Ex _____ (LAS-T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

KING COUNTY DEPARTMENT OF PUBLIC WORKS, SOLID WASTE DIVISION, Complainant, vs. SEATTLE DISPOSAL COMPANY, RABANCO, LTD., d/b/a/EASTSIDE DISPOSAL AND CONTAINER HAULING Respondent.	DOCKET NO. TG-940411 TESTIMONY OF LISA A. SKUMATZ, Ph.D

Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

A. My name is Lisa A. Skumatz. My business address is Skumatz Economic Research Associates (SERA), located at 1511 Third Avenue, Suite 1018, Seattle, Washington, 98101.

Q. WHAT IS YOUR WORK BACKGROUND AND CURRENT POSITION?

A. I was employed as a Research Economist by Battelle Pacific Northwest Laboratories in Richland, Washington from 1980

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until 1985. I was employed as an Energy Research Analyst by Pacific Gas and Electric Company from 1985-1987. I was employed as a Rates Analyst by the City of Seattle Solid Waste Utility from 1987-1990. In 1990, I became Director of the Seattle office of Synergic Resources Corporation (SRC) with responsibility for the Company's nationwide practice in solid waste issues and the regional practice in energy issues. I was promoted to Vice President in 1992. I am currently Principal of Skumatz Economic Research Associates (SERA) and manage the company's nationwide practice in solid waste rates and planning issues.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.

A. I am an Economist. I received a Bachelor of Arts in Economics from the University of Wisconsin at Madison, and a Master of Arts and a Ph.D. in Economics from the Johns Hopkins University. A copy of my resume, which details my work experience and publications is attached as Exhibit _____ (LAS 1).

Q. ARE YOU FAMILIAR WITH THE SUBJECT MATTER OF DOCKET NO. TG-940411?

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A. Yes. I am familiar with Washington Utilities and Transportation Commission (WUTC) Docket TG-940411, in which Seattle Disposal Co., Rabanco Ltd., d/b/a Eastside Disposal and Container Hauling (Eastside) filed for increased residential garbage and residential recycle rates. I have reviewed the tariff revision adopted by the WUTC. I submitted a declaration related to the matter in February of this year.

Q. WHAT AREAS WILL YOUR TESTIMONY ADDRESS?

My testimony will address several key areas: my experience in solid waste rates, my work in rate incentives and impacts on customer waste management behavior, and findings regarding solid waste rate modeling and my conclusions regarding the specific rates proposed by the WUTC in regard to this docket.

Q. WILL YOU PLEASE SUMMARIZE THE CONTENT OF YOUR TESTIMONY?

My testimony demonstrates that, in my experience, rate incentives provide strong motivation for residential customers to recycle and divert waste from the landfill. The evidence indicates that stronger incentives from more aggressive rates tend to provide greater diversion levels.

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Larger diversion levels can be realized if stronger incentives are provided, even if the customers have already had a long-standing incentive from variable can rates. Customers react to rates, and continuing rate incentives provide one of the best methods of causing and maintaining higher recycling and waste reduction levels.

Although providing rates that reflect cost of service is one principle of rate setting practice, the practice of setting solid waste rates involves significant judgment in allocating joint costs between customer groups and service levels. Cost of service rate calculations can result in a range of specific rate levels that are all cost of service justified. Cost of service rates allow room for policy, and incentives can be provided within cost of service rates in solid waste. Revenue uncertainties can be mitigated through careful estimation of service levels or through a widely accepted practice of balancing accounts.

Finally, in examining the specific rate recommendations of the WUTC in regard to this docket, I find that, using the differentials provided in the filing, it appears that the rates do not reflect cost of service, and generally result in rates that overcharge mini-can customers and undercharge large can subscribers. The rates proposed would, based on my

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experience, have a detrimental impact and would lead to a loss of momentum in the progress toward reaching the solid waste management goals established by the King County Comprehensive Plan.

Q. WHAT EXPERIENCE DO YOU HAVE IN AREAS RELATED TO THIS DOCUMENT?

A. I have been involved in rate design and rate studies including rate designs for solid waste services across North America since 1985. I have performed solid waste rate design and incentive feasibility studies for jurisdictions including Victoria, B.C.;, Cincinnati, Ohio; Oak Park, Illinois; Anchorage, Alaska; Fort Wayne, Indiana; Ventura, California; Berkeley, California; and Pasadena, California. I have performed detailed rate studies and implementation work for Pasadena, Cincinnati, and Oak Park.

