then it

23 might make the ten-year a little bit more important to

24 look at, which would then increase the number of

25 observations once again. So -- so there's maybe a

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 1 little bit of a caveat there, but these -- these are all

 2 permutations that we'll -- we'll address in -- in our

 3 commentary as well.

 4 And then of course we'd want to use the most

 5 seven recent years of information. The proposal in

 6 January went through 2016 information is now available

 7 through 2018 on an annual basis. And so, you know, if

 8 this decision were made today, that would be the

 9 appropriate time frame to use.

10 When it comes to averaging, the -- the LG is

11 based upon a regression that actually averages in a

12 couple different ways and then buckets in certain ways

13 and -- and gets the -- the ten data points by doing all

14 of that. The -- one of the issues with averaging is

15 that you -- you're not treating companies with equal

16 weight. You're -- you're, by definition, giving

17 companies that are -- you know, have fewer data points

18 potentially more weight and those with more data points

19 less weight, and so that -- that may not be appropriate.

20 And so we think that all in all the -- the,

21 you know, statement in the proposal that the data is the

22 data. It's hard -- it's hard -- it's certainly hard to

23 disagree with that statement. And -- and so averaging

24 probably just add some additional concerns that don't

25 really make sense, so we're -- we're comfortable with

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 1 the idea of using the individual data points for those

 2 regression analysis.

 3 Then on the variable definitions, the profit

 4 margin even over net revenue, that makes sense. The

 5 proposal has at the turnover is run is net revenue over

 6 average property, plant, and equipment. The -- the one

 7 sort of wrinkle here to consider and think about is that

 8 when defining the asset turnover in this way, this --

 9 this definition makes sense when combined with the idea

10 of a profit margin because if you -- if you have a

11 profit margin, which is really, you know, realize that

12 the course of the year, you're -- you're measuring the

13 investment at points in time. So it makes a lot of

14 sense to take the average over the course of the year.

15 There's sort of an implicit assumption in

16 here that the industry is, you know, making investments

17 at sort of a -- a random points in time through the year

18 so that it's not sort of, you know, more weighted

19 towards part of the year or the end of the year or

20 anything like that. We -- we think that's been a pretty

21 reasonable assumption to make. But the -- the wrinkle

22 here is that the number that is used in the

23 spreadsheets, whether it's the LG or the DuPont, is

24 the -- is the last information you have from the -- from

25 the test year, which of course is the most recent

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 1 information you would have for a particular company.

 2 And -- and of course what you're trying to do is to try

 3 to develop margins on a go-forward basis.

 4 So that provides a bit of a disconnect

 5 between what the model finds to be the relationship

 6 between ATO and profit margin and what the spreadsheets

 7 are doing. So the way -- the way to rectify that would

 8 be to actually use the -- in the regression analysis

 9 instead of the average PPE, it would be to use the

10 property, plant, and equipment from the beginning of the

11 year. Now, there is a little bit of anticipation there

12 in the sense that it then would sort of in some sense

13 presume that the companies that are -- that are getting

14 their rates would be investing or sort of increasing

15 their investments in the same ways the companies have in

16 the industry at large, but -- but this is something

17 that, again, you know, I think it's something that

18 will -- will sort of show, you know, how -- how this --

19 you know, point this out in our comments in a few weeks

20 and short -- sort of show empirically, you know, how

21 much this matters.

22 But regardless of what's decided here,

23 certainly, you know, one would want to have their --

24 their eyes wide open in terms what is being done or, you

25 know, whether there's a mismatch between the -- the

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 1 modeling and the -- and the spreadsheets.

 2 MR. DIVER: So this is -- this is now Paul

 3 Diver. In preparing a -- a regression model or any

 4 physical analysis for that matter, it's -- it's

 5 important to consider the -- the impact of -- of

 6 outlier. As Cleve mentioned, part of the -- the use of

 7 this is to separate from the rest of the data, those --

 8 those data points really which are anomalous, those

 9 which inappropriately impact the model and not really

10 [inaudible] for the relationship between ATO and -- and

11 the profit margin. And therefore, it -- it's incredibly

12 important that we -- that we really do consider the --

13 the overall impact of outlier's analysis. And given

14 that results is quite sensitive to outlier, it's

15 critically important for us to be able to identify those

16 anomalous observations in a rigorous way.

17 The -- the outlier method specified in the

18 January proposal was to remove outlier's -- such that

19 all observations, all asset turnover and profit margin

20 pairs such that there were asset turnovers above 400

21 and/or a profit margin above 100. And additionally, to

22 drop any pair that had a single observation a negative

23 value in either variable because these cannot be

24 transformed into the log form of these variables, which

25 are what kind of the specification of the model actually

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 1 is.

 2 So when considering our approach to handle

 3 outliers, we -- we considered data-driven outlier

 4 methodology, methodologies that are driven by the

 5 characteristics of the underlying data, which includes

 6 the individual data value, of course, but also wanted to

 7 include and consider the correlation of the variance

 8 relationship or relationship between asset turnover and

 9 profit margin. We wanted method -- a method that is

10 flexible in -- in that it updates as the existing data

11 set changes in the future. That is a time window of the

12 data naturally shifts or moves.

13 And then it should also take into

14 consideration [inaudible] the symmetry for -- for one

15 that's present in the data, in the underlying data

16 distribution. And then it also has the ability to

17 eliminate outliers from both sides, both the left and

18 the right side of asset turnover and profit margin.

19 So then we will have certainly more of this

20 in -- in the formal write-up, but one method that we --

21 we considered is actually a two-stage approach where

22 the -- the first stage is a -- is a calculation of a

23 measure of distance between each pair of data and what

24 might think as center of mass of all of the hairs of --

25 of data points.

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 1 And then stage two is that [inaudible] those

 2 distances of the observations for the center of the data

 3 and apply methods developed by two authors, Hubert and

 4 Vandervieren in 2008, which automatically adjusts

 5 robustly for -- for skewness in the underlying

 6 distribution of the data, and we'll talk about -- about

 7 that a little bit more in just a moment about why that

 8 is critically important.

