

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	DOCKET TG-140560
TRANSPORTATION COMMISSION,)	
)	ORDER 13
Complainant,)	
)	ORDER MODIFYING INITIAL
v.)	ORDER 12 FOLLOWING
)	ADMINISTRATIVE REVIEW
WASTE CONTROL, INC. (G-101),)	UNDER RCW 34.05.464 AND
)	WAC 480-07-825
Respondent.)	
)	
.....)	

Synopsis: *The Commission here reviews Initial Order 12 and addresses the four remaining contested issues that the parties were unable to resolve in their Partial Settlement Agreement. Considering Waste Control, Inc.'s (WCI) Petition for Administrative Review, WRRRA's Answer, Staff's Answer, and the full record of this proceeding, we take the following actions in this Order:*

- *We approve the Initial Order's application of Staff's allocation methodology to the utility expenses WCI incurs in facilities it shares with two affiliates and allow \$15,424 into revenue requirement, thus sustaining the Initial Order on this issue.*
- *We reverse the Initial Order's acceptance of Staff's calculation of land rent for facilities WCI shares with affiliates, and reject both WCI's and Staff's respective calculations of an adjusted level of land rent. We leave the amount of land rent included for recovery in rates at the level previously approved in 2009, \$80,250.*
- *We find reasonable Staff's recommended rate case expense as a basis for establishing a normalized cost for rate case expense to be included for recovery in WCI's rates. However, we reverse the Initial Order's approval of a four-year amortization period in favor of using a five-year amortization period in the normalization formula.*
- *We agree with the Initial Order that it is appropriate to require WCI to pay an assessment to cover, in part, the Commission's costs incurred in this investigation, as provided by RCW 81.20.020, but we reduce the assessment amount by one-half to \$21,909.41.*

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SUMMARY

- 1 **NATURE OF PROCEEDING.** On April 3, 2014, Waste Control, Inc. (WCI or Company), filed with the Washington Utilities and Transportation Commission (Commission) new Tariff No. 16 reflecting a general rate increase that, if approved, would generate approximately \$532,000 (15.4 percent) in additional revenue. The Company is currently collecting temporary rates that include revenues for increased disposal fees in Cowlitz County, and temporary revenues for rates agreed to as part of a Partial Settlement Agreement (Partial Settlement) filed on October 14, 2014, and approved by Order 12. All temporary rates are being collected by WCI subject to refund.
- 2 Administrative Law Judge Marguerite Friedlander entered an Initial Order, Order 12, on June 8, 2015, approving and adopting the Partial Settlement and resolving four contested issues. WCI, dissatisfied with the Initial Order’s resolution of the four contested issues, seeks administrative review under RCW 34.05.464 and WAC 480-07-825.
- 3 **PARTY REPRESENTATIVES.** David W. Wiley, Williams, Kastner & Gibbs PLLC, Seattle, Washington, represents WCI. Brett Shearer, Assistant Attorney General, Olympia, Washington, represents the Commission’s regulatory staff (Commission Staff or Staff). James K. Sells, Gig Harbor, Washington, represents the Washington Refuse and Recycling Association (WRRRA).

MEMORANDUM

1. Background and Procedural History

- 4 WCI originally requested approximately \$392,000 in rate relief on September 23, 2013, in Docket TG-131794. The Commission suspended the Company’s tariff revision on November 27, 2013, and effective December 1, 2013, allowed WCI to collect rates to recover increased disposal fees on a temporary basis, subject to refund.¹ The Commission also authorized the Company to collect a temporary fuel surcharge to recoup its increasing fuel costs.²
- 5 On March 25, 2014, Staff filed a Motion to Dismiss (Motion) the Company’s rate request, alleging that WCI, in its prefiled direct testimony and exhibits, “failed to make a prima facie

¹ *WUTC v. Waste Control, Inc.*, Docket TG-131794, Order 01 (November 27, 2013).

² *Id.* Order 03, Order Approving Temporary Special Fuel Surcharge on Less Than Statutory Notice (January 24, 2014). The Commission has approved numerous extensions of this temporary fuel surcharge in Docket TG-140560, as well.

case for its requested rate increase.”³ The Commission granted Staff’s Motion in Order 05 and ordered that the Company refund the temporary disposal fee rate increase unless WCI refiled its rate request, including the original temporary disposal fee increase, within ten business days from the effective date of Order 05.⁴

6 WCI refiled its rate request in this docket, including the temporary disposal fees increase, on April 3, 2014.⁵ The Company’s requested tariff revision would increase rates to recover approximately \$532,000 in additional revenue.⁶ In Order 01, the Commission suspended WCI’s tariff revision and the Company was “allowed to continue to recover the rates related to the increased disposal fees on a temporary basis, subject to refund, pending the Commission’s final order.”⁷

7 Staff and WCI filed a Partial Settlement Agreement on October 14, 2014, proposing to resolve all but four of the contested issues in the proceeding.⁸ WRRRA did not object

³ Staff Motion ¶ 7.

⁴ Order 05, Initial Order Granting Motion to Dismiss and Rejecting Tariff Filing ¶ 20 (March 25, 2014).

⁵ In this Order, we refer to Docket TG-131794 as the “precursor” case or docket to Docket TG-140560. It remains relevant here because it forms the basis of the filing in this docket, certain testimony and exhibits were brought forward based on work product filed or submitted in the earlier docket, and Staff conducted a significant preliminary investigation during the pendency of Docket TG-131794 that informs the record in this proceeding.

⁶ We find it noteworthy that the Company’s request for increased revenue in this docket is 36 percent higher than its request in the precursor docket, which was filed only seven months earlier. Ms. Davis’ testimony includes some discussion of the increased revenue requirement, tying it principally to “capital structure adjustments.” *See* Davis, Exh. No. JD-1T at 6:15-7:24. In addition, she discusses increased rate case expense and other adjustments that account for the increase in her supplemental testimony. *See* Davis, Exh. No. JD-12T at 2:4-7.

⁷ *WUTC v. Waste Control, Inc.*, Docket TG-140560, Order 01 ¶ 3 (April 10, 2014).

⁸ The Partial Settlement Agreement, filed on October 14, 2014, and attached as Appendix A to this Order, resolves 11 contested issues, including:

- Asset Useful Lives Reflect USOA/Depreciation Expense, Adjustment R-1A.
- Property Tax Expense, Adjustment R-6G.
- Spare Trucks Expense, Adjustment R-6H.
- Capital Structure in Lurito-Gallagher, Adjustment R-8.
- Cost of Debt in Lurito-Gallagher, Adjustment R-9.
- Allocation of Average Investment to Non-regulated Operations, Adjustment R-10.
- Labor Expense, Adjustment P-1.

to the settlement terms. The Commission held a limited-scope evidentiary hearing, focusing on the four remaining issues, on March 11, 2015. On June 8, 2015, Administrative Law Judge Marguerite Friedlander entered Order 12, an Initial Order approving and adopting the Partial Settlement and resolving the four contested issues. WCI filed its Petition for Administrative Review on June 29, 2015, addressing each of the four contested issues, which are:

- Shared Utility Expenses.
- Affiliate Land Rents.
- Rate Case Costs.
- Investigation Fees.

WCI raises an additional issue in its Petition, which we discuss below as a procedural matter.

2. Procedural Issue

8 WCI asserts in its Petition for Administrative Review that it would be contrary to the appearance of fairness doctrine for the Commissioners' only accounting advisor to offer any needed support to the Commissioners as they consider the Petition because he advised the presiding administrative law judge. WRRRA supports this argument in its Answer. These arguments apparently are based on the mistaken premise that Commission adjudicative proceedings governed by the Administrative Procedure Act and the Commission's detailed procedural rules do not adequately ensure a fair and impartial hearing and decision process to WCI. This is a patently and demonstrably false premise.

9 Formal adjudicative proceedings such as this docket and its related precursor, Docket TG-131794, are governed by Part IV of Administrative Procedure Act, RCW 34.05.410-494, and Part III of the Commission's procedural rules, WAC 480-07-300 - 885. Among these statutes and rules are detailed provisions that concern ex parte communication.⁹ To assure

-
- Fringe Benefit Expense, Adjustment P-1A.
 - Fuel Expense, Adjustment P-4.
 - Residential and Commercial Disposal Expense, Adjustments RC-1A and P-5A.
 - Remove Non-regulated City of Kalama Operations, Adjustment RC-1.