I performed detailed rate studies and implementation work for the City of Seattle Solid Waste Utility. I pioneered the concept of "Garbage by the Pound" and obtained grant funding from the Environmental Protection Agency (EPA), Region 10, to design and implement a garbage by the pound study for the City of Seattle. The study, which included a test involving

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Seattle Solid Waste Utility customers, was designed to determine the impact of garbage by the pound rate design on levels of waste reduction and recycling.

I have given single and multi-day workshops, presentations, and training on the effect of rate incentives on waste reduction and recycling for the Washington Utilities and Transportation Commission, the Greater Vancouver, B.C. Regional District, the British Columbia Ministry of the Environment, the California Five Cities Council, EPA national headquarters, and the County and City Managers Association.

I have drafted manuals on the effect of rate incentives on waste reduction and recycling, and implementation of such incentives for EPA national headquarters, EPA Region 10, and the States of California and Illinois.

I also worked with a task force examining the commercial sector rates charged by haulers operating within the City of Seattle to determine whether the rates provided sufficient incentives for commercial businesses to engage in recycling activities.

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Q. PLEASE DESCRIBE WORK YOU HAVE CONDUCTED IN THE AREA OF THE IMPACTS OF RATE INCENTIVES ON SOLID WASTE MANAGEMENT IN THE RESIDENTIAL SECTOR.

I have conducted detailed studies of the reaction of residential customers to incentive-based (either volume- or weight-based) rates. Generally, I have found that there are several reactions to variable rates: garbage tonnage reductions; increases in recycling and yard waste diversion; and reductions in garbage set outs. These results are consistent with reinforcing the state and local solid waste management hierarchy. The results show that incentive rates, in conjunction with diversion programs, have led to reports of between 25% and 65% reduction in the amount of tonnage going to landfills or transfer stations (with an average of 44%). Customer surveys show that incentive rates lead to waste diversion and careful purchasing on the part of customers. One survey shows that 76% of customers reported more careful decisions in purchasing to minimize waste, and 25% reported using additional efforts to reduce garbage. This is the first rung on the waste management hierarchy (waste reduction). Preliminary statistical work I have conducted shows that incentive rates are a crucial link to recycling. Extensive evidence shows that incentive rates lead to greater recycling, but even with mandatory recycling

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and mandatory yard waste programs, volume-based incentive rates lead to an additional 8-13% percentage points of diversion and recycling. In addition, garbage set outs from communities decline dramatically. Reports from Hoffman Estates, Illinois showed a decline from an average 3.1 units set out (1.86 33-gallon equivalents) to 1.3 stickered bags (a 30% reduction). See Exhibit 30 (JAG-1) ~~(LAS-2)~~. alh

I have also published detailed work examining the reaction of City of Seattle customers, and found that they reduced their subscribed garbage cans from an average of 3.5 per household per week to less than 1.7 cans per week in reaction to the implementation of variable can charges. The first reduction, to about 2.6 cans, came about in response to medium-incentive rate differentials, where differentials for extra cans were about $3. However, when rates increased, and in particular, when the rate for the extra can increased to $5 in 1987, customers reduced their subscriptions to about 1.5 cans (a much larger percentage reduction). In addition, the City's recycling rate increased from about 14% to over 26% during this period. Finally, in 1989, when more aggressive rate incentives were implemented (the rate for additional cans increased to $9), and the City introduced yard waste collection and expanded the recycling program, customer subscriptions fell to 1.0 cans per household per week.

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Almost 90% of Seattle's customers subscribe to the mini-can or one-can service levels, and the mini-can made sense for almost a quarter of Seattle's customers. And when even better incentives were offered through the pilot test of "Garbage by the Pound", we found an additional 15% reduction in the number of pounds of garbage put out for collection. See Exhibit ____ (LAS 3).

Q. TO WHAT DO YOU ASCRIBE THESE CHANGES IN BEHAVIOR?

Customers change behavior to minimize their bills. Customers in Seattle reacted to new rates proposals in a manner that showed they were rational. When rates for extra cans increased, they selected a mix of services (garbage, yard waste, and recycling) that reduced the impact of the rate increases on their bills. Customers make selections among the waste management options and change their behavior to the extent that the impact on their bill is reduced up to the point that the effort is worth it. And they make sensible choices. When the yard waste program was introduced in Seattle with $2 per month charge it was feared that customers might not subscribe. However, the evidence clearly shows that customers can make rational economic decisions. Customers reduced their extra garbage can subscriptions (saving $9) and signed up for the yard waste collection. In

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doing this, customers reduced their bills by $7 over what they would have been, and Seattle's yard waste program had over 62% participation and considerably more yard waste than anticipated was diverted. Seattle's recycling and diversion rate jumped to almost 39%. Recycling and yard waste participation were increased significantly because customers could reduce their bill by participating.

