Agenda Date: November 29, 2006
Item Number: B1

Docket: **TG-061433 – WM – SnoKing**
Company: Waste Management of Washington, Inc., G-237

Staff: Bob Colbo, Transportation Program Staff
Gene Eckhardt, Assistant Director, Transportation and Water

Recommendation

Issue an order approving the revised filing of Waste Management of Washington, Inc., G-237, (Waste Management or the company) in Docket TG-061433, for WM-SnoKing, to become effective December 1, 2006. Approving the filing will implement a three-year test program, expiring November 30, 2009, of a deferred fuel accounting mechanism, subject to the conditions set forth in the order including a 10 percent “dead-band” sharing mechanism and a requirement to file a general rate case after three years. If the program extends beyond the pilot period, then a rate case will be filed every two years thereafter. Further, grant the company’s request to waive WAC 480-70-271(1), Customer Notification, and allow the company to notice its customers on the next billing cycle. The notice will include an explanation of the deferral mechanism in plain language understandable to consumers, as agreed by the company and the commission’s consumer affairs section.

Discussion

The commission considered this docket and two others at its October 25, 2006, open meeting. Commissioners expressed concerns that the proposed deferral mechanism did not include a sharing mechanism, the company had no incentive to manage fuel expense and the proposal may set a precedent for other types of expenses and other industries. The company agreed to postpone the effective date of all three filings until December 1, 2006, and subsequently withdrew the filings for WM-Northwest and WM-Seattle and South Sound. The company wants to proceed with the WM-SnoKing filing on a pilot basis for three years and it filed revised pages agreeing to the methodology explained in the following pages. The filing as revised generates $96,426 (0.81%) on an annual basis.

Since the October 25, 2006, open meeting and staff memorandum, staff circulated a second memorandum on October 30, 2006. Staff subsequently met with each commissioner and company representatives.

The memorandum and discussions reviewed public policy perspectives and the commission’s practice in approving deferred accounting mechanisms, including:

- <u>Precedent for other expenses and other industries.</u> Staff believes the implications to other industries and other expenses are very limited. There are sufficient differences, regarding size of expense, price volatility and the company’s inability to manage or control price.

Solid waste operating and expense characteristics are also easily distinguishable between other transportation industries (e.g. auto transportation companies, household goods movers and passenger ferries) and from other regulated industries (gas, electric, telecommunications and petroleum pipelines).

- Sharing Mechanism. The original proposal did not contain a sharing mechanism. The revised methodology proposed by Waste Management now includes a 10 percent “dead-band” sharing mechanism that would (a) spread both the risk and potential benefits between the company and customers and (b) create an incentive for the company to effectively manage fuel purchases. The company will absorb fuel price increases up to 10 percent of the base fuel cost, and customers will pay the amounts that exceed 10 percent of the base fuel cost. Similarly, the company will retain the savings caused by fuel price decreases up to 10 percent of the base fuel cost. Customers will “save,” through reduced rates, fuel price decreases that exceed 10 percent of the base fuel cost.
- Incentive for the company to manage both consumption and price. The original proposal resulted in no incentive for the company to manage fuel price because the deferral passed all fuel costs through to the customers. The proposed 10 percent “dead-band” sharing mechanism addresses this problem by requiring the company to absorb the first 10 percent price increase and allowing the company to retain the first 10 percent of a price decrease. Staff believes the current rate setting method creates sufficient incentive for the company to effectively manage fuel consumption because the company retains any costs savings after the rates have been set and fuel costs are always directly associated with greater costs of labor and capital, etc.

Materiality. The total dollars are relatively small to the company (less than one percent of total revenues) and the impact to rates that customers pay is small (less than one percent of rates). The following table shows the cost impact (increase or decrease) per 25 cents of fuel price:

Company		Residential 64 gal. tote + Recy + YW		Commercial 1 Yard Container		DropBox 20 Yd w/o P. Thru.
SnoKing	Present	$ 34.60	Present	$ 79.11	Present	$ 165.60
	W/O Fuel	33.33	W/O Fuel	77.52	W/O Fuel	148.46
	+ Fuel Supplement	34.90	+ Fuel Supplement	79.50	+ Fuel Supplement	169.79
	Rate if fuel decreases 25c	34.76		79.31		167.88
	monthly savings	$ 0.14		$ 0.19		$ 1.91

- Current rates include average fuel costs of $2.29 per gallon. The company’s most recent 12-month average fuel purchase cost is $2.79 per gallon.

