Deposition of Docket No. TG-131255 - Vol. I

Re Inquiry into Methods for Setting Rates for Solid Waste Collection Companies

October 8, 2019

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BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

_____

Re Inquiry into Methods for   ) DOCKET TG-131255
Setting Rates for Solid   )
Waste Collection Companies   )
_____

TECHNICAL WORKSHOP, VOLUME I

Pages 1-73

_____

October 8, 2019

9:30 a.m.

Washington Utilities and Transportation Commission
621 Woodland Square Loop Southeast
Lacey, Washington 98503

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3   WELDON BURTON, CPA
    SARA CAMPBELL, Sanitary Service Company
4   MARC TORRE, Sunshine and Disposal and Recycling
    DAVE WILEY, Williams Kastner
5   HEATHER GARLAND, Waste Connections
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6   MARC VASCONI, Regulatory Services
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11 BRAD LOVAAS, Washington Refuse and Recycling Association
    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
5
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

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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?

3 (Pages 9 to 12)

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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 --

4 (Pages 13 to 16)

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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

5 (Pages 17 to 20)

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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

9 (Pages 33 to 36)

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

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

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

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

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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

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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

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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 --

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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

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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 --

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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
2
3   STATE OF WASHINGTON
4   COUNTY OF THURSTON
5
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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11
12   _Tayler Garlinghouse_
13   Tayler Garlinghouse, CCR 3358
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