There are several important lessons from this evidence. Customers react to rates, and greater differentials or greater incentives are important to generating this behavior. Second, incentive rates are one of the best methods of causing and maintaining customer behavior that is consistent with the waste management hierarchy. Rates are monthly reminders to customers to make appropriate waste management decisions, and evidence shows that the pocketbook is an excellent mechanism to affect behavior.

However, there are thresholds. Customers reacted sluggishly to $1.50 and $3 differentials. They reacted more dramatically to $5 and $9 differentials. Rate incentives must give clear economic signals that are consistent with the waste management hierarchy and are clearly understandable to customers. Then customers will change waste management behavior consistent with the signals provided.

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In addition, differentials between garbage rates and diversion need to be high to provide incentives for separating the waste. The high yard waste participation results from the relatively large dollar savings customers could realize from modifying behavior and separating yard waste.

Q. WOULD YOU PLEASE DESCRIBE THE EFFECTS OF RATE INCENTIVES AND DISINCENTIVES, BASED ON STUDIES YOU HAVE PERFORMED AND YOUR PROFESSIONAL EXPERIENCE?

The role of rate incentives in solid waste has been a focus of my work for the last several years. I have conducted case studies, quantitative analyses, and reviewed literature to develop an understanding of the roles of incentives in solid waste.

I have reviewed the rate practices in Alameda County, California. This group of communities is urban or suburban, and offers variable can service for customers. A review of the rates offered in these communities shows that it is fairly common for garbage service to be priced relatively aggressively. Many of the communities charge "a can is a can", or even more aggressive rate schedules for garbage

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service. Some of the rates are shown in Exhibit ____ (LAS 4). A number of these communities show impressive diversion rates from their recycling efforts, even under the strict measurement standards set by California legislation.

One relevant example is provided from a discussion with the Acting Recycling Supervisor of Oakland, California. Oakland used to charge "a can is a can" differentials (e.g., in 1985, their rates were $6.40 per can). When they changed rates in 1991, they introduced a lower-priced mini-can (20 gallons for $10.08) and increased added a premium of 20% beyond a "can is a can" for cans beyond the first. After the rate incentives were increased, the diversion rates increased from 13% to an estimated 30% by 1993. Differentials, incentives, and disincentives were understood by customers and incorporated into their behavior.

In Alameda County, the rates incorporate a separate line item for recycling, which customers may not opt out of. However, a phone call with the Director of Solid Waste and Recycling indicates that Susquehannah County, Pennsylvania, incorporates a separate charge for recycling participation. In this County, customers pay 50 cents less for recycling bags than for garbage ($2). Even with only a 50 cent

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differential, their recycling diversion is over 16%. Customers do participate when differentials are provided.

As mentioned before, a similar phenomenon is found for yard waste participation. Even when separate charges are levied for yard waste collection, customers participate. Seattle's 62% participation the day the program was introduced (with its accompanying $2 charge) is evidence of this incentive.

Finally, I have conducted a great deal of work on elasticities, in both solid waste and energy. The work I have done on elasticities in solid waste show that the reaction of residential customers' tonnage to prices is in the range of -.09 to -.14. See Exhibit ____ (LAS 5). This means that, in general, fairly significant rate levels and differentials are needed to provide incentives to customers to affect their behavior.

However, evidence from Seattle's customer reactions and from other communities, both in terms of can set outs and in terms of tonnage reductions, shows that differentials in rates provide strong incentives to reduce waste and modify set out behavior.

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In my work on variable can set out elasticities that was published in my EPA manual (See Attachment ____, LAS 6)., I found that lower can levels had lower elasticities. This implies that when customers are already on lower can levels, it takes a differential to get them to reduce. In my work on Seattle rate studies, I found that the elasticity for switching from two cans to one can was about -1, about -1.5 for three cans to two, and about -2 for higher can levels. This implies that, even with the same differential in rates, the number of customers switching to smaller cans would be lower for those already on few cans. Reducing differentials for small can levels will lead to a slowing in progress toward reducing customers' garbage set outs.