⁹ RCW 34.05.455; *see also* WAC 480-07-310.

impartiality and fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors¹⁰ are barred from discussing, and do not discuss, the merits of the proceeding with regulatory staff assigned to a docket, or any other party, without giving notice and opportunity for all parties to participate.¹¹ Regulatory staff, as distinct from the Commissioners' advisory staff, are expressly identified in formal proceedings as "Commission Staff" or "Staff" to underscore their separate role as a party and this separate role is noted in all Commission orders in contested cases. The importance of this so-called ex parte separation, or ex parte wall, is impressed upon newly employed regulatory staff and advisory staff, and reinforced through regular continuing education provided by the agency. Moreover, because the Commission conducts scores of formal adjudicative proceedings each year, the ex parte requirements are familiar to all professional employees and to those who appear regularly at the Commission. Strict adherence to ex parte requirements, quite simply, is a central part of the agency's culture.

10 Counsel for WCI and WRRRA are long-time practitioners before the Commission. They are, or should be, fully aware of the high level of attention the Commission gives to ex parte requirements and the dedication of the agency and its personnel to fairness in the conduct of formal adjudicative proceedings, among others. Nevertheless, WCI states in its petition "that the appearance of fairness doctrine would also seem to preclude the accounting advisor to the administrative law judge . . . from any role in advising the Commissioners on this Petition."¹² WRRRA agrees.¹³ WCI calls for "a complete separation of the Initial Order authors and advisors for the internal appeal consideration" and states further that:

Attaining an appropriate appearance of fairness standard is also seemingly more difficult in a circumstance where, as here, the public service company has a statutory

¹⁰ The Commission has in its employ a small number of subject matter experts, including one accounting advisor, whose exclusive role in adjudicative proceedings is to offer impartial, expert advice to the presiding officers (*i.e.*, Commissioners and administrative law judges) to whose supervision they are subject. Their expert advice can be critically important as they assist the presiding officers who must develop a full understanding of the record of proceedings that often include highly complex, specialized, and nuanced regulatory accounting and financial evidence, and specialized modeling and analyses peculiar to regulatory ratemaking practice.

¹¹ RCW 34.05.455 (1) provides: A presiding officer may not communicate, directly or indirectly, regarding any issue in the proceeding other than communications necessary to procedural aspects of maintaining an orderly process, with any person employed by the agency without notice and opportunity for all parties to participate, except as provided in this subsection.

¹² Petition ¶ 2.

¹³ WRRRA Answer at 8:15-9:5.

burden of proof and the presiding officer and opposing side are all employees of the same agency rendering the final decision in this matter.¹⁴

11 Presiding officers and their advisors all understand the importance of maintaining their neutrality and objectivity at every stage of every Commission proceeding. All are professionals possessed of the highest degree of integrity. WCI and WRA make reference to nothing that actually suggests any lack of fairness in the Commission's conduct of this, or any other, adjudicative proceeding. RCW 34.05.455, the statutory embodiment of the appearance of fairness doctrine, establishes an ex parte wall that ensures separation of the Commission's decision makers from the advocates who appear before them, including the regulatory staff.¹⁵ It identifies what communications the presiding officers in an adjudicative proceeding may have and with whom.¹⁶ It bars communications between presiding officers and any party representative concerning the subject matter of an adjudicative proceeding without notice and opportunity for all parties to participate in the communication. It even requires disclosure of any communication that occurs prior to a matter becoming an

¹⁴ Petition ¶ 2. WCI essentially suggests that the organizational structure of the Commission that has been in place for many years, and that is specifically designed to ensure fairness in adjudicative proceedings, somehow now suddenly gives an appearance of unfairness.

¹⁵ See RCW 42.36.060 (Chapter 42.36 RCW - APPEARANCE OF FAIRNESS DOCTRINE – LIMITATIONS; RCW 42.36.060 - Quasi-judicial proceedings - Ex parte communications prohibited, exceptions.

During the pendency of any quasi-judicial proceeding, no member of a decision-making body may engage in ex parte communications with opponents or proponents with respect to the proposal which is the subject of the proceeding unless that person:

(1) Places on the record the substance of any written or oral ex parte communications concerning the decision of action; and

(2) Provides that a public announcement of the content of the communication and of the parties' rights to rebut the substance of the communication shall be made at each hearing where action is considered or taken on the subject to which the communication related. This prohibition does not preclude a member of a decision-making body from seeking in a public hearing specific information or data from such parties relative to the decision if both the request and the results are a part of the record. Nor does such prohibition preclude correspondence between a citizen and his or her elected official if any such correspondence is made a part of the record when it pertains to the subject matter of a quasi-judicial proceeding.)

Ex parte communications are governed in addition under the Commission's procedural rules at WAC 480-07-310.

¹⁶ The Commissioners are considered presiding officers in all formal adjudicative proceedings inasmuch as they have final decision authority. The Commission may also, and regularly does, designate one or more administrative law judges as a presiding officer in a given proceeding.

adjudicative proceeding if such communication would be considered improper ex parte communication during the pendency of a proceeding.¹⁷ It provides, on the other hand, that: “[a]ny presiding officer may receive aid from legal counsel, or from staff assistants who are subject to the presiding officer's supervision.”¹⁸

- 12 The Commission has a standing advisory staff, including several policy advisors and one accounting advisor, all of whom are subject to the supervision of the presiding officers in adjudicative proceedings and do not communicate with Staff or other parties to such proceedings. The accounting advisor who WCI argues should be barred from advising the Commissioners because he advised the presiding administrative law judge is a member of the Commissioners’ advisory staff. He is subject to the supervision of both the Commissioners and the administrative law judge in their roles as presiding officers. The APA expressly provides that he may assist the presiding officers at all stages of this proceeding, including the administrative review that has led to this Order.¹⁹
- 13 We add one final point to explain why it is important to address at such length WCI’s misplaced argument that the Commission should not have the assistance of its advisory staff at every stage of an adjudicative proceeding. Much of the Commission’s work depends on equipping its decision makers with a sophisticated understanding of highly specialized regulatory practices, policies, and law pertinent to the economic regulation of utility and transportation industries that are, to one degree or another, natural monopolies. Regulatory accountants and policy analysts employed to assist the presiding officers as they develop this understanding in the context of individual cases spend their careers focused on the sometimes arcane principles that are critical to good decision-making. Their expert assistance to the presiding officer, or officers, in a given proceeding may be critical to the success of the adjudicative process employed by the Commission when performing its duties to:

- (2) Regulate in the public interest, as provided by the public service laws, all persons engaging in the transportation of persons or property within this state for compensation.

¹⁷ RCW 34.05.455(4).

¹⁸ RCW 34.05.455 (1)(b).

¹⁹ We note, too, that RCW 34.05.458, the APA’s separation of functions statute, provides that: “(3) A person may serve as presiding officer at successive stages of the same adjudicative proceeding unless a party demonstrates grounds for disqualification in accordance with RCW 34.05.425.” The grounds for disqualification are “bias, prejudice, interest, or any other cause provided in this chapter or for which a judge is disqualified.” RCW 34.05.425(3). Neither WCI nor WRRRA suggest the presence of any such factors in this proceeding.

- (3) Regulate in the public interest, as provided by the public service laws, the rates, services, facilities, and practices of all persons engaging within this state in the business of supplying any utility service or commodity to the public for compensation.²⁰

WCI's argument that the very presiding officers to whom it appeals "hoping for some resonance with the Commissioners on the procedural hurdles, substantive legal outcomes and the conflicting policy initiatives circulating in this unfortunately contentious and prolonged proceeding," should be deprived of any needed accounting advice is antithetical to the goal WCI purports to seek by its petition for administrative review.²¹ It is also contrary to the public interest.

3. Contested Substantive Issues

A. Shared Utility Expenses

- 14 The Company and two of its unregulated affiliates, Waste Control Recycling (WCR) and Waste Control Equipment (WCE) share employees, facilities, and equipment.²² WCR, in addition, conducts its operations, in part, from facilities it does not share with WCE or WCI. The disputed issue here is determination of an appropriate allocation of utility expenses among the three companies that share some facilities.²³
- 15 WCI "reluctantly" agreed to apply Staff's proposed allocation factor to utility expenses for purposes of this case.²⁴ This methodology identified facilities that WCI and its affiliates share.²⁵ Staff then selected three cost drivers "that recognize common activities that [cause] costs and are based on information provided by the Company, [namely] number of employees, revenue, and fixed asset per book value."²⁶ The Initial Order agrees with Staff that these three factors combine into "a reasonable indicator of the size and scope of each

²⁰ RCW 80.01.040(2) and (3). RCW 81.01.010 adopts the provisions of chapter 80.01 RCW.

²¹ We note in concluding this part of our Order that the Commissioners did not require assistance from their accounting advisor during this administrative review.

²² Order 12 ¶ 23 (citing Staff Initial Brief ¶ 9).