 9 So a bit about the Mahalanobis distance

10 calculation, and I think these two quotes are -- are

11 really helpful to understand not only the importance of

12 Mahalanobis distance, but also its -- its general

13 acceptance in the beauty in using. So the first quote

14 from Mahalanobis distance is a well-known criterion

15 which depends on estimated parameters of a multivariable

16 distribution. So unlike other outlier methodologies

17 which might consider one variable at a time, the

18 Mahalanobis distance is able to look at the multivariant

19 characteristics or the relationship of multiple

20 variables to [inaudible] simultaneously.

21 And even though there -- there are some

22 missing pieces in the Mahalanobis distance calculation,

23 it's actually quite straightforward and quite simplistic

24 to -- to apply, but it's actually accomplishing a good

25 bit while it does so. I mean, and I think that's

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 1 captured very nice in the second quote, although the

 2 Mahalanobis method seems simplistic at first, the

 3 Mahalanobis method accounts for the interattribute

 4 tendencies in a graceful way. This simple approach

 5 turns out to have surprising advantages over more

 6 complex distance-based methods in terms of accuracy,

 7 computational complexity, and parameterization.

 8 So one way of visualizing this is that

 9 rather than think about distance in -- in just a

10 circular fashion or in a one-directional left, right, up

11 down fashion, the Mahalanobis distance allows for, as I

12 mentioned, a comparing -- or an interdependency between

13 ATO and a profit margin in such a way that you consider

14 distances in -- in more of a shape like an oval, an

15 oblong shape, which takes into consideration these

16 complex relationships between the variable.

17 And this is important. As the quote on the

18 screen says -- or shows, classical statistics, a

19 univariate outlier as an observation that is far from

20 the sample mean. However, when variables are

21 correlated, you can have a multivariable -- a

22 multivariate outlier that is not extreme in any

23 coordinate.

24 Some variable that might be a little bit

25 nudge outside of what might be thought of as typical

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 1 bounds and two directions in outlier while something

 2 that might appear to be further away in a single

 3 univariant measure might actually not be all that far in

 4 terms of Mahalanobis distance from the center. And I

 5 think this is illustrated quite nicely by points A and B

 6 in the -- on the screen.

 7 Point A would not be considered an outlier

 8 due to the complex relationship in the variable that's

 9 at issue whereas point B, which might constantly -- or

10 what's in outlier -- or might be considered a nonoutlier

11 can actually be correctly and appropriately identified

12 as being a -- an outlier mistake.

13 So moving to stage two. When we think about

14 the underlying data distributions, it's important to

15 consider the shape and how the data are distributed

16 around the center of mass. And -- and the -- the big

17 crux here are -- is -- is this symmetry of the data. So

18 we want to consider techniques that will actually

19 appropriately discriminate and identify the two

20 distributions from symmetric distribution.

21 So symmetric distribution is one like we see

22 in figure A. This is, for example, a data distribution

23 that follows the -- the normal distribution or the

24 typical bell curve shape. And when you have

25 distribution of this type, you can use relatively common

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 1 methods of detecting the outliers that -- that make

 2 assumptions about the methods, such as a box plot

 3 method, which is a method that's been around for 50

 4 years or so.

 5 However, when you have data -- a data

 6 distribution which is skewed such as a right skewed

 7 distribution, which as you can see in figure B, has a

 8 long tail to the right, what can happen when you apply

 9 these -- these outlier methods that assume symmetry in

10 the data, is you can actually end up identifying

11 outlier -- or identifying observations as outliers when,

12 in fact, they are not real outliers. They are just more

13 of the underlying characteristic of the -- of the data

14 distribution and they -- they should not be -- should

15 not be segmented for the rest of the data as anomalous

16 or -- or inappropriately there in the model.

17 So the -- the Hubert and Vandervieren method

18 is a -- is a very nice method that was developed in 2008

19 that incorporates into its calculation a measure of the

20 skewness in the underlying data. And it automatically

21 puts this into account. So you can apply the method to

22 any data distribution, it will calculate a measure of

23 skewness, and automatically adjust how it would identify

24 the threshold or the fence, where it would start

25 identifying outliers in conjunction with that measure

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 1 of -- of skewness.

 2 One really nice benefit of how the actual

 3 calculation takes place in the Hubert Vandervieren

 4 method is that when the underlying data distribution

 5 that's applied to it is actually symmetric, it produces

 6 results that are equivalent to the -- the common box

 7 plot approach that I just mentioned that assumes

 8 symmetry. So it creates symmetric results -- or it

 9 creates consistent results when the underlying data

10 are -- are indeed symmetric, but it can adapt

11 appropriately when the underlying data happens to be

12 right there.

13 MR. TYLER: So a couple of -- this is Cleve

14 Tyler again. So a -- a couple of other points here with

15 regards to the regression. The January proposal uses a

16 log 10 transformation of the underlying data. We -- we

17 think that it makes more sense to use the natural log.

18 Now, when you use log 10 or natural log, it -- it really

19 doesn't change the results very much one way or another

20 regardless of what model you're taking a look at in

21 anything we've seen. But the reason for this is -- is

22 the idea that we want to use something that will be

23 regarded as a standard approach. Natural log is widely

24 used in economic analyses whereas log 10 is not.

25 So it's one of those things that if we were

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 1 to use log 10, someone in the future would sit there and

 2 scratch their head and -- and -- well, likely scratch

 3 their head. It's hard to predict what anyone will do in

 4 the future, but -- but I think it's likely they'll

 5 scratch their head and wonder why are we using log 10

 6 instead of natural log. So we think a better approach

 7 is to use something that is -- is -- is commonly used

 8 across regression analyses today.

 9 With regard to the specification of the

10 regression itself, there's -- there's that log

11 transformation as we're looking at the natural log of

12 profit margins. We have the natural log of the asset

13 turnover ratio, there's an intercept term, there's --

14 there's a natural log of the asset turnover ratio, which

15 is our relationship between the two, and then an error

16 terms. So this is a very standard progression approach,

17 but essentially specification that is used in the LG as

18 well. There -- there's a few -- there's a few things

19 that we've been thinking about maybe as alternatives to

20 this, but -- but -- but -- but generally this is the

21 right -- this is a decent approach for analyzing these

22 relationships.