Q. IN A MARKET WHERE INCENTIVES HAVE EXISTED FOR AN EXTENDED PERIOD, WHAT WILL HAPPEN IF INCENTIVES ARE INCREASED?

My work on the Garbage by the Pound experiment showed that, given an incentive, small can customers were very willing and anxious to reduce the amount of waste in their cans. Under the standard variable can program, customers on mini-cans could not pay less, even if they did not fill their cans. When the Garbage by the Pound experiment started, customers were able to see savings from every pound of waste diverted.

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We found overall reductions (after a mature variable rate system) of about 15% in the average pounds per week set out over the course of the experiment. However, the mini-can customers reduced their waste by 23% (or 2.1% per week average), and the higher can customers reduced by an impressive, but smaller 1.4% per week. See Exhibit ____ (LAS 3). Incentives need to be continued and enhanced if low use customers are to continue to be encouraged to reduce set outs.

Q. DO INCENTIVES HAVE TO BE MAINTAINED, OR MAINTAINED AT A CERTAIN LEVEL, TO MAINTAIN SPECIFIC LEVELS OF WASTE REDUCTION AND RECYCLING?

I am unaware of specific data to support this conclusion because I am unaware of any communities that have significantly reduced incentive levels. However, based upon my experience, incentives need to continue to be provided if low use customers are to be expected to continue to be encouraged to reduce set outs. I base this conclusion on the results of the Garbage by the Pound experiment, which found that customers especially noted that the experiment provided them with the opportunities to understand what they were paying for, and provided them a continuing incentive to

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reduce waste. This experiment also showed that providing a stronger incentive was effective, even for customers that had already had a long-standing incentive system (variable can rates). In addition, improved diversion was noted for Seattle, Oakland, and other communities, after differentials were increased. Maintaining customer behavior consistent with the waste management hierarchy is improved through maintaining incentives, and providing them on a recurring basis.

Q. WHAT IS YOUR EXPERTISE REGARDING RATE STUDIES AND COST OF SERVICE MODELS?

I have conducted detailed solid waste rate studies and cost of service modeling work for the Cities of Seattle, Washington; Cincinnati, Ohio; Berkeley, California; and Oak Park, Illinois, among others. I have also reviewed commercial rates and incentives for Seattle, and conducted rate analyses for Pasadena, California and other communities.

Q. WOULD YOU PLEASE DESCRIBE THE STEPS INVOLVED IN DETERMINING COST OF SERVICE RATES?

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The process of determining rates involves four basic steps. Step 1 is to estimate demand for service. This step analyzes the demand for each type of service offered for each customer class. It generates estimates of the number of tons or cubic yards disposed (by program or customer type), customer counts by type, and number of service units used. Step 2 is to calculate revenue requirements. This step analyzes the costs that would be incurred meeting the demand for service estimated in the demand step. The revenue requirements step evaluates all the activities that would be required to provide the services on a cost-center basis. This module considers staffing and equipment requirements, production and cost relationships, and estimates the total costs. These, along with financial considerations, provide an estimate of the total amount of revenues that need to be collected from all sources, including rate and non-rate revenues. Step 3 is cost allocation. This step analyzes how the revenue requirements calculated in step 2 are to be distributed between and within customer classes and service levels. Relationships are developed that allow the service provider or agency to attribute the system's costs (or revenue requirements) based on the type of service delivered and the customer class served. The last step is to develop the form and relationships of the rates to be charged and calculate the rate levels to cover revenue requirements. Generally,

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these steps will need to be performed and refined several times before the system reaches "equilibrium". I have published a manual describing in detail the steps needed to conduct a variable can rate study. See Exhibit ____ (LAS 6).

The determination of rate levels depends on assumptions and relationships derived in each of these steps. However, one of the areas with perhaps the most "judgment" involved is step 3, in which the total costs of providing service are "allocated" between customer types and services provided. The basis on which costs are incurred are very joint in nature. It would not make sense to charge each customer the full cost of driving the truck to their house from "base". Determining the share of those costs, and the wide range of other costs, that should be attributed to each individual customer or types of customers involves making estimates of cost relationships and attributing them between customers. Determining whether certain cost elements should be allocated proportionally, or based on tonnage, or based on number of customers, accounts, or cans is based at least partly on judgment.