²³ Order 12 ¶ 32. Order 12 n.52 states that these shared expenses include electricity, water, and sewer, citing Cheesman, Exh. No. MC-13T at 3:8.

²⁴ Petition ¶ 19; *see also* Order 12 ¶ 32.

²⁵ Order 12 ¶ 23 (citing Cheesman, Exh. No. MC-1T, at 16:14-15).

²⁶ *Id.* (quoting Cheesman, Exh. No. MC-1T at 16:16-17).

affiliate entity's operations relative to WCI and one another."²⁷ In turn, "the relative size and scope of each entity's operations reasonably estimates the proportional costs each entity places on common resources."²⁸ The three-factor methodology is consistent with regulatory accounting principles that, in Staff's words: "dictate that shared costs should be allocated based on cost-drivers."²⁹ This is the familiar regulatory principle referred to as "cost causation."³⁰ In the context of inter-affiliate cost allocation in this case, adherence to this basic regulatory principle that those who are deemed to cause a cost should pay it protects against cross-subsidization between or among affiliates and protects WCI ratepayers from having to pay costs that support unregulated affiliate operations.

- 16 Staff arrives at a 23.36 percent allocation factor for WCI associated with three shared properties: 950 3rd Avenue, 1150 3rd Avenue, and 1152 River Road.³¹ Applying its allocation factor to the total utility expenses incurred at these shared facilities, Staff recommended allocating \$13,975 of the shared utility expenses to WCI.³² Staff's calculation, however, failed to allocate \$6,202 in shared utility expense that the Initial Order finds should have been included.³³ Applying Staff's three-factor allocator to the \$6,202 shared expense results in an increase of \$1,449 in utility expense allocated to WCI, for a total of \$15,424. This is the amount approved in the Initial Order.
- 17 Accepting Staff's allocation factor, but not the amount of utility expense to which the factor should be applied, the Company argues that the Commission should allow \$27,749.29 in

²⁷ *Id.* (quoting Staff Initial Brief ¶10 (citing Cheesman, Exh. No. MC-1T at 16-17)).

²⁸ *Id.* Staff explained the underlying basis for its three-factor proposal. The revenue allocator indicates the size of revenue earning activities, importance to management, and impact on administrative operations. The number of employees also indicates the size of an operation and strain on administrative resources. The net book value of assets is a measurable indicator of a company's investments, the importance or priorities of management, and the overall size of a company.

²⁹ *Id.* ¶ 24 (citing Staff Initial Brief ¶ 12 and Cheesman, TR 152:11-14).

³⁰ *Id.*

³¹ *Id.* (citing Staff Response to Bench Request No. 1, Schedule 4, revising Cheesman, Exh. No. MC-7, and explaining that "[w]hile Staff's exhibit indicates the allocation percentage for WCI is 23, the percentage is more precisely defined as 23.36, or as WCI rounds to the nearest tenth, 23.4 percent.").

³² Staff Initial Brief ¶ 9; Cheesman, TR 152:11-14.

³³ Order 12 ¶ 35.

shared utility expenses.³⁴ WCI calculates this figure using the “23.4 [percent] derived Staff allocator for utility costs [as] applied to the \$118,586.73 total utility costs the three affiliates incurred during the test period rather than Staff’s utility expense attributed to shared facilities of \$66,024.77.”³⁵ Specifically, the difference results from the Company’s inclusion of more than \$50,000 in utility costs that WCR incurred in facilities it does not share with WCI.³⁶

- 18 Staff argues that the additional expense is exclusively WCR’s and should not be included in the calculation to avoid having WCI’s regulated operations subsidize WCR’s unregulated operations.³⁷ Staff asserts that inclusion of WCR’s utility expenses from buildings as to which it retains exclusive use violates “[f]undamental accounting principles [which] dictate that direct costs should be directly assigned rather than allocated.”³⁸
- 19 The Company’s final position below, and its argument here, is that it accepts Staff’s three-factor allocation method but would have us apply it to the full utility costs incurred by WCI, WCE and WCR, including the significant costs WCR incurs in facilities it does not share with WCI. The Company’s argument confuses the fact that development of an allocation factor for a particular cost, or class of costs, does not dictate the costs to which the allocation factor is applied. It is reasonable to use measures of each affiliates’ total number of employees, total revenues, and total assets to develop an allocation factor that reflects the size and scope of each affiliate entity’s operations relative to WCI and one another. Such an allocation factor reasonably approximates the demands each affiliate places on any shared facilities.
- 20 It is equally reasonable and appropriate that the company-wide allocation factor thus determined should be applied only to the shared costs it is meant to allocate. The Company’s proposal to allocate directly assignable utility costs (*i.e.*, those incurred in facilities that are not shared) is contrary to standard ratemaking practice. The principle of cost causation requires that costs should be paid by those who cause them to be incurred. WCR’s costs incurred in facilities it does not share with WCI cannot be said to be caused by WCI

³⁴ *Id.* ¶ 27 (citing WCI Reply Brief n.16. Demas, Exh. No. LD-2T at 6, Table 2). We believe the Initial Order, which refers in ¶ 27 to the Company’s “opening brief” may have meant to cite to WCI Initial Brief ¶ 4.

³⁵ *Id.* ¶ 27 (citing Demas, Exh. No. LD-2T at 6:12-14).

³⁶ Staff Answer ¶ 11 (citing Demas, Exh. No. LD-2T at 2:22-24; Demas, TR. 51:5-22). There is some discrepancy in the evidence concerning the exact amount of these WCR utility costs but it does not appear to affect the amount of shared utility costs approved by the Initial Order and accepted here.

³⁷ Staff Answer ¶ 11; *see also* Order 12 ¶ 27 (citing Staff Initial Brief ¶ 22).

³⁸ Order 12 ¶ 28 (citing Staff Initial Brief ¶ 24); *see also* Staff Answer ¶ 12.

customers. To impose such costs on WCI ratepayers is contrary to sound regulatory practice and would be unfair.³⁹ Put differently, WCI's proposal would require its ratepayers to subsidize the unregulated operations of WCR. Such cross-subsidization is inappropriate, and would likely result in rates that are not "just, fair, reasonable and sufficient,"⁴⁰ the statutory standard the Commission must apply in establishing rates for transportation services.

- 21 We deny WCI's petition insofar as shared utility expense is concerned and accept Staff's proposed Adjustment R-6D, plus the additional \$1,449 Order 12 finds should be allocated to WCI for shared utility expenses, for a total of \$15,424. We thus reject WCI's exceptions to the Initial Order's Finding/Conclusion (8) at ¶ 90 and (9) at ¶ 91.

B. Land Rents

- 22 WCI has no direct ownership interests in the shared facilities it uses to conduct its operations. WCI and its affiliates, WCR and WCE, lease their shared facilities from two other affiliates known as Heirborne Investments I LLC (HB I) and Heirborne Investments II (HB II).⁴¹ The standard for a reasonable allowance for lease expense in such circumstances is the lower of the competitive market price or the affiliate's cost plus a fair return.⁴²

³⁹ Davis, Exh. No. JD-41T at 12:10-17.

⁴⁰ RCW 81.28.010; *see also* RCW 81.04.130; RCW 81.04.250.

⁴¹ Mr. Joe Willis owns these closely held businesses together with his brother, Kevin. The Company was founded by their father, Stanley, in 1949. Willis, Exh. No. JW-1T at 1:9-11. There is no holding company or corporate parent. *Id.* at 1:2-4:11. *See also* Exh. Nos. JW-2; JW-3; JW-4. Mr. Willis testified that Heirborne Investments "was set up many years ago because that was how I -- our father did it. It made it very easy for estate planning and things like that, and it would just rent the land and buildings to all the companies, and it would take the risk for that, so that's the intercompany relationship." TR. 66:24-67:4. Staff disagrees with Mr. Willis concerning the corporate relationship between HB I and WCI and considers HB I to be in the role of a parent corporation. *See* Cheesman, Exh. No. MC-1T at 5:20-7:20. We find Staff's analysis and conclusion somewhat strained when considered in the context of the usual definitions of a corporate parent or a holding company. In any event, any significance that Staff might attach to HB I and HB II being in the role of parent corporations, or holding companies, seems lost in Ms. Cheesman's insistence on cross-examination that these two companies are property investment companies, not solid waste collection companies, and Staff's repeated references to them as "landlords," which is indeed the role they appear to play. *See* TR. 209:9-18.

⁴² *WUTC v. Bremerton-Kitsap Airporter*, Docket TC-001846, Fifth Supplemental Order ¶ 36 (August 2, 2002) (*Bremerton-Kitsap*).