- Single-issue ratemaking. Is it appropriate to treat fuel expense different from other expenses outside a general rate case? Staff thinks it is appropriate for the commission to address fuel expenses as a single issue because (a) the company is unable to manage fuel price in a meaningful way, (b) the current rate setting method encourages the company to efficiently and effectively manage fuel consumption (which continues even if the commission approves the proposed deferred accounting treatment), and (c) staff believes there have been no events or circumstances that would appear to offset the company's need for additional revenue. However, the small amount of fuel expense means there is a greater likelihood that other factors (e.g. price decrease for other expenses or customer growth) may offset increased fuel costs. Staff recommends that the commission require the company to file a general rate case on a regular basis (at least every two or three years) to normalize costs and ensure customers pay reasonable rates.

- <u>Why should the commission treat fuel costs different from cities?</u> Regulated solid waste companies contract with cities to provide nonregulated solid waste collection services. Many of those contracts contain no specific provisions to recover increased fuel costs. Most contracts allow an annual adjustment to all operating costs, including fuel costs, using the Consumer Price Index. The increase is imbedded in rates. No city contract treats fuel expense similar to the proposed deferral mechanism. Some newer contracts allow companies to recover increased fuel costs that exceed ten percent of the fuel costs imbedded in rates. The emerging city model appears to be similar to the commission's current fuel surcharge mechanism.
- <u>Customer Understanding.</u> Deferral programs generally true up annually. Recent experience with the Purchase Gas Adjustment (PGA) in energy showed customers find deferral programs difficult to understand and both the companies and the commission find them difficult to explain. Customers do not understand the delay between the time a company incurs the costs and the time the customers receive a bill to pay the costs, especially during a period when prices are falling. Customers do not understand why the deferred PGA on their bills increased at the same time the news reports that energy prices are following. The experience with the PGA points to the importance of the company providing a clear and proactive explanation of the mechanism to customers.
- <u>Increased effort.</u> The deferral program will require additional record keeping, reporting, and review by both the company and commission staff. Based upon experience with PGAs, staff expects both the company and commission staff will spend more time explaining the deferral program to customers. The company will initially bear the additional costs incurred to operate the deferral program. Those additional costs will be included in general rates when the company files its next rate case. The result, however, will be a system that more accurately passes through to customers the actual costs of fuel consumed in providing their service.
- <u>Fuel surcharge mechanism.</u> Compared to a deferral mechanism, the surcharge mechanism:
    - Takes less effort for both the company and commission staff.
    - Applies to a shorter period of time, so it is more closely linked to the period in which fuel costs increased or decreased.
    - Is better understood by customers.
    - Is more consistent with the way most nonregulated municipal contracts deal with fuel.
    - Does not reflect or return to the customer any price decreases.

Waste Management agreed to:

- Include a sharing mechanism to split the risk and benefits between the company and its customers. Waste Management will now absorb the first 10 percent of all fuel price changes.
- Make the program a test program to expire November 30, 2009, followed by a comprehensive review.
- File a general rate increase within three years to ensure costs are normalized and customers pay reasonable rates. In this case, the company and staff both agree that an initial rate case will not be necessary since the company filed a recent rate case with a pro forma fuel test period no older than two years (see attachment). There have been no intervening material operational changes. If the program is extended beyond the initial three years, subsequent rate increases will be filed every two years.
- Refile the proposed fuel components to include actual fuel expense incurred in the most recent 12 months rather than an index (Oil Price Information Service) derived proxy.

Although compared to a surcharge the proposed deferral mechanism will take more time and resources for both the company and staff, staff believes the proposal provides a reasonable, alternate costing method for WM-SnoKing that does not now qualify for the current solid waste fuel surcharge because of the 1.0 percent of revenue threshold. Resulting rates are fair, just, reasonable, and sufficient.

Staff recommends that the commission approve the proposed filing, subject to the conditions set forth in the order, including a 10 percent "dead-band" sharing mechanism, the program will expire November 30, 2009, a comprehensive review of the program will be made after November 30, 2009, and a requirement for the company to file a general rate case coincident with the three year review of the program (and every two years thereafter if the program is extended). Staff thinks that with the additional conditions largely mitigate the concerns raised earlier.

Conclusion

Issue an order approving the revised filing of Waste Management of Washington, Inc., G-237, in Docket TG-061433, for WM-SnoKing, to become effective December 1, 2006. Approving the filing will implement a three-year test program ,expiring November 30, 2009, of a deferred fuel accounting mechanism, subject to the conditions set forth in the order including a 10 percent "dead-band" sharing mechanism and a requirement to file a general rate case after three years. If the program is extended beyond the pilot period, then a rate case will be filed every two years thereafter. Further, grant the company's request to waive WAC 480-70-271(1), Customer Notification, and allow the company to notice its customers on the next billing cycle. The notice will include an explanation of the deferral mechanism in plain language understandable to consumers, as agreed by the company and the commission's consumer affairs section.

Attachment A