23 One of the other aspects of the January

24 proposal is a -- is a range of certainty the idea

25 that -- that the regulator should have some degree of

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 1 flexibility when -- when determining what the margins

 2 ought to be for any particular company. The January

 3 proposal uses the standard error of the intercept term

 4 to do this, so it's -- it basically just sort of shifts

 5 the results up or down by that standard error.

 6 This -- this I think is something that might

 7 be a little bit of a sort of a not quite the right way

 8 to think about what the standard error does. The

 9 standard error is really trying to provide some idea

10 about the -- the degree of certainty or the confidence

11 that you have about where the true relationship lies

12 between certain variables or here where the true

13 intercept lies. And so to then sort of shift things

14 around by that, I think really kind of, you know,

15 mystifies that concept a little bit. And one way to

16 think of it is well, we have our best estimate of what

17 this relationship is between the asset turnover ratio

18 and profit margins, so -- so why would we move away from

19 what we think that relationship really is.

20 So it's probably better if -- you know, to

21 the extent, you know, flexibility is perceived as

22 desirable by the Commission and they -- and they want

23 that sort of flexibility, it's better to target well,

24 why -- why do we need that flexibility, why do they want

25 that flexibility. And -- and my understanding is it's

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 1 because there may be certain expenses that -- that

 2 might, you know, want -- they might want to take into

 3 account or they might want to view differently or

 4 investments that they might want to view differently,

 5 you know, maybe increase them or decrease them, either

 6 one of these. And it would be better to change the --

 7 those variables that are fed into the ultimate model in

 8 the spreadsheet at the end of the day rather than using

 9 the results from the regressions analysis and moving

10 away from the -- the best estimate that -- that is

11 obtained there.

12 So -- so -- so that, I think, concludes our

13 observations on the January proposal and -- and -- and

14 our current thinking. You know, we've -- we've -- we're

15 still working, we're still thinking about these issues.

16 Our thoughts are -- in some areas are continue --

17 continuing to evolve, but -- but that gives you an

18 update as to where we are.

19 MR. KERMODE: Great. Is there any

20 questions? It was pretty in -- in depth there. I'm --

21 I'm still figure out the -- the guy's name, the first

22 guy from India, what's that name again?

23 MR. DIVER: Yeah, Mahala- -- Mahalanobis.

24 It -- it takes some practice, and you're -- the first

25 couple times, you might injure your tongue, but I --

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 1 you -- you can get there for sure. It -- it -- it --

 2 I -- I struggled with that one initially myself for

 3 sure.

 4 MR. KERMODE: It -- it'll be on my

 5 whiteboard for a while. Okay. Well, I -- I think --

 6 that's what I was looking for from I think Staff's view,

 7 is a real good constructively -- you know, constructive

 8 criticism put into a framework that we can really work

 9 with, I think. I think the next step I would like to

10 try -- I'm going to try and take the presenter away from

11 you, and then I'm going to -- so I just --

12 Just do what? So I can actually -- okay.

13 Can you see my screen now, Cleve?

14 MR. TYLER: Not -- not -- not yet.

15 MR. KERMODE: Okay. Let me -- I'll go ahead

16 and just switch over. High tech gets me every time.

17 Oh, I see, here. Okay. How about now? Cleve? Or did

18 I disconnect it?

19 MR. TYLER: I think we can -- I think we can

20 see it now, yes.

21 MR. KERMODE: Okay. Cool. So I went

22 through the -- the 11 different attributes of the matrix

23 and kind of -- and we'll -- and we'll discuss this and

24 we can -- at this point, what I want to do is be able to

25 have an agreement or at least a clearer understanding of

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 1 where we're headed with it. So we'll kind of step

 2 through this if that's okay with you, Tyler -- or Cleve

 3 and Paul.

 4 MR. DIVER: That sounds perfect.

 5 MR. KERMODE: Yeah, the -- the first one

 6 here, the first attribute talks about the database and,

 7 you know, since Compustat does not exist anymore, and

 8 we've actually -- I believe we actually have a

 9 subscription here at -- for Capital IQ. So we might

10 actually be able to replicate what you're doing. So

11 that's -- that's -- we definitely agree with that.

12 So on two is comparable companies. Looking

13 at, you know -- I'll hop over to LG, but looking at

14 the -- the report, the proposed DuPont, you actually

15 have more companies than what the report has, that's

16 correct?

17 MR. TYLER: Yes, that's -- that's -- that's

18 right.

19 MR. KERMODE: And I like that. Now, it has

20 here as a note Staff recommendation includes natural gas

21 and water companies, excludes water -- I put water

22 shipping and rail. Is that still correct from what you

23 believe?

24 MR. TYLER: Right, the January proposal does

25 not include water transportation companies or rail.

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 1 MR. KERMODE: Right. Now --

 2 MR. TYLER: And that's the -- that's the --

 3 MR. KERMODE: Say that again.

 4 MR. TYLER: Yes, the proposed DuPont does

 5 not include water transportation companies or rail and

 6 the draft or the -- the -- what we're thinking of right

 7 now does include water, shipping, and rail. So that's

 8 the difference.

 9 MR. KERMODE: Okay. Okay. So and your --

10 your definition if I remember right, I don't have it

11 here, you fine-tuned it to transportation by vehicle; is

12 that right?

13 MR. TYLER: Well, you know, I -- I think

14 that we're in a territory where we think about best

15 practices and you want to follow those certainly. It

16 can be thought of almost like, you know, rings on a

17 tree, and so the transportation with vehicles is

18 probably, you know, sort of a closer more targeted

19 perspective of, you know, the companies that are most

20 relevant, and then if you were to go out a ring from

21 there, then I think what you would do is basically go to

22 what is on the screen here under draft model from WRA,

23 which would basically add in the pipeline companies as

24 well.