23 Ms. Davis presents two exhibits for the Company that show “per operations” or “per books” rental expenses totaling \$138,000 for the test period.⁴³ This compares to either \$92,000 or \$80,000 in per operations rent at the time of WCI’s prior rate case in 2009 in Docket TG-091653. It is unclear which figure was on the Company’s books at the time. Ms. Davis’ exhibit suggests \$92,000 as the “total annual rent expense” that the Company would adjust by adding \$31,500 in “newly rented items” recognized in the 2009 docket for a total of \$123,750. In any event, Ms. Davis testifies unequivocally elsewhere in the record that the Commission allowed \$80,250 in land rent in the 2009 case, which was not adjudicated.⁴⁴

24 WCI and Staff agreed in this case to calculate the Company’s allowed affiliated rents in shared facilities using a cost-plus-return approach but disagreed on what capital structure, cost of debt, cost of equity, and allocation of depreciation and average net investment should be used to calculate allowed rent. There is nothing new about the Commission’s use of the cost-plus-return method to determine costs for affiliated transactions such as land rent. The rationale for using this approach is usefully discussed in a 2002 rate case cited repeatedly in the record of this docket, *Bremerton-Kitsap*.⁴⁵ The fuller discussion is in the Initial Order in the case, as follows:

The approach taken by Staff has been the Commission’s standard ratemaking approach for many years, as the Company acknowledges at page 6 of its brief. Deciding this issue requires balancing fairness to both the owners of the facilities, who are also the stockholders of the Company, and the ratepayers. It is assumed in the cost plus fair return approach that, like utility property, if the owners are allowed full capital recovery plus a fair return on the investment at issue, the owners of the property are fairly treated.

An owner may choose to hold property and facilities separate from the business and lease it to the regulated utility. There may be tax advantages in doing so, if the lease expenses are allowed as a deduction for federal income tax purposes. However, the concern the Commission has historically expressed is that an owner could keep all property separate from the regulated utility and charge a lease expense to the Company. The ratepayers could find themselves in a pay-forever situation, in which they would continue to pay the owner an amount for capital recovery on the property

⁴³ Davis, Exh. Nos. JD-8 (submitted as Exh. No. JD-7) and JD-45 (submitted as Exh. No. JD-43).

⁴⁴ Davis, Exh. No. JD-1T at 12:11-13; *see also* Davis, Exh. No. JD-8 (submitted as Exh. No. JD-7). The exhibit notes that “[a]lthough \$12,000 was adjusted in the prior case, there was not an explanation and we did not follow up because the full rate increase was granted.”

⁴⁵ *See supra* n.41 for the full citation.

at issue long after the property has been fully depreciated and pay the owner, potentially, an excessive return on the property through the lease expense.

The standard to apply regarding this issue is that the ratepayers should pay for the full historical cost of service, no more and no less. Original cost ratemaking is the Commission's standard ratemaking approach, and is especially important in situations where there is less than arm's length transaction conditions involving lease payments paid by the regulated utility. The standard for a reasonable price is the lower of the competitive market price or the affiliate's cost plus a fair return.⁴⁶

This determination was not an issue on review and the Commission's Final Order in *Bremerton-Kitsap* adopted the rationale of the Initial Order.⁴⁷ While *Bremerton-Kitsap* offers this excellent summary of the rationale behind the cost-plus-return method for determining costs in affiliated transactions, the Third and Fifth Supplemental Orders lack detail in terms of the actual application of the method under the facts of the case. Indeed, these must be inferred from an appendix attached to both the Initial and Final Orders that simply shows the calculation of the land rent adjustment in the case. This leaves room for considerable dispute and land rent is one of the more contentious issues in this proceeding.

25 The Company proposes using an asset-specific capital structure, a 15 percent return on equity (ROE), and an asset-specific cost of debt, resulting in an adjustment of \$164,303.⁴⁸ All of this is asserted to be based on the approach the Commission approved in the *Bremerton-Kitsap* case. In addition, Mr. Demas testified for the Company that “[t]he Commission has

⁴⁶ *Bremerton-Kitsap*, Third Supp. Order ¶ 39.

⁴⁷ *Bremerton-Kitsap*, Fifth Supp. Order ¶ 37 states that:

The approach taken by Staff has been a standard ratemaking approach used by the Commission for many years. It protects the ratepayers by ensuring that they pay for the full historical cost of service, no more and no less. The owners of the property also are fairly treated because they are allowed the equivalent of full capital recovery plus a fair return on the investment at issue, analogous to what occurs under rate-base/rate-of-return ratemaking commonly used in the utility sector. Reliance on principles derived from original cost ratemaking methodology is especially useful in situations where there is less than arm's length transaction conditions involving lease payments paid by the regulated utility.

⁴⁸ Order 12 ¶ 36 (citing Demas, Exh. No. LD-1T at 6:15). In the Company's initial effort to “work with the Staff and their desired calculation of return on net book value based on the *Bremerton-Kitsap* Airporter formula” and to include operating costs and depreciation, the Company determined a cost-plus-return land rent cost of \$127,596. *See* Davis, Exh. No. JD-8 (submitted as JD-7).

long used a 15 [percent] return on equity for affiliated transactions.”⁴⁹ However, he also testifies that this was “[n]ot because of any exhaustive quantitative analysis, but simply for the lack of a better thoroughly vetted number.”⁵⁰ Ms. Davis’ exhibit showing the Company’s calculation indicates “disallowed” rent of \$26,302, the “excess” of its cost-plus-return land rent calculation over its per operations amount. It is not clear exactly what significance the Company attaches to this “excess” or “disallowed” amount. What is clear is that WCI wishes to have the full \$164,303 it calculates included in rates.⁵¹

26 We agree with the Initial Order’s finding that the Company failed to carry its burden to support its proposed land rent. Indeed, we need look no further than to the fact that the \$164,303 WCI requests exceeds by nearly 20 percent the Company’s unadjusted per books amount of rent paid to affiliates.⁵² The excess is almost 30 percent when compared to the adjusted, or pro forma amount of land rent, \$123,526.⁵³ Taking for the purposes of discussion that the per books amounts shown on Ms. Davis’ exhibit are the Company’s idea of what constitutes a market-based rent, WCI’s request for considerably higher cost-plus-return rent must be denied under the standard for allowable cost in the case of affiliated transactions: the lower of the market price or the affiliate’s cost plus a fair return.

27 Beyond this, the methodology the Company uses is not one we are prepared to accept on the record of this proceeding. We cannot be certain of exactly how the cost-plus-return model was formulated in the *Bremerton-Kitsap* case nor do we have a full understanding of the Commission’s rationale for accepting the results. For example, while WCI argues the cost-plus-return method in the 2002 case uses the “capital structure” of the assets, this is not clear from Appendix C to the Final Order in the case. The basis for the determination of the “facility’s debt/equity portions” shown in the appendix is unexplained. Since there are two or three improvements involved, with different in-service dates, even if the allocation is based on the financing of the individual assets, we would expect to see several asset-based debt/equity ratios somehow reconciled, but this is not evident. Indeed, there is no discussion in the Commission’s orders concerning the financing of the various properties shown in Appendix C. Moreover, it could be that the debt/equity ratio was determined on some other basis and simply applied to the total average test period rate base. Under these circumstances, we cannot endorse WCI’s interpretation and application of *Bremerton-Kitsap* to measure the

⁴⁹ Demas, Exh. No. LD-1T at 6:14-17.

⁵⁰ *Id.*

⁵¹ See WCI Reply Brief ¶ 25 n.18.

⁵² See Davis, Exh. No. JD-3 (submitted as Exh. No. JD-3A).

