EXH. RLS-18
DOCKET TP-250574
2025 PSP GENERAL RATE CASE
WITNESS: R. LANE SISUNG

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND PILOTS,** **Respondent.**	**Docket TP-250574**

SECOND EXHIBIT (NONCONFIDENTIAL) TO THE SURREBUTTAL TESTIMONY OF

R. LANE SISUNG

ON BEHALF OF PUGET SOUND PILOTS

MARCH 6, 2026

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
STAFF RESPONSE TO DATA REQUEST

DATE PREPARED: February 23, 2026 DOCKET: TP-250574 REQUESTER: Puget Sound Pilots	WITNESS: Scott Sevall RESPONDER: Scott Sevall

DATA REQUEST NO. 27:

Identify any regulatory cases, including those before the WUTC, that were considered in, or otherwise provide the basis for, your recommendation to use the expense ratio methodology. If none exist or were considered, so state.

RESPONSE:

There are no cases which use this exact methodology. However, the UTC regularly employs financial models which compare financial data from proxy groups to include expenses, revenues, and assets. See Attachment DR 27 Staff Response.

Service Date: December 3, 2020

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Commission Inquiry into Methods for Setting Rates for Solid Waste Collection Companies	DOCKET TG-131255 POLICY STATEMENT AFFIRMING AND UPDATING THE LURITO GALLAGHER MODEL FOR RATE SETTING FOR THE SOLID WASTE COLLECTION COMPANIES

I. INTRODUCTION

1 The Washington Utilities and Transportation Commission (Commission) is charged by statute with supervising and regulating solid waste collection companies by "fixing and altering … rates, charges, classifications, rules and regulations."[1]

2 The Commission meets its responsibility to establish rates for solid waste collection companies that are fair, just, reasonable, and sufficient through audits of company requests for rate changes and evaluation of company expenses. To determine whether a company's rates will be sufficient to allow a company to earn a fair return on its investment, the Commission since 1988 has used a financial model, known as the Lurito Gallagher methodology, to set rates for regulated solid-waste haulers.[2] The model uses the test period adjusted expenses and average investment to calculate the revenue required to recover those expenses and allow a return on invested capital. The return component is shown as an operating ratio.

3 The Lurito Gallagher methodology is based on an analysis conducted in the late 1980s of the empirically observed relationship between profit margins and capital turnover ratios among a set of comparable companies. The model, named after its sponsoring witnesses, is a 1987 update of a financial model first used to set rates for Washington's trucking industry in the 1960s, known as the "Kosh" methodology. The Kosh methodology, like

[1] RCW 81.77.030: *"*The commission shall supervise and regulate every solid waste collection company in this state, (1) By fixing and altering its rates, charges, classifications, rules and regulations.*"*

[2] D. Philip Locklin, The Economics of Transportation 710-11 (7th ed. 1972); Richard J. Lurito and Kenneth F. Gallagher, Regulation of the Garbage and Refuse Collection Industry in the State of Washington: An Analysis and Appraisal, testimony on behalf of the WUTC, Docket TG-2016 (Oct. 1987).

the Lurito Gallagher methodology, is based on the relationship between capital turnover and revenue margin.

4 In 1986, the Commission instituted a proceeding to investigate the application of an operating ratio in the solid-waste industry for rate making due in part to increasing dump fees across the state.[3] The Commission also held proceedings to consider two methodologies for setting rates and ensuring an appropriate return on investments: the methodology proposed by witnesses Lurito and Gallagher and the Capital Asset Pricing Model (CAPM). The Commission found the modified operating ratio methodology proposed by and referred to as Lurito Gallagher as the most appropriate.

5 In 1991, the Commission accepted the Lurito Gallagher methodology as an appropriate model, stating:

> The Commission must use an appropriate analytical framework, or methodology, for determining the revenue requirements of the companies it regulates. The Lurito Gallagher method, which rests on the assumption that a firm's capital turnover ratio measures risk and thus indicates the company's required rate of return, is an appropriate available methodology for setting solid waste collection rates.[4]

II. ANALYSIS OF RATE METHODOLOGIES IN DOCKET TG-131255

6 On July 17, 2013, the Commission initiated the rulemaking in this docket, TG-131255, and filed with the Code Reviser a Preproposal Statement of Inquiry (CR-101) to review current methods for setting rates for jurisdictional solid waste collection companies and for developing substantive standards for determining such rates. The Commission stated that the purpose of the rulemaking was to reexamine the Lurito Gallagher model's "suitability for setting rates going forward and a broader evaluation of other possible rate-setting methods … with a specific focus into the determination of the return-on-equity component."[5]

7 One of the Commission's concerns with the Lurito Gallagher model was related to the fact that data of comparable companies and their corresponding returns on equity upon

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[3] Consolidated Garbage Cases, Cause Nos. TG-2016, TG-2017, TG-2018, TG-2020, TG-2021, TG-2024, TG-2025, TG-2026, TG-2027, TG-2032 & TG-2056, Final Commission Order (January 1988).