25 So, you know, a -- I think it's an

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 1 alternative so to -- you know, to think about and

 2 consider, but it -- and -- and there's not I don't think

 3 sort of ex ante or -- or ahead of time, you know,

 4 necessarily one jumps out as more right than the other.

 5 It's really a question of, you know, sort of precision

 6 and also how many -- how much data you have. You know,

 7 the more precise the definition gets, the fewer data

 8 points there are. So that's -- that's really the

 9 tradeoff.

10 MR. KERMODE: I think the -- the big issue

11 I -- or so the -- the sweet spot you said it, is that

12 the sample includes those companies whose risk factors

13 are most similar to the solid waste haulers, and, you

14 know -- and they inherently include those -- those

15 industry-type risks. So I -- actually, I kind of like

16 the vehicle component because that's a risk component.

17 If I look at oil pipeline or -- or water companies,

18 they're -- they're transporting without transforming,

19 but they're -- they -- I can't say they have all the

20 same risk characteristics that would be in your sample.

21 So at this point, you know, I -- I still

22 want to look deep into your sample, but I -- first of

23 all, you have more companies, which I like and -- and

24 the fine-tuning of it, I'm more comfortable with too.

25 So I -- I think that's a good suggestion that we can

0048

 1 keep moving forward on.

 2 Is there any other comments on that in here,

 3 in the room?

 4 Let's see here, so I put three here, so

 5 elimination of SIC codes. So when you put none, you

 6 went ahead and you selected the SIC codes, and whatever

 7 they were, they stood on their own until later on when

 8 you do the -- the -- the other testing, the outlier

 9 testing, correct?

10 MR. TYLER: Yes, that -- that's correct.

11 Exactly right.

12 MR. KERMODE: And other than that

13 transportation characteristic -- so I guess number one

14 is still similar. I -- I think that's close to what

15 you're doing, but I -- I know the number two, the Chow

16 test, and -- and I've done some further research since

17 then, since we talked and I agree with you. It seems to

18 be a time series type of thing, looking for changes and

19 a characteristic of a series after some event. And so I

20 agree the Chow test, that's -- that's kind of off my

21 list right now, so I think that was a really good look.

22 Number of years, it -- it seems we both

23 agree with seven years. What were you saying about it

24 maybe going up to ten?

25 MR. TYLER: Yeah, I -- I think that the one

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 1 maybe little wrinkle here is that if ultimately the

 2 Commission decides that the restric- -- restriction to

 3 SIC codes where companies use vehicles, what that does

 4 is it -- you get to that sort of inner ring, so you get

 5 more targeted, but you lose a bunch of observations by

 6 doing it that way. And so that then might suggest --

 7 it -- it makes the having more data a little bit more

 8 preferable. So when you have a broader set of

 9 companies, using seven years is fine because we got

10 plenty of data. When you go down to SIC codes of

11 vehicles, you lose some of that information.

12 And so one way to potentially hone in a

13 little bit better on that relationship is to extend that

14 back out to ten years as opposed to seven. So I -- I

15 think it becomes sort of a, you know, this is where

16 the -- the levers as you described them are -- are --

17 can be a bit interrelated with each other. So there's

18 just a tradeoff there that -- that I think one would

19 want to consider a little bit.

20 MR. KERMODE: So you had -- you have 300

21 companies -- so you got 318 companies, I got 230, but

22 you have less data points?

23 MR. TYLER: Well, that's -- that's with

24 the -- that's really applying the definition in the

25 January proposal, so it -- it includes all the companies

0050

 1 with vehicles, but it also includes the pipelines. If

 2 you -- if you were to take -- if you were to restrict it

 3 to the companies with vehicles, that -- that number

 4 drops too, and I -- I don't remember the number offhand,

 5 but less than yours and also less than 200, and -- and

 6 it's somewhere in the, you know, 150 range or something

 7 like that.

 8 MR. KERMODE: Okay.

 9 MR. TYLER: And -- and because of that,

10 it -- at that point, if you were to use SIC codes based

11 on vehicles, it might make sense to use ten years

12 instead of seven because that then increases the number

13 of data points once again.

14 MR. KERMODE: Right.

15 Now, when -- you know, we've talked about

16 this too, and -- and maybe with your studies, I -- I --

17 I still take the inflationary thing with a grain of

18 salt. I got to look a little closer at that, but

19 doesn't a ten-year analysis, you know, as -- as the

20 economy changes, that puts quite a lag on when those

21 financial data starts to reflect the current financing

22 environment?

23 MR. TYLER: Right. Yeah, I -- I -- you

24 know, I -- I agree with that. And -- and so this is

25 where, you know, there -- there's a tradeoff in terms

0051

 1 of, you know, if you were to move to ten years, how much

 2 additional information is gained, how many additional

 3 data points are gained, and it's worth being a little,

 4 you know, more lag and having the -- that additional

 5 information because you have three more years or not. I

 6 mean, that -- that becomes a -- you know, prob- -- you

 7 know, probably all that is still within the context of,

 8 you know, best practices. I -- I don't see any of that

 9 falling outside of that question itself.

10 MR. KERMODE: What -- what --

11 MR. TYLER: I agree there's a tradeoff

12 there. So I think we're in agreement on that.

13 MR. KERMODE: I -- I had mentioned this

14 before and I -- it'd be interesting to hear your

15 response. I have also mentioned that maybe in a period

16 of a -- some kind of rapid like in, you know, currently

17 rapid inflation or something within three years, things

18 have changed dramatically, what would be -- would it be

19 proper to weigh like the more current years by two or

20 something like that just to give it more weight?

21 MR. TYLER: You know, I -- my -- my initial

22 inclination is to say, you know, no, I don't think so.

23 I -- I think it's probably, you know -- you know, I

24 think that just adds additional complexities into the

25 analysis, and I don't really --

0052

 1 MR. KERMODE: Yeah, and that -- that was my

 2 fear right there, is the complexity. So for you saying

 3 not, I -- that made me smile so...

 4 Okay. So for number five, it looks like

 5 both -- EBIT on both your model and mine. LG is of

 6 course still a little different, but I think that's one

 7 of those ones where we can agree on as a -- as a good

 8 cut point.