⁵³ *Id.*

costs of affiliated property rentals in this case, and certainly not as a ratemaking practice to be applied generally.⁵⁴

- 28 Finally, we reject the Company's proposed land rent because it is based on a return of 15 percent that is not supported by any analysis or precedent. It may have been the informal practice of the Commission's solid waste regulatory division to use such a figure over the course of many years of rate cases being resolved informally between companies and Staff, but that does not validate the use of such a return in a contested case. Nor does the use of this level of return in *Bremerton-Kitsap* 13 years ago support its use today. This is particularly evident considering Mr. Demas' testimony that its use generally was "[n]ot because of any exhaustive quantitative analysis, but simply for the lack of a better thoroughly vetted number."⁵⁵ Rates of return on equity change over time, vary by industry and company, and are otherwise very dynamic numbers. In a contested case such as this one, we expect to see a "thoroughly vetted number" that is based on sound cost of capital analysis.
- 29 Staff's cost-plus-return model uses the actual capital structures of WCI's property landlords, HB I and HB II, relies on what it characterizes as a discounted cash flow (DCF) methodology to determine 12.5 percent and 13.1 percent ROEs for HB I and HB II, respectively, and calculates the landlords' actual costs of debt by dividing test period interest expense by actual debt yielding 1.93 percent for HB I and 4.28 percent for HB II. Based on its proposal, Staff recommends an adjustment of \$85,217 to WCI's per operations land rent of \$138,000.⁵⁶ Thus, Staff would allow, and the Initial Order approved, WCI's recovery in rates of \$52,783 in land rent.⁵⁷
- 30 Staff's application of the cost-plus-return methodology in this case evolved over time, going through at least five iterations, with significant changes being made during the initial audit period from one version to the next.⁵⁸ Staff initially ran its cost-plus-return model using a 15 percent return on equity, the level of return that had been applied in settlements of WCI rate cases for many years. Staff did not initially include depreciation in its calculations then, in a second model run, added depreciation and a return on depreciation *expense* instead of a return on the net book value (*i.e.*, original cost minus depreciation). Staff corrected the return calculation in its third cost-plus-return model run and at that point substituted the HB I and HB II capital structures for the previously used combined company capital structure, still

⁵⁴ *Bremerton-Kitsap*, Third Supp. Order ¶¶ 37-39 (April 15, 2002).

⁵⁵ Demas, Exh. No. LD-1T at 6:14-17.

⁵⁶ See Order 12 ¶ 58.

⁵⁷ Order 12 at 30, Table 2

⁵⁸ See Davis, Exh. Nos. JD-1T at 11:9-12:7 and JD-8 (submitted as JD-7).

using a 15 percent return on equity. In its fourth model run, Staff reduced the return on equity to 9.8 percent, apparently taking this figure from what the Commission had recently approved in utility general rate cases, according to Ms. Davis.⁵⁹ Ultimately, Staff stuck with its decision to abandon the use of a combined company equity structure in favor of using the capital structure of HB I and HB II and applied separate rates of return, 12.5 percent for HB I and 13.1 percent for HB II, nominally based on a DCF cost of equity analysis. Staff also used the actual debt of the two HB affiliates.

31 The dynamic nature and novelty of Staff’s approaches to determine land rent in this case, relative to the Company’s long-term experience in settling previous cases before the Commission, is a principal source of complaint in the Company’s briefing and in its Petition.⁶⁰ Although a number of WCI’s arguments are misplaced and plainly incorrect,⁶¹ there is enough in the Company’s criticisms of Staff’s analysis and results to raise our concerns and cause us to probe deeply into the record and discussion of this issue.

32 Based on our review, we determine that Staff’s land rents analysis should be rejected. Without being exhaustive on the subject, we here highlight two reasons for this determination. First, Staff’s analysis of rate of return for purposes of a cost-plus-return calculation for land rent nominally using the discounted cash flow methodology falls short of what this sophisticated model requires. The first step in such an analysis requires selection of a proxy *group* of companies that are similar to the company for whom cost of equity is being estimated.⁶² Staff, however, does not use a proxy group; it selects one company to estimate a DCF return for HB I and another company to estimate a DCF return for HB II. One company does not constitute a group and is wholly unsuitable as a basis for a DCF calculation.⁶³ This

⁵⁹ Davis, Exh. No. JD-1T at 17:15-24.

⁶⁰ See, e.g., Petition ¶ 24.

⁶¹ WCI’s arguments against determining land rents based on the net, or depreciated, value of real property assets and its suggestion that this is outside “conventional return on investment” analysis in the last three bullet points in ¶ 24 of its Petition are good examples. WCI’s position is belied by the very case on which it principally relies, *Bremerton-Kitsap*. Appendix C to the Commission’s order plainly shows a classic approach to the original cost-less-depreciation method for determining rate base, to which equity return is then applied to calculate a cost-plus-return based land rent. Moreover, this approach that the Commission describes as being “analogous to what occurs under rate-base/rate-of-return ratemaking commonly used in the utility sector,” is discussed approvingly in both the Initial Order and the Final Order in the *Bremerton-Kitsap* proceeding. *Bremerton-Kitsap*, Fifth Supp. Order ¶ 37; Third Supp. Order ¶¶ 37-39.

⁶² Use of a group of companies protects against statistically unreliable results and selection bias.

⁶³ A nationally recognized cost of capital expert who testified in a recent utility case before the Commission criticized another expert’s use of a 15 member proxy group because, among other

would be true even if the selected comparable company was identical to the subject company in important respects such as size, credit rating, business model, risk profile, and so forth.⁶⁴ There is no evidence, however, that the two companies Staff used to calculate individual costs of equity for HB I and HB II are similar to those companies by any measure other than capital structure.⁶⁵ There is some evidence, on the other hand, that they are quite dissimilar.

33 Staff chose Annaly Capital (Annaly) as the basis for its ROE for HB I and Realty Income Corporation (Realty Income) as the basis for HB II's ROE. These are both multi-billion real estate investment trusts (REITs).⁶⁶ HB I and HB II, in contrast, hold and manage only the small amount of property needed to support WCI and the company's other operating affiliates. Small, closely held companies are inherently more risky than large, publicly traded companies such as Annaly and Realty Income, both of which are relatively low-risk investments.⁶⁷ WCI, which is, as discussed below, the company of interest in this analysis of what constitutes a fair return, is subject to economic regulation by the Commission; neither of the REITs are subject to such regulation.

things, because he considered it "unduly restrictive in some areas, thereby creating a smaller sample of utilities than may otherwise be warranted." *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-121697, et al., Order 14/15 ¶ 49 (citing Morin, Exh. No. RAM-16T at 9:17-20). Dr. Morin also testified that "use of a handful of companies in a highly fluid and unstable industry produces fragile and statistically unreliable results." *Id.*

⁶⁴ This is not to say that in the highly unlikely event such a publicly traded company could be identified its dividend yield and forecast growth would give no indication of a reasonable return on equity for the subject company. It indeed might be evidence of a reasonable return, but it could not be claimed as being a return indicated by DCF modeling.

⁶⁵ Staff selected the two real estate investment companies it used based on their having capital structures similar to HB I and HB II, respectively. Cheesman, TR. 207:1-6; 208:8-11; 210:12-16. Similar capital structure is a valid criterion to consider in selecting proxy companies, but it is insufficient in itself to identify a truly comparable company. Similar levels of investment risk, for example, is a critically important consideration. Yet, Ms. Cheesman did not evaluate how differences in risk factors might affect the comparability of two very large, publicly traded real estate investment trusts relative to the real estate holding and management affiliates of a small, closely-held solid waste company. TR. 212:1-6.

⁶⁶ See TR. 207:15-22; 208:4-22.

⁶⁷ See Cheesman, Exh. No. MC-6, Schedule 4, Adjustment R-6E at col. L, lines 51 and 52 showing Annaly's beta at the time of Staff's measurement was 0.65 while that of Realty Income was 0.85. Beta is a measure of market risk. Beta values less than 1.0 indicate lower risk investments. A beta of 1.0 indicates neutral risk. Any measure less than 1.0 means the company is relatively a less risky investment while betas above 1.0 indicate higher investment risk.

- 34 Finally, Staff's DCF analysis is flawed considering that Value Line reports negative growth in the case of Annaly Capital, selected as a proxy for HB I.⁶⁸ In a recent order the Commission notes the testimony of two nationally recognized experts on cost of capital analysis generally, and the DCF model specifically, that offer reasons why it is not appropriate to include companies with negative growth in DCF models.⁶⁹ Mr. Hill, for example, is quoted in the Commission's order, saying that "it is certainly reasonable to believe that investors do not rely on negative earnings growth rate forecast in forming their long-term growth expectations for a utility investment."⁷⁰ Since the goal of DCF analysis is to estimate investor expectations for return on an investment in the company that is the subject of the DCF modeling, it certainly makes no sense to include in the analysis a company that is unlikely to attract equity investors who seek growth.
- 35 In short, Staff's approach to DCF analysis falls short of what is required if such an approach is to be used to estimate a market-based required return on equity. Related to this, a second reason we reject Staff's cost-plus-return model is that it focuses on the wrong affiliates. The underlying basis for using a cost-plus-return model is that a reasonable estimate of costs can be determined by treating assets used by a regulated company, but held by an affiliate, as if they were held by the regulated company. With that foundational assumption, it is then reasonable to use original cost less depreciation to determine the asset's net book value. Applying the company's capital structure, the debt and equity supporting the asset on the company's books is determined. The company is then allowed the sum of an equity return on the equity share, a debt return on the debt share, and depreciation expense during the test period.
- 36 This is the classic rate base/rate of return methodology in a nutshell. It provides a measure of fair cost the regulated company should be deemed to incur for using an asset held by an affiliate. Affiliated transactions are by definition less than arm's length. Thus, the idea of using a cost-plus return is to protect ratepayers from having to pay what may be above-market costs due to the relationship between affiliates, while being fair to the investor who makes the asset available. Customers pay in rates the same amount they would pay if the regulated company owned the asset; they pay a return on, and a return of, the original cost less depreciation, plus depreciation expense. The investor receives a return of, and a return on, the asset just as if the investor paid in capital to the regulated company so that it could purchase the asset. Thus, the focus must be on the company for which rates are being set, not

⁶⁸ Demas, Exh. No. LD-1T at 6:6-12 (Table 2).