[4] *WUTC v. Sno-King Garbage Company, Inc./Northwest Garbage Co., Inc.*, Docket Nos. TG-900657 & TG-900658, Fourth/Fifth Supplemental Order (December 1991).

[5] Notice of Opportunity to File Comments, *Inquiry to Consider Methods for Setting Rates for Solid Waste Collection Companies Pursuant to WAC 480-70*, Docket TG-131255 (July 19, 2013).

which the model relied had not been updated since 1977.[6] In the rulemaking notice, the Commission requested comments from interested parties on rate setting approaches for solid waste collection companies, in particular:

- Retaining the Lurito Gallagher Model, correcting and updating it with current data;
- Switching to the Capital Asset Pricing Model (CAPM); and
- Developing a new alternative financial model.

8 Following a September 2013 workshop, the Commission held to discuss methods for setting rates for solid waste collection companies, the Commission retained a consultant, Bell and Associates, Inc., to assess whether the Lurito Gallagher methodology and resulting model continued to be appropriate for setting solid waste collection company rates. On December 14, 2014, Bell and Associations, Inc., and Sound Resource Economics submitted their findings and recommendations to the Commission (2014 Report).

9 The 2014 Report provided four conclusions and recommendations including: (1) an analysis of current returns on equity for regulated haulers indicating the returns were not unreasonably high, (2) correcting deficiencies in the Lurito Gallagher rate model for the near term, (3) moving to an economic cost model, and (4) developing a standardized reporting protocol for financial and operational reports submitted by all regulated haulers when requesting a rate adjustment.

10 The economic cost model proposed in the 2014 Report, according to its authors, provided a return on investment based on both an operating ratio and a "reasonable return" on property, plant, and equipment. Additionally, the consultant argued that the operating ratio approach reflected in the Lurito Gallagher Model does not adequately cover the economic costs of new investments, which led to the new model's suggested approach to use operating ratio combined with an explicit return on property, plant, and equipment.[7]

11 In January 2019, after lengthy consultation with stakeholders and assessment of the various models, Staff prepared a report (2019 Staff Report), filed in the docket, that discussed and evaluated rate making alternatives to the Lurito Gallagher model. The alternatives discussed included: (1) the Bell and Associates' Economic Cost Model, (2) updating the Lurito Gallagher model with current data, (3) using the Capital Pricing Asset

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[6] UTC Staff Report to the Utilities and Transportation Commission, Recommendation on Methodology for Deriving Operating Ratio for Solid Waste Haulers (January 16, 2019).

[7] Bell and Associates, "Solid Waste Rate Setting Methodology" (Final Report, December 15, 2014).

Model (CAPM), and (4) consideration of a new model referred to as the DuPont Formula Model.

12 Staff disagreed with the economic cost model in the 2014 Report, stating that this approach improperly combines two distinct theories of cost of capital: comparable earnings standard and capital attraction standard. Staff further argued that combining the comparable earnings approach (operating ratio) and capital attraction approach (rate base) results in a form of double recovery of return on investment.[8]

13 The second option addressed in the 2019 Staff Report provides for an update of the Lurito Gallagher model with current data. Staff updated the model using only transportation companies as proxies and included changes in tax rates, which Staff found produced a return similar to its preferred DuPont Formula Model. However, Staff continued to support its preferred model, the DuPont Formula Model, because it believes that model provides for "proper business and financial incentives to the company to maintain an optimal capital structure."[9]

14 Third, Staff evaluated the use of the Capital Asset Pricing Model (CAPM). The CAPM uses a measure of market volatility called "beta" to derive a market-required return on equity. Normally, beta is measured using proxy companies from commercially-available financial databases such as Standard & Poor's (S&P) or Compustat. According to the 2019 Staff Report, studies have shown smaller companies, as measured by market capitalization, earn higher equity returns than predicted by the CAPM. The understatement, commonly referred to as the "size effect," would result in rates being set below a fair return and in under-earning by regulated companies. Staff therefore rejected consideration of this model.[10]