 9 So number six, calculation of ATO. They

10 looked the same, but now you had also talked about using

11 the -- the beginning of the year to -- to calculate it.

12 How does that fit with what we got here in the model, in

13 the matrix, I mean?

14 MR. TYLER: Yeah, that -- that would --

15 where it says a draft model for WRA, it says ATO equals

16 revenue over average PPE, I -- you know, I think -- you

17 know, my thinking on that now is that it -- it -- it

18 matches up better to use the beginning of -- beginning

19 of year PPE as opposed to the average PPE. And, again,

20 there's a little bit of a tradeoff here in that if

21 we're -- if -- if we're seeking the relationship between

22 PPE and -- and, you know -- or APO and profit margins,

23 you would want to compute those exactly as it's

24 portrayed here in the proposed DuPont and the draft

25 model for WRA. But knowing that it's going to flow into

0053

 1 a spreadsheet that -- that uses the end of test year PPE

 2 for a company, that creates a mismatch between the

 3 property, plant, equipment used in the spreadsheet

 4 versus how the relationship is calculated in the

 5 regression model.

 6 MR. KERMODE: Yeah, I --

 7 MR. TYLER: So --

 8 MR. KERMODE: -- I -- I would suggest,

 9 though, that we're pretty -- I think we're pretty good.

10 I won't get anything thrown at me. I think we're pretty

11 good at projecting the rate year. So if -- if a company

12 is going to make a material investment middle of the

13 rate year, we should be putting that investment into --

14 to plant. Because I -- one of the things I -- I'm

15 really focused on and I think the -- the team is, is

16 that we're setting rates for a year, for the rate year,

17 not just for the beginning of the year. And if we

18 can -- if a company is thinking of buying a new -- I

19 don't know, three new trucks, we tried to put that in

20 there. So that -- that -- you know, okay. That's

21 something we can look at and talk about.

22 As a sidebar also, even as far as the

23 Commissioners go, the Commissioners are used to using a

24 13-month average for plant over the revenue. So

25 they're -- they're more comfortable with average PPE, I

0054

 1 think.

 2 MR. TYLER: Yeah. I certainly agree with

 3 you, that it depends on how the relationship is used

 4 and -- and what inputs flow in. And so if -- if -- if

 5 the method there is to take into account the PPE that is

 6 expected to come online then -- that -- you know,

 7 then -- then yeah, that -- that would make sense to use

 8 an average. So yeah, but that -- that's something that,

 9 you know, I -- I don't know the details of that, but --

10 but I agree, that's really the issue is how is the

11 information used, you know --

12 MR. KERMODE: And I think that is something

13 we really have to keep our thumb on because I think that

14 is -- that can cause material difference either way of

15 the -- on either way of the spectrum, so we'll -- we'll

16 keep an eye on it.

17 Averaging, I -- I appreciate that. I --

18 I -- I'm happy not to average, so I think that's one

19 area we can agree on. Let the data stand on its own.

20 One of the things I was saying about LG when it first

21 started and as I started working on my model, is I -- I

22 think the volatility as that turnover ratio increases,

23 the volatility in earnings, I -- I don't know if

24 dramatic, but it certainly you can see it, and -- and it

25 would be sad to average it away. I -- it -- it

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 1 highlights that there is -- when we talk about higher

 2 rate of returns for the solid waste industry, it

 3 highlights that risk that their -- their -- those

 4 companies are encountering when that turnover ratio

 5 increases. So averaging would, in my opinion, mask

 6 that.

 7 So number eight, the Mahalanobis and H&V

 8 method. The -- so we didn't have -- the -- the -- the

 9 Chow test was a way of eliminating data, and then we had

10 very loose like you were saying on the -- on the

11 outliers, we either looked at the ATOs or the -- the

12 profit margin or we -- we just looked at some value that

13 just looked, you know, insane and we would pull it out.

14 Very visual, very subjective, so I -- I'm -- I'm

15 actually excited about this approach. I -- I hit the

16 YouTube last night, and then I somehow slipped over to a

17 football game. It was 50/50 and I went over there. So

18 but I -- I like this. I -- I want to learn more about

19 it, and I think that's something we definitely can --

20 can head for so...

21 And then --

22 MR. TYLER: Well, and in our -- in our -- in

23 our comments, we will be providing additional detail and

24 information about the method, how it works and, you

25 know, we're hopeful that that helps you to learn about

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 1 it.

 2 MR. KERMODE: Great.

 3 And then number of data points, we'll talk

 4 about the -- to what extent we keep those others in

 5 there or do we expand it, but I think we're also on the

 6 same -- I think we're on the same wavelength. Nobody

 7 has suggested added -- adding electric companies or

 8 anything like that, so I -- I think we're in the same

 9 mind thought, and if we can find a comfortable set of

10 proxies that we can embody into the record, then

11 whenever things get updated, we're not going to be going

12 through this -- this thing again. So that -- that's --

13 I'm excited about that too.

14 Then data transformation. Absolutely. I

15 have no problem going to natural log. I think I told

16 you, I did log 10 simply because I looked at the

17 statistical data, and it just was a slightly tighter

18 fit, but nothing that, you know, was material that I --

19 I like the logic of people scratching their head going

20 why did they go log 10? There must be a reason other

21 than, you know, well, it -- it was shorter. So I have

22 no problem of going to a natural log. I don't think

23 it's a material difference and it makes it a better -- a

24 better model.

25 The range of return, I'm going to have to

0057

 1 talk to the Commissioners. They're used to -- in a

 2 normal cost capital setting, they are used to having a

 3 range. And so -- and -- and when we first started, I

 4 think it was Chairman Goltz had expressed concern that

 5 the Lurito-Gallagher produced a number certain, and he

 6 was wondering why he didn't have more flexibility. And

 7 so we'll -- we'll see where this goes. This might be a

 8 policy thing versus a factual issue, so we can move

 9 forward on that too. But it does reduce the complexity

10 if we do get rid of that.

11 Is there any -- and this is why I wanted to

12 make sure to ask the people here, is there any other,

13 what'd I call them, levers or stuff that's important

14 that you think we should be considering or looking at or

15 that we're missing a point on?