⁶⁹ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-121697, et al., Order 14/15 ¶ 47, n.40 (citing Morin, TR. 564:24-565:1, and Hill, Exh. No. SGH-2T at 54:16-18).

⁷⁰ *Id.*

on the investor, who may be a private owner as in the *Bremerton-Kitsap* case, or the shareholders in the case of a publicly traded company. Either way, it is the regulated company's capital structure that is relevant to the determination of the costs allowed for recovery in rates, not the capital structure of the private owner or the shareholders.⁷¹

37 Summing up, we find neither the Company's nor Staff's land rent adjustment proposals adequately supported in this case. Nor is there evidence adequate to support any other adjustment to land rent. As a consequence, we are left with no alternative but to determine that there will be no adjustment to the level of land rent approved in WCI's 2009 case. WCI accordingly will continue to be authorized to recover in rates and the amount of \$80,250 in land rents for purposes of the Company's compliance filing.⁷²

C. Rate Case Expense

38 The Company's figures for its combined legal and accounting expenses in this proceeding and in Docket TG-131794 through February 28, 2015, were \$502,478.⁷³ WCI wishes to amortize "full recovery of Company rate case costs less [a] \$47,822, [or] 50 [percent] reduction in costs in TG-131794 [for the] interval from December, 2013 to April, 2014."⁷⁴ WCI says this reduction, proposed for the first time in its Petition, acknowledges "shared responsibility for the protraction of this proceeding," and acceptance of "the Staff premise of 50% reduction in rate case costs in Docket No. TG-131794" from the time of the prehearing conference in that docket though April 4, 2014, when WCI refiled its case in this docket, following dismissal of Docket TG-131794.⁷⁵ WCI proposes a four-year amortization of its rate case expense. Thus, using \$502,478 as a benchmark, the Company would recover

⁷¹ This is not necessarily a complete answer in a case such as this one where the company is comprised of multiple affiliates, some regulated and some not regulated. Here it might be appropriate to use the capital structure of the overall operation or a hypothetical capital structure to protect against capital structures that might result in cross-subsidies flowing from regulated to unregulated businesses within the affiliate family.

⁷² This outcome demonstrates the importance of a collaborative effort on the part of industry participants and Staff in the pending rulemaking in Docket TG-131255, and informally, to develop a workable methodology that can be consistently applied to determine affiliated land rents and the costs that should be allowed for other affiliate transactions.

⁷³ Order 12 ¶ 59 (table).

⁷⁴ Petition ¶ 43. It appears that the Company may consider rate case expense to be a pass-through of costs that it will be allowed to recover over time. As discussed below, this is incorrect. Our consideration of rate case expense is for the purpose of determining what normalized level of legal and accounting expenses will be embedded in permanent rates going forward.

⁷⁵ Petition ¶ 36.

annually in rates \$113,649 (*i.e.*, $(\$502,478 - \$47,882)/4 = \$113,649$) to cover the costs of rate cases that can be expected to be filed from time to time in the future.⁷⁶

- 39 The Initial Order finds these reported costs through February “exorbitant” and “excessive” considering that they exceed the revenue increase WCI requested initially in Docket TG-131794, which was dismissed, and are very close to the \$532,000 WCI requested in this docket.⁷⁷ The Initial Order observes, too, that with the additional costs of hearing and post-hearing process, it is conceivable WCI’s costs exceed its current revenue request. The Initial Order states that “[t]o expend approximately the same amount of money as your rate case request tests the bounds of logic” and questions the prudence of such expenditures.⁷⁸ Although the Initial Order questions the prudence of WCI’s incurrence of such costs, there is no express finding of imprudence. While such a finding has supported in the past a complete disallowance of rate case expense, it is not a necessary finding to support an adjustment.⁷⁹

⁷⁶ The Company’s Petition is unclear regarding whether WCI proposes to recover costs incurred after February 28, 2015, which could be a considerable amount considering the costs of hearing, two rounds of briefing, supplemental testimony filed with its initial brief, and the costs of preparing its Petition. If so, we reject the proposal. Rate case costs are not treated as a pass-through expense. The starting point on which we rely in this Order, the amount of rate case expense on record as of the publication of Order 12, is adequate to the purpose of establishing a normalized cost.

⁷⁷ Order 12 ¶¶ 69, 96.

⁷⁸ *Id.* ¶ 69.

⁷⁹ See *Bremerton-Kitsap*, Fifth Supp. Order ¶ 27 n.7:

WUTC v. Sno-King Garbage Company, Inc., Docket Nos. TG-900657, TG-900658, Fourth and Fifth Supp. Orders, (Dec. 1991) (Commission found no benefit to ratepayers from the amounts spent on expert and attorney fees in the case and denied their recovery in rates as exorbitant and imprudent); *Petition of PSE*, Docket No. UE-920433, Fifteenth Supp. Order (Dec. 15, 1993) (Commission affirmed rejection of portion of PSE’s rate case expenses, partly in response to Public Counsel argument that the Company simply spent too much); see also, *WUTC v. Rosario Utilities, LLC*, Docket No. UW-951483, Fourth Supp. Order, pp. 7, 8 (November 25, 1996) (\$6,000 allowed, \$18,000 sought).

These cases illustrate the range of the Commission’s exercise of discretion in considering and determining a normalized level of rate case expenses to be included in rates. Expenses found to be “exorbitant and imprudent”, as in the *Sno-King Garbage* case, may not be considered at all. There the Commission said it would “do whatever is necessary to discourage ‘gold plating’ of rate case expenses.” *Sno-King Garbage*, Fourth and Fifth Supp. Orders at 19. Costs found to be extraordinary and excessive, although not imprudent, may be disallowed in part, as in the *PSE* and *Rosario Utilities* cases cited above.

40 The Initial Order determines that:

Staff's proposal to allow 100 percent recovery of the expenses from the informal audit process in Docket TG-131794 and 50 percent recovery of the expenses from the formal adjudications in Dockets TG-131794 and TG-140560, as described in paragraph 69, is reasonable.⁸⁰

Again using \$502,478 as a benchmark and the four-year amortization the Initial Order approves, the Company would recover annually in rates \$75,839 (*i.e.*, $\$104,232 + (\$362,759 + \$35,487)/2 = \$303,356$; $\$303,356/4 = \$75,839$). Applying Staff's proposed five-year amortization the annual amount would be \$60,671.

41 WCI disputes the Initial Order's finding that "WCI's rate case costs in this proceeding were exorbitant [sic]"⁸¹ but acknowledges in its Petition that:

WCI well understands and concurs with the premise that a litigant's costs are nevertheless fully reviewable by the Commission and may be disallowed where they are "exorbitant and imprudent."⁸²

WCI argues, however, that its costs in litigating this case were not imprudent and should be allowed for full recovery.⁸³ WCI nevertheless states in its petition that:

It is now willing to accept the Staff premise of 50% reduction in rate case costs in Docket No. TG-131794 for the interval between the prehearing conference Notice of December 24, 2013 and the unfortunate dismissal circumstances and the refile of the dismissed rate case on April 4, 2014.⁸⁴

⁸⁰ Order 12 ¶ 96 (Finding and Conclusion 14).

⁸¹ Finding/Conclusion 14 (Order 12 ¶ 96) to which the Petition cites actually uses the word "excessive," not "exorbitant" though the Initial Order does describe these costs as exorbitant in ¶ 69, as previously stated.

⁸² Petition ¶ 32 (citation omitted). While this is certainly true, another reason to disallow costs incurred in a proceeding such as this one is that the costs, even if not exorbitant and imprudent, are not representative of normal levels of expense that should be included in rates on a continuing basis and for that reason they are excessive by definition. We discuss this point in more detail below.

⁸³ *Id.*

⁸⁴ *Id.* ¶ 36.