15 Finally, Staff proposed using a new model it refers to as the DuPont Formula Model. Staff recommended this model because it believes the model develops a fair return for each company through the application of a formula that uses a proven relationship between asset turnover ratio (a measure of risk) and profit margin (a measure of earnings) to derive a supportable return on investment that can be used to set rates.[11] Staff identified four aspects that distinguish the DuPont Formula Model from the Lurito Gallagher model. Specifically, the DuPont Formula Model: (1) derives capital costs and earnings before interest and income taxes, (2) does not recognize income taxes or debt

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[8] 2019 Staff Report at 8.

[9] *Id.* at 7.

[10] *Id.* at 8.

[11] UTC Staff Report to the Utilities and Transportation Commission, Recommendation on Methodology for Deriving Operating Ratio for Solid Waste Haulers (January 16, 2019) at 9.

costs as inputs to the computation of a fair return, (3) uses a comparable seven-year data set, and (4) does not average data in order to smooth results.[12]

16 The industry stakeholders responded to the Staff recommended methodology contained in the 2019 Report with a detailed analysis highlighting concerns that the DuPont Formula Model would not provide the industry with sufficient rates to obtain capital, earn a fair rate of return, and continue to provide Washington with an essential public health service.[13]

17 The Commission appreciates the efforts of Staff and the industry stakeholders in conducting a careful and detailed review of the Lurito Gallagher model and the alternatives. Consistent with the Commission's intent in initiating this rulemaking, it is appropriate to maintain the Lurito Gallagher model for solid waste collection companies, but make certain changes to the inputs to that model to ensure that it reflects current comparable company returns and tax rates to uphold the statutory requirement to ensure that solid waste collection company rates are fair, just, reasonable, and sufficient.

III. STATEMENT OF COMMISSION POLICY

18 The Commission is an agency of the State of Washington vested by statute with the authority to regulate, in the public interest, the rates, practices, accounts and affiliated interests of public service companies, including solid waste companies.[14] The Commission supervises and regulates solid waste collection companies by "…fixing and altering its rates, charges, classifications, rules and regulations" as required by RCW 81.77.030(1). It is in the public interest for the Commission to undertake a review of the methodology the Commission uses to set rates and charges for solid waste companies under its jurisdiction, including the methodology used to determine a company's return on investment, to ensure fair, just, reasonable, and sufficient rates.[15]

19 The Commission concludes in this Policy Statement that it is in the public interest to update the Lurito Gallagher model with current industry data from the Capital IQ database maintained by S&P. As the 2019 Staff Report notes in discussing the alternatives, the Commission relies on such current comparable company data when considering returns on equity for other regulated industries, based on long-standing

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[12] UTC Staff Report at 12.

[13] Written Comments Regarding Recommendation on Methodology for Deriving Operating Ratio for Solid Waste Haulers Submitted on Behalf of the Washington Refuse and Recycling Association (WRRA) (October 25, 2019).

[14] RCW 80.01.040(2); RCW 81.77.030.

[15] RCW 81.28.010.

regulatory principles.[16] In addition to updating the industry data, the Commission finds that the Lurito Gallagher model should be based upon 10 years of operational data for comparable companies that provide transportation services.[17] Including 10 years of data should avoid significant year to year changes in data, smoothing the effect of the data on rates.

20 Under these regulatory principles, the Commission has determined that the Commission should refresh the operational industry data used in the Lurito Gallagher model every five years and that the model should be made available on the Commission's website to ensure that the model remains a current reflection of the industry.

21 Nothing in this Policy Statement excludes a regulated solid waste collection company from filing with the Commission a rate making model that deviates from the standard Lurito Gallagher model, including the treatment of federal income taxes.

DATED at Lacey, Washington, and effective December 3, 2020.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

ANN E. RENDAHL, Commissioner

JAY M. BALASBAS, Commissioner

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[16] Recommendation on Methodology for Deriving Operating Ratio for Solid Waste Haulers, Docket TG-131255 at 8 (Jan. 16, 2019), citing *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944).

[17] Written Comments Regarding Recommendation on Methodology for Deriving Operating Ratio for Solid Waste Haulers Submitted on Behalf of WRRA October 25, 2019, BRG Model 1 SICs at 13.