16 MR. LOVAAS: I know you're going to talk a

17 little bit more about -- this is Brad Lovaas. You're

18 going to talk a little bit about next steps in the model

19 and stuff.

20 MR. KERMODE: Oh, and -- yeah, one thing,

21 and we'll talk about that. What I wanted to talk about

22 is -- and I -- I guess this is as good as any, I -- I --

23 I understand that there's discussion as to companies

24 that are highly leveraged or have a higher leverage --

25 I'm sorry, that have higher equity, the return goes down

0058

 1 these -- of these LG, whereas on a highly leveraged

 2 company, the return is actually going up.

 3 And I wanted to make sure that at least I

 4 put on the record that the -- the difference is that the

 5 LG, the Lurito-Gallagher method, would compute a return

 6 on equity from the start, and it was indifferent as to

 7 what the capital structure is. LG then uses that equity

 8 amount or -- or return and plugs that into the equity

 9 structure. Even if the equity was 10 percent of the

10 company or 90 percent of the company, the equity amount

11 would stay the same. I -- and I say it in the report, I

12 find that -- that's -- that's in correct. That's wrong

13 finance.

14 If something is highly leveraged, the risk

15 on equity is higher. If something is highly -- or

16 equity rich, the risk is lower. So we -- we have that

17 effect where Lurito-Gallagher had a flat return, and

18 that's why the companies that have a high equity amount

19 would be seen -- when they compare what Lurito-Gallagher

20 produces and what the DuPont model produces, they see a

21 reduction return because the DuPont model is recognizing

22 that it's less risky. And I just wanted to get that

23 also -- if anyone wanted to discuss that.

24 MR. LOVAAS: Yeah, Brad Lovaas again. So

25 under number five, I just want to make sure, because

0059

 1 there are concerns regarding that, the capital structure

 2 and leverage, and I know we'll be bringing that up more

 3 specifically in the model. But I don't know that we're

 4 fully in agreement on EBIT at this point.

 5 MR. KERMODE: Okay.

 6 MR. LOVAAS: Just --

 7 MR. KERMODE: Perfect.

 8 MR. LOVAAS: -- because we've been living

 9 with this LG for a long time, and those things that may

10 be identified as flaws now are something that we've been

11 basing our finance for many years.

12 MR. JOYCE: Maybe you should elaborate on

13 your -- on your thought that it's a flaw to -- because I

14 think of risk based on more of an industry aspect versus

15 a source of financing, right? So if my business is,

16 let's say, computer software, I can finance complete

17 with equity, and it'd be fair and risky. So I'm just

18 trying to understand maybe your --

19 MR. KERMODE: That's a -- that's a --

20 MR. JOYCE: -- elaborate on that a little

21 bit more.

22 MR. KERMODE: That's a great question. I

23 would say they're -- you're -- you're citing two -- two

24 different types of risk. So you have business risk. So

25 I could go build an apartment building in Olympia right

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 1 now, my business risk is relatively small. But if I

 2 finance it all with debt, my financial risk is very high

 3 because I don't have the coverage ratio that the banks

 4 need.

 5 So if all of a sudden, I don't get the fill

 6 out in those apartments like I expected, I can't make

 7 my -- my debt payments, and the bank takes it over.

 8 Where I have the same scenario, but it's halfway -- it's

 9 half equity. Now I have a balance between risk between

10 the economy, because debt's cheaper, and safety because

11 of equity. Now it doesn't fill out like it should, I

12 can cover my debt because I have that portion -- my --

13 my interest payments are lower, my coverage coming from

14 my equity component is enough to cover that. And so

15 that's -- that's the difference. It's two different

16 risk components.

17 MR. JOYCE: Okay.

18 MR. KERMODE: Good question.

19 Okay. That's -- go ahead.

20 MR. TYLER: Yeah, I -- I -- I was just going

21 to sort of add -- add my two cents to this right now in

22 that, you know, the -- the LG makes certain assumptions

23 about the relationship between, you know, capital

24 structure and return on equity. But the -- the -- the

25 DuPont also makes assumptions about that relationship

0061

 1 and, you know -- and, of course, that appeals to the

 2 Modigliani-Miller theorem, which, you know, goes back to

 3 the -- I'm sure you're well aware, it goes back to the

 4 late 1960s and was, you know, pretty -- pretty

 5 revolutionary theory at the time.

 6 And -- and I -- I spent some time over the

 7 last couple of weeks because, you know, as an economist,

 8 as -- as an applied economist, you know, what you would

 9 want to do is you would want to look at, you know, for

10 any theory that's out there, you -- you want to -- you

11 want to test that theory and see if it makes sense or

12 not. And -- and, you know, the theory itself I think

13 makes a lot of logical sense. And -- and so I started

14 looking for some papers on, okay, well, who's tested

15 this empirically. Of course there had been a number of

16 people who have raised theoretical concerns, practical

17 concerns of the theory over the years, and -- and

18 there's a surprising lack actually of empirical tests of

19 the theorem for what -- for whatever reason.

20 So, you know, I -- I think that one thing

21 that concerns me about the DuPont a little bit is that

22 it adheres quite strictly to the Modigliani-Miller

23 theorem and it assumes that that is -- is very strictly

24 true, and -- and that's one thing I -- I -- you know,

25 makes me a bit uncomfortable is I would like to see that

0062

 1 empirical evidence that, you know, demonstrates that --

 2 that we see it, you know, actually at work, and --

 3 and -- and even better if it were at work in this

 4 industry. So anyway, that's -- that's one thing I'm

 5 continuing to think about and -- but -- but wanted to

 6 raise that here.

 7 MR. KERMODE: Yeah, I -- I -- I think that's

 8 a good point. I've -- I've heard that before and I --

 9 the -- the example I use, and I know I -- I should take

10 time and start trying to find some journal articles, but

11 the example I use from I remember college and -- and the

12 example was -- and Modigliani-Miller says this, that the

13 value of the company is not related to how it's

14 financed, right? That's kind of the essence of it.