Because joint costs are involved and estimates and judgments are needed, cost allocation is a combination of a science, art, judgment, and policy. Therefore, cost of service rates

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are virtually never one indisputable set of numbers in the field of solid waste, or in any utility. Rather, they are a range of rate calculations that are all justifiable on cost allocation rationales. As an example, for one rate study I worked on, alternative justifiable cost allocation assumptions could be used to support rates for extra cans that varied between about $3 per can up to about $6 per can. And then, for policy reasons -- to provide even stronger incentives for recycling and diversion -- we actually proposed extra can rates that were higher than the cost of service estimations.

Thus, cost of service is an art, rather than pure science and does not lead to one pure, indisputable answer. Cost of service by its nature, allows significant room for policy.

Q. ALTHOUGH MORE AGGRESSIVE RATES PROVIDE BETTER INCENTIVES, DON'T THEY DEVIATE FROM COST OF SERVICE AND PUT THE SERVICE PROVIDER AT FINANCIAL RISK?

A. Charging each customer the average cost of providing service, and mandating payment, would result in low financial risk. Given that a relatively high percentage of the costs of garbage collection service is represented by the cost of getting the truck and staff to the house, the flatter the

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rates, the more certain the revenue recovery. However, flat rates reflect neither cost of service, nor provide an economic incentive to manage waste appropriately.

As mentioned before, cost of service rates are represented by a range of rates, some with higher differentials than others. Better incentives are provided by more aggressive rates. A desire to provide incentives can make recovery of full costs less certain. However, these financial risks can be managed. One method is through accurate estimation of customer service choices. With the years of experience in a wide variety of communities, the haulers in this area have good quality information on historical customer selections in terms of variable can subscriptions.

However, even without perfect information on customer reactions, providing better incentives does not necessarily result in financial risk. For many years, the Joint Refuse Rate Review Committee (JRRRC) in Alameda County has been operating to review solid waste rates for over a dozen communities in Alameda County. In order to remove the issue of financial risk to the hauler, the hauler maintains a "balancing account". If costs are greater than revenues, these are tracked, and the hauler begins charging interest until another rate change is put in place and at that point,

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these costs may be recovered. The process works in a similar ways in the other direction. This is a process that has also been used successfully for years in the electric industry, and allows mitigation of financial risk under a system of incentives. Financial risk is manageable, and the impressive gains realized by incentive-based rates allows the communities to achieve their waste reduction and diversion goals.

Q. HAVE YOU REVIEWED THE COST OF SERVICE INFORMATION PRESENTED AS PART OF THIS SUBMITTAL?

Yes, I have examined the WUTC Staff Report on TG-931585 to examine the incentives, and the apparent appropriateness of differentials provided. See Exhibit ___ (LAS 7).

Q. PLEASE DESCRIBE THE RESULTS OF YOUR REVIEW OF THE COST OF SERVICE AND RATE DESIGN INFORMATION PRESENTED IN THE SUBMITTAL.

The rates, as proposed by Eastside, provide a situation under which customers who reduce waste and recycle would pay more than those who simply put out more waste as garbage.

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In addition, my analysis shows that the rates (either as proposed by Eastside or as recommended/approved by the WUTC) do not appear to reflect cost of service. Even without sufficient information to do a careful analysis of the rates calculations, the rate differentials show that the levels charged are undercharging high can levels and overcharging smaller can subscriptions. See Attachment ____ (LAS 8).

The table shows that, using the differentials provided by the WUTC and Eastside's recommended rates, that no matter which can level is assumed as the "correct" cost of service rates, the rates proposed generally overcharge low can levels and undercharge the higher can set outs.

Q. DO YOU FEEL THAT THE RATES PROPOSED BY THE WUTC WILL SLOW PROGRESS TOWARD WASTE REDUCTION AND RECYCLING GOALS?

A. Bills are important, and customers will change behavior to reduce bills. The rates that are proposed in this filing do not provide an incentive to reduce the amount of garbage set out. In fact, they create an active disincentive for low levels of garbage. Customers who produce low levels of garbage through careful buying, recycling, and yard waste separation will pay higher bills than those who simply throw all their garbage in the trash. This is an incentive that is

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specifically contrary to the waste management hierarchy, goals stated in legislation, and in the County's comprehensive plans. Further, the rates will work against the need to maintain levels of incentive if waste reduction behavior is to be expected to be encouraged to persist. Based on my experience, I would anticipate that the rates would have a detrimental impact and would lead to a loss of momentum in the progress toward reaching the solid waste management goals in the County.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

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