Thus, WCI agrees with Staff's recommendation and the Initial Order's determination that half of the adjudicative proceeding costs in the Company's precursor case that was dismissed should not be allowed as a basis for recovery. Given that the Initial Order also accepts Staff's recommendation that 100 percent of the costs incurred during the informal auditing process in Docket TG-131794 should be reflected in rates because the accounting undertaken during that period contributed to the Company's filing in Docket TG-140560, the only question for us on review is whether the Initial Order's disallowance of one-half the Company's costs in this adjudicative proceeding (*i.e.*, Docket TG-140560) should be sustained.

42 WCI states correctly that “[n]o one disputes that this was a protracted, heavily contested case.”⁸⁵ The Company relates in its Petition a litany of fault on Staff's part that the Company contends helps account for this being so.⁸⁶ Nevertheless, WCI “is willing to accept part of the penalty and blame for the protraction and/or duplication in [Docket TG-131794].”⁸⁷ Staff places on WCI the principal responsibility for this case taking over two years, requiring two dockets, and for the case's complexity and contentiousness. Staff, like WCI, offers details to which it attributes “the extraordinary costs associated with Docket TG-140560.”⁸⁸ The Initial Order finds fault on both sides.⁸⁹

43 In our view, all of this argument about who is at fault is largely beside the point. What is important to our consideration is that everyone agrees this case took an unusually long time, was highly contentious, and produced costs that are excessive by any measure of what is normal. Yet, what we must determine is the level of normalized costs for rate case expense.⁹⁰

44 Normalization of costs is a familiar concept in regulatory ratemaking. There are various ways to achieve it. Just as in the case of overall rates, when considering what is appropriate for individual components that go into those overall rates, the proper focus is not on the means by which we arrive at the end result. Rather, the focus is on the reasonableness of the end result achieved by whatever means we employ.⁹¹

⁸⁵ *Id.* ¶ 33.

⁸⁶ *Id.* ¶ 37.

⁸⁷ *Id.* ¶ 40.

⁸⁸ Staff Answer ¶ 32.

⁸⁹ *See* Order 12 ¶ 74.

⁹⁰ *See Bremerton-Kitsap*, Fifth Supp. Order ¶ 28.

⁹¹ *See Fed. Power Comm 'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S. Ct. 281, 88 L. Ed. 333 (1944) (the methods by which government regulators determine a utility's rate are inconsequential so long as the *end result* is fair); *see also In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767, 88 S. Ct. 1344, 20 L. Ed. 2d 312 (1968); *People's Organization for*

45 Ms. Cheesman discusses Staff’s perspective on normalization of rate case expense in her initial response and her supplemental testimony. She says in her response testimony that:

Rates should reflect prudent and recurring expenses incurred by a regulated company. Test year expenses used for rate setting should reflect the prudent expenses incurred by a regulated company in a typical year. Non-recurring expenses are, by definition, rare and atypical.

While rate case expenses are recurring, they typically are not incurred every year. Staff’s adjustment normalizes the accounting and legal expenses related to general rate case expenses and normal operations. This smoothing treatment normalizes rare and atypical general rate case expenses while allowing for a reasonable recovery of accounting and legal expenses.⁹²

Ms. Cheesman returns to this point in her supplemental testimony, stating that:

Staff’s proposed general rate case recovery is logical and reasonable because half recovery of each formal adjudicated general rate case allows recovery of one fully supported formal adjudicated general rate case.

Staff’s full approach to normalization of rate case expense is to allow all of the Company’s expense—largely accounting expense—incurred in preparing its filing in Docket TG-131653, because the Company’s preparatory work in Docket TG-131794 was “useful and relevant” to this case.⁹³ To this, Staff would add the average of the legal and accounting expenses the Company incurred in the two general rate case dockets, thus arriving at an approximate reasonable cost for a single contested rate proceeding for WCI of \$303,354.

46 Staff suggests amortizing whatever rate case expenses the Commission allows over a five year period.⁹⁴ Staff arrived at the five year figure by averaging approximately 4.5 years, which is the time between WCI’s 2009 rate case in Docket TG-091653 and Docket TG-

Washington Energy Resources v. WUTC, 104 Wn.2d 798, 711 P.2d 319 (1985) (*POWER*) (“within a fairly broad range, regulatory agencies exercise substantial discretion in selecting the appropriate rate making methodology.” *POWER* 104 Wn.2d at 812).

⁹² Cheesman, Exh. No. MC-1T at 47:18-22.

⁹³ See Order 12 ¶ 61 (citing Staff Initial Brief ¶ 56).

⁹⁴ Cheesman, Exh. No. MC-1T at ¶ 63.

140560, and 5.2 years, which is the time between the effective dates of the two filings.⁹⁵ Staff argues that the Company's four-year amortization proposal "fails to consider the extraordinary magnitude of rate case costs in this proceeding and the potential effect on rates."⁹⁶

47 We largely agree with the Initial Order's determinations of normalized rate case expense and sustain them, with one exception. We disagree with the Initial Order's finding that "[t]he difference between the parties' suggested amortization periods is negligible."⁹⁷ WCI has proposed four years, while Staff has proposed five. A four-year amortization period results in WCI's recovery in rates every year, whether or not it files a rate case, the amount of \$75,839. A five-year amortization reduces this by 20 percent to \$60,671. According to WCI's Petition "as frequently noted in this record, there has not been a contested solid waste rate case going to Final Order since 1994."⁹⁸ This includes WCI's most recent prior case in 2009, which was resolved informally with Staff and approved by the Commission taking no action and allowing the Company's refiled rates to become effective by operation of law.

48 Amortization periods used to normalize legal and accounting costs vary depending on the time between rates cases, consideration of the magnitude of the cost claimed, and the effect of including such costs in rates.⁹⁹ Given the Company's history with rate filings, it seems unlikely that WCI will file another general rate case within the next five years. Given the Commission's long-term experience with WCI settling rather than litigating its general rate cases, and similar experience across the solid waste industry in recent decades, whenever WCI does file its next case it is highly unlikely that it will be as hotly contested as this one.¹⁰⁰ Our expectation that WCI's historical pattern of rate case filings will continue, and that the extraordinary level of costs it incurred in this case will not be repeated in the foreseeable future, militate strongly in favor of our approval of the longer amortization period proposed

⁹⁵ *Id.* at 47:22-48:2.

⁹⁶ Staff Initial Brief, ¶ 65.

⁹⁷ Order 12 ¶ 75.

⁹⁸ Petition ¶ 3 n.2. The Initial Order observes that "this rate case is the first fully litigated solid waste rate case before the Commission in more than 20 years." Order 12 ¶ 79 (citing *King County Dep't. of Public Works, Solid Waste Division, v. Seattle Disp. Co., et al*, Docket TG-940411, Third Supplemental Order (Sept. 1994)). The *King County* case was a complaint case, not a general rate case.

⁹⁹ *Bremerton-Kitsap*, Fifth Supp. Order ¶ 27.

¹⁰⁰ It has been 21 years since any solid waste case was litigated before the Commission and even longer since any solid waste general rate case was litigated. See *WUTC v. Sno-King Garbage Company and WUTC v. Northwest Garbage Company*, Docket Nos. TG-900657 and 900658 Fourth and Fifth Supp. Orders (December 10, 1991).

by Staff with the resulting smaller annual recovery.¹⁰¹ To this extent, we reverse the Initial Order, require a five-year amortization period in the normalized expense equation, and direct that WCI's compliance filing include no more than \$60,671 in annual rate case expense.¹⁰²

D. Investigation Costs

49 The Initial Order adopts Staff's recommendation that the Commission should require the Company to pay the maximum allowed investigation costs under RCW 81.20.020. The statute provides that:

Whenever the commission in any proceeding upon its own motion or upon complaint shall deem it necessary in order to carry out the duties imposed upon it by law to investigate the books, accounts, practices and activities of ... or render any engineering or accounting service to or in connection with any public service company, and the cost thereof to the commission exceeds in amount the ordinary regulatory fees paid by such public service company during the preceding calendar year ... such public service company shall pay the expenses reasonably attributable and allocable to such investigation ... or services.¹⁰³

50 WCI argues the Initial Order errs as a matter of law in treating the statute as mandatory because it "overlooks RCW 81.20.020's title, which states: 'Cost of investigation **may** be assessed against company.'"¹⁰⁴ WCI argues:

¹⁰¹ See *Bremerton-Kitsap*, Fifth Supp. Order ¶ 28:

Commission Staff argues that the objective in setting an appropriate amortization period in each individual case is "to choose a period that will normalize the level of legal and accounting expenses that are to be embedded in permanent rates." Staff argues the related principle that rate case expenses should be amortized "over the period between expected occurrences or over a reasonable period." We agree that these are sound principles to follow when determining the appropriate amortization period to use in pro forming BKA's legal and accounting costs. The Company's last litigated rate case was more than a decade ago, and the present case before the Commission is the first time, to our knowledge, that the Commission has ever filed a complaint against BKA. In light of these facts, a five-year amortization period is reasonable.