15 So a company -- I buy an apartment building

16 and it -- it's an economic machine, it throws off a

17 certain amount of money. When people come and rent

18 apartments from me, my apartments are set at market

19 value. The -- the -- the people that come in to rent do

20 not say, so how do you have this apartment building

21 capitalized? The -- the -- the machine, that economic

22 machine, that apartment building, throws off money. And

23 so now it's up to the owner to capitalize that the best

24 it can.

25 That's why I'm at EB -- EBIT. EBIT is what

0063

 1 this -- the solid waste collection industry throws off.

 2 That machine is throwing off EBIT. Now the question is,

 3 how do I pay the financing that's financing that? We

 4 changed the financing in a competitive environment, EBIT

 5 does not change. Revenue does not change, because I've

 6 now come more leveraged or if I come more equity rich,

 7 EBIT remains the same. I go above EBIT and change some

 8 expenses or lower costs, now I'm changing what that

 9 machine throws off. But that financing machine stays

10 the same, and that's I think what Modigliani-Miller is

11 saying, is that the -- it's the economic machine above

12 that's throwing off the -- the money. Now the question

13 is, how do you optimize that capital structure to get

14 the most money at that bottom line? But that's --

15 that's a good point.

16 Let's see, next steps. So what we're going

17 to do on the, what is it, the 28th, I think, the written

18 comments come in --

19 MR. LOVAAS: 25th. I think, 25th.

20 MR. KERMODE: 25th.

21 MR. LOVAAS: We'll take the 28th.

22 MR. KERMODE: Yeah, I knew it was wrong when

23 I said it.

24 So on -- on the 25th, right around the

25 corner, the Commission is being -- asking for comments

0064

 1 about the staff report, and comments -- I'd like the

 2 comments to address factors in the report that requires

 3 the Commission to exercise judgment such as selection of

 4 the company proxies, number of years in analysis,

 5 averaging or update requirements would be useful, and

 6 I -- I think we've hit that dead-on-plus.

 7 The comments that provide wording, this

 8 is -- now, this is something we didn't talk about

 9 because this is more procedural. Provide wording or

10 guidance on proposed rules that implement the update or

11 the adoption of a method of setting rates for solid

12 waste. Now, we've talked about this off and on about to

13 what extent does the enabling order give guidance or

14 the -- rule, the adopted rules, give -- give

15 requirements. Of course there's a balance there. If --

16 if -- if there's guidance or instructions in the order,

17 the next order that comes out has more flexibility in

18 how they can implement any type of tweaks to the model.

19 In rule, there has to be a rule waiver, and it's a --

20 it's a harder standard to -- to get by.

21 And the -- my discussions with the Chairman

22 and with -- with -- to tell you the truth, with all

23 three, they are not on one mind and one mind as far as

24 how they see it constructed. And they're looking for

25 input and wisdom as to how should they do it, because

0065

 1 they do want to give the industry flexibility to react

 2 to stuff, but also give the industry assurance that

 3 we're not going to be wavering down the road as time

 4 goes by. So that -- that's an important component. So

 5 yeah, on the 25th, those should come in, and we should

 6 be good on that. We'll put together a -- a matrix and

 7 go from there.

 8 The next is we would -- with that

 9 information, with those comments, we'll probably do

10 draft rules and do another 101. And then this will

11 actually have some meat on it versus the 101 that

12 initially went out. At that point, we once again

13 probably give comments, and then we'll go to an actual

14 workshop with the Commissioners. By that time hopefully

15 we got a lot of these things honed down.

16 And Brad and I always talked about as far as

17 if we can get this down to pure policy issues clearly

18 defined where they can make those decisions, I would be

19 delighted. And, you know, I'm -- I'm -- I've said it

20 time and time again, I really want to be a -- I'm not

21 conclusion-driven here, I -- I want the right answer.

22 And where the -- where the Commission lies in the

23 decisions they make, I'm -- I'm comfortable with. What

24 I'm not comfortable with is giving them not clear

25 definitions as to how we -- we differentiate, and so

0066

 1 that's -- that's one -- one reason I have the technical,

 2 one reason I have the court reporter. I want -- I want

 3 us to be very, very crisp.

 4 Once the workshop with the Commissioners is

 5 finished, then proposed rules will come out in 102. And

 6 after that, we get the final comments. And at that

 7 point, you know, the 102 cannot change substantially.

 8 If it changes substantially, new proposed rules have to

 9 come out. So hopefully with final comments, we'll be

10 close enough where at that point we can actually then

11 get adoption of rules by a Commission order. Those are

12 the next steps.

13 Now what you probably saw missing is dates

14 on this, because I'm not sure at this point where we're

15 going to end up at. Commissioner Rendahl was shooting

16 for the end of the first quarter next year. That's, you

17 know, if -- if we can get a good meeting in mind, I -- I

18 think's actually possible. So we'll see where we're at

19 on that.

20 Any comments on the schedule anything I

21 missed or...

22 Andrew?

23 MR. KENEFICK: Well -- this is Andrew

24 Kenefick. Danny, maybe I'm a little confused there. I

25 thought you said that the Commissioners weren't set on

0067

 1 whether it would go through a rule. It sounds like that

 2 the course --

 3 MR. KERMODE: Oh, I'm sorry. I -- I -- I

 4 was unclear, then. There will be a rule, but to the

 5 extent that rule embodies, you know --

 6 MR. LOVAAS: A level.

 7 MR. KERMODE: Yeah, level of specificity as

 8 to how the model should be set up and ran. Like, you

 9 know, in the one -- the -- I'm not suggesting this, but

10 let's say in one extreme it would be the rule would say

11 these SIC codes, these SIC codes will be used to set

12 ratings where the rule might say SIC codes, or whatever

13 code we use, that are for transportation only, you know,

14 should be renewed -- should the rule say that this must

15 be renewed every five years or -- or should the order

16 say we expect this back in five years.

17 That's -- that's the difference. And -- and

18 the -- the industry has made clear that they would -- at

19 least the -- the people I've talked to that they really

20 would rather have flexibility and that the rule not be

21 so strict as to how things are done. So but there's

22 arguments on both sides.

23 MR. KENEFICK: Thanks.

24 MR. WILEY: Danny, going back to your

25 schedule, I was just trying to take quick quotes. I may

0068

 1 have gotten a little bit confused. But -- but I think

 2 that the comment you suggest in your -- your deadline

 3 for October 25th some proposed language, whether or not

 4 that is forthcoming, you are anticipating a Staff

 5 drafting rules that will then circulate in a, I guess,

 6 another CR 101 and then have the workshop, correct?

 7 MR. KERMODE: Right.

 8 MR. WILEY: One other point of clarification

 9 I wanted to ask about, and that is when you talk about

10 an order adopting the rule in the auto tran switch for

11 everybody's benefit is really the airporter industry,

12 there was a rulemaking at the Commission about 2013.

13 And it issued a very extensive order adopting those

14 rules that we used in subsequent hearings to interpret

15 the rules. Are you saying that there's the possibility

16 that the rules could be very, shall we say, skeletal and

17 that the order adopting those rules would go into

18 extensive interpretive detail by the Commissioners. Is

19 that a possibility?

20 MR. KERMODE: That's -- that's one of the

21 scenario -- that -- that's what we have in front of us

22 right now. To what extent does the -- the order have

23 most of the discussion and the -- the rule is -- is more

24 of a skeleton swinging over to here, where the rule is

25 very constrictive, directive, and the order itself is

0069

 1 just an adoption.

 2 MR. WILEY: I would point out that, you

 3 know, for those of us who were around for the original

 4 Lurito case, the order was very instructive for the

 5 companies going forward. If we are -- you know, I think

 6 there would be a preference to keep the rules fairly

 7 objective, neutral because rules for tariff filings, if

 8 they get constrictive, are problematic. That

 9 interpretive order would be very important as an

10 alternative to an adjudication if you're going

11 rulemaking.

12 MR. KERMODE: No, that's -- to tell you the

13 truth, that's my preference, and I -- I've argued -- I'm

14 not an attorney, but I've argued that that would at

15 least set the -- the foundation. And for the Commission

16 to come in and take a left-hand turn, they would have to

17 explain why these are these original order that they're

18 going in a different direction. So...

19 MR. KENEFICK: Just -- Dave or -- just in

20 the other industries, what -- how sort -- how sort of

21 prescriptive or formulaic are the rules for rate setting

22 either in Washington or -- or what you've seen

23 elsewhere? Do they tend to be flexible or do they tend

24 to be, here's the formula, plug in it, get your answer?

25 MR. WILEY: Definitely the former, and --

0070

 1 and as lawyers, we of course would prefer that it be

 2 that way because many filings are sort of case by case.

 3 There are sort of standards codified in the rules. For

 4 instance, in auto trans you've got a floor and ceiling

 5 of flexible rate structure, but -- but it's where you go

 6 in between those kind of broad outlines of rules that

 7 makes for an individual case. I think this industry,

 8 because of the variance of capital structure, the

 9 variance of size, revenues, et cetera, needs that

10 flexibility as it moves forward in -- in a possibly

11 revised rate.

12 MR. KERMODE: And -- and, you know, going

13 back, and I'm sure you have too, gone back through all

14 the orders going back pretty far, it seems that the

15 solid waste industry have always had fairly dense orders

16 and fairly instructive, and so I -- I'm -- I'm leaning

17 more that way.

18 MR. KENEFICK: To have a dense order?

19 MR. KERMODE: Having an order that really

20 explains things and what -- what they would like going

21 forward, how the model would -- should be put together

22 instead of putting the fine line SEC -- SEC codes will

23 include XYZ and becomes very structured. And I -- I

24 think that leaves a flexibility that -- that the

25 industry needs.

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 1 MR. KENEFICK: Well, but, I mean, I know

 2 that, you know, overly prescriptive order, if you then

 3 use it as sort of as if it were a rule for all future

 4 proceedings, then becomes a rule without it actually

 5 being a rule. And then you -- you would not be able to

 6 say, well, we cannot vary from this.

 7 MR. WILEY: Like an interpretive policy

 8 statement.

 9 MR. KENEFICK: Yeah, it's going to have to

10 go through rulemaking at some point.

11 MR. KERMODE: Well, but that's -- that -- I

12 think that just highlights the point. That's why I

13 think the Commission wants that discussion as to pros,

14 cons, where you headed, what, when do you want it so --

15 I'm certainly not going to be writing the order so...

16 Any other -- any other comments or...

17 Well, you know, we -- it's only 11:17, so I

18 think that's really cool. Thank you for participating,

19 coming in. Really focus on those comments. I think

20 it's really constructive. I'm going to go back and try

21 and pull some numbers to see about that inflationary

22 stuff there.

23 MR. WILEY: Yeah.

24 MR. KERMODE: And -- and probably try to get

25 more information on Modigliani and we'll see where we're

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 1 at on that. But other than that, I -- I think we've

 2 accomplished what I was hoping we would. Is there any

 3 other final words that somebody wants to put in just to

 4 get it on the record and --

 5 Brad?

 6 MR. LOVAAS: No, just thank you very much

 7 for all the prework and then leading up to this and then

 8 this discussion as well. We're looking forward to the

 9 comments and then the iterations of -- that we'll have.

10 I -- I think the comments will set up kind of a base for

11 us too, similar to what you were able to do in January,

12 and then hopefully we can have some conversations going

13 forward leading up the workshop.

14 MR. KERMODE: Well, and you'll notice I

15 didn't put hearing up there, so I don't expect that we

16 will have to do any type of hearing stuff.

17 So with that, thank you.

18 (Adjourned at 11:18 a.m.)

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 1 C E R T I F I C A T E

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 3 STATE OF WASHINGTON

 4 COUNTY OF THURSTON

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 6 I, Tayler Garlinghouse, a Certified Shorthand

 7 Reporter in and for the State of Washington, do hereby

 8 certify that the foregoing transcript is true and

 9 accurate to the best of my knowledge, skill and ability.

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13 Tayler Garlinghouse, CCR 3358

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