¹⁰² Considering the Company's history with rate cases we think normalized rate case expense of this magnitude is probably too high for the longer term. We therefore encourage Staff to revisit this issue in future rate cases with any eye to adjustment that takes into account the Company's historical rate case experience and its experience going forward from the time of this case.

¹⁰³ RCW 81.20.020.

¹⁰⁴ Petition ¶ 45.

Because the statute and its title are in conflict as to whether investigation fees must be imposed on a company, the statute is subject to more than one reasonable interpretation. As a result, the statute is ambiguous, and the Commission may use principles of statutory construction, legislative history, policy preferences, and relevant case law to interpret it. Additionally, the title of the act may properly be referred to in ascertaining legislative intent.¹⁰⁵

We do not further analyze the Company's legal argument because it is flawed in its premise. RCW 81.20.020's title, whatever it says, cannot render the statute ambiguous because, as provided in RCW 81.900.020: "Title headings, chapter headings, and section or subsection headings, as used in this title do not constitute any part of the law."¹⁰⁶

51 The statute is unambiguously mandatory by its terms when the costs of a "necessary" Commission investigation of a public service company exceed "the ordinary regulatory fees" paid by the public service company. This is the case here.¹⁰⁷

52 Staff investigated the books and records of the Company as necessary to fulfill its obligation to review WCI's rate request and recommend rates that are just, fair, reasonable, and sufficient.¹⁰⁸ The record shows that Staff was required to spend an extraordinary amount of

¹⁰⁵ *Id.* ¶ 46 (emphasis added by Petitioner).

¹⁰⁶ *See also* RCW 80.90.020, which is identical in text.

¹⁰⁷ *Bremerton-Kitsap* is another such case. It presents significant parallels to this proceeding in terms of the costs of investigation and the costs of litigation. In that case, the Final Order finds: "The Commission incurred more than \$45,000 in agency-wide costs in this proceeding. This amount exceeds the \$6,633.90 that the Company paid in regulatory fees in 2000." *Bremerton-Kitsap*, Fifth Supp. Order ¶ 64 (finding of fact no. 13). The company was required to pay 1 percent of its gross revenues, or \$16,634, the maximum costs allowed under RCW 81.20.020. *Id.* ¶ 71 (conclusion of law no. 6).

Although not precedential, it is noteworthy that the Initial Order in *Bremerton-Kitsap* also treats RCW 81.20.020 as being mandatory by its terms:

When the Commission decides it is necessary "to investigate the books, accounts, practices and activities" of a public service company "and the cost thereof to the commission exceeds in amount the ordinary regulatory fees paid by such public service company during the preceding calendar year," RCW 81.20.020 *directs* the public service company to pay the expenses that are reasonably attributable to the investigation.

Id., Third Supp. Order ¶ 69 (emphasis added). *See also id.* ¶¶ 90, 91, 99 (related findings and conclusions the Commission upheld by its Final Order).

¹⁰⁸ Staff Initial Brief ¶ 67. *See* RCW 81.28.010.

time on this general rate case and incurred considerable expense during its investigation.¹⁰⁹ Indeed, Staff incurred \$84,305 in expenses in the combined Dockets TG-131794 and TG-140560 through June 2014 and additional costs after June 2014.¹¹⁰ This is more than four times the \$18,732.55 in regulatory fees WCI paid during 2013.¹¹¹

53 The magnitude of the Commission's costs of investigation in this case relative to the amount of the Company's annual regulatory fees militates in favor of our recovering at least a part of the maximum allowed costs of investigation from WCI.¹¹² However, the record shows that the level of these costs is unusually high in part because of contentiousness and conflict between the parties, the responsibility for which is shared between the Company and Staff. This militates in favor of our assessing less than the maximum allowed costs under RCW 81.20.020.

54 The Initial Order finds that WCI and the Company share equally in terms of taking actions during these proceedings that added to their duration and expense.¹¹³ We determine on this basis to assess one-half the maximum fee authorized by RCW 81.20.020. This amount is \$21,909.41. Requiring the Company to pay a portion of the costs of investigation in this case is not a "sanction," as WCI contends.¹¹⁴ Rather, the statute simply protects the public interest by requiring a contribution to costs of a necessary investigation that exceed a Company's annual regulatory fees. This is particularly appropriate in cases such as this one that required Staff to expend resources that are significantly disproportionate to the Company's annual fees.¹¹⁵

¹⁰⁹ *Id.* (citing Cheesman, Exh. No. MC-1T at 55-56).

¹¹⁰ *Id.*

¹¹¹ *See* Order 12 ¶ 81 (citing Cheesman, Exh. No. MC-1T at 55:15-16).

¹¹² We note that there is limiting language in RCW 81.20.020 that affords the Commission a degree of discretion in terms of the amount of regulatory fees it imposes, as follows:

The total amount which any public service company shall be required to pay under the provisions of this section in any calendar year *shall not exceed* one percent of the gross operating revenues derived by such public service company from its intrastate operations during the last preceding calendar year.

The emphasized language necessarily implies that the Commission has discretion to require a public service company to pay less than maximum amount.

¹¹³ Order 12 ¶ 74.

¹¹⁴ Petition ¶ 44.

¹¹⁵ WCI asserts that neither it nor Staff is aware of any instance where the Commission has actually assessed investigation fees against an applicant in a solid waste general rate case. WCI Initial Brief ¶ 14. There is no evidence, however, that any other solid waste general rate case

- 55 While WCI is correct that the complaints and orders suspending both WCI's filing in this matter and the previous docket did not contain notice that the Commission may impose investigative fees upon the Company, this is not the only avenue under which notice can be conveyed. When WCI signed the Partial Settlement, it acknowledged that one of the four remaining contested issues was whether the Commission should require the Company to pay investigation fees. Order 10 in this docket discusses Staff's recommendation that the Commission require WCI pay investigation fees. Further, the Company was given an opportunity to be heard at the March 11, 2015, evidentiary hearing on the issue of investigation costs. We conclude that the statutory notice and opportunity to be heard requirements have been fulfilled.
- 56 We find Staff's proposal to enforce RCW 81.20.020 and impose investigation fees is in the public interest. WCI should be required to pay costs of investigation in the amount of \$21,909.41. This amounts to about one-fourth of the full costs of the Commission's investigation and is one-half the maximum recovery authorized by RCW 81.20.020.

FINDINGS AND CONCLUSIONS

We endorse certain of the findings and conclusions in the Initial Order, and restate them below. In addition, we modify certain of the Initial Order's findings and conclusions to make them consistent with the discussion in this Order. Modifications are indicated by the use of italics and strikethrough. We reject certain findings as being unnecessary or contrary to our determinations on review. These are indicated by strikethrough. Finally, we add new findings and conclusions based on our de novo review of the record. These, too, are italicized.

- 57 (1) The Washington Utilities and Transportation Commission (Commission) is an agency of the state of Washington vested by statute with the authority to regulate the rates, rules, regulations, and practices of solid waste companies.
- 58 (2) On April 3, 2014, Waste Control, Inc. (WCI) filed with the Commission new Tariff No. 16 reflecting a general rate increase that, if approved, would generate approximately \$532,000, or 15.4 percent, in additional revenue.

during the past two decades, a period when there has been no other fully litigated solid waste rate case, resulted in the magnitude of investigation costs incurred in this case or exceeded the amount of regulatory fees paid by the company investigated. Further, the statute applies to all public service companies subject to Commission jurisdiction under Title 81 and does not exclude solid waste companies.

- 59 (3) On October 14, 2014, WCI and the Commission's regulatory staff (Staff) entered into a Partial Settlement Agreement (Partial ~~Agreement~~Settlement), attached to this Order as Appendix A, resolving all but four contested issues:
- Shared utility expenses.
 - Land rents for shared facilities.
 - Rate case expenses.
 - Recovery from WCI of investigation costs under RCW 81.20.020.
- 60 (4) *The parties reached agreement on eleven contested issues as reflected in their Partial Settlement, and summarized in the body of this Order.*¹¹⁶
- 61 (5) Pursuant to WAC 480-07-540, WCI bears the burden of proof in this case requesting an increase in its rates for regulated operations. This burden of proof includes the burden of going forward with evidence and the burden of persuasion.
- 62 (6) The terms and conditions within the Partial ~~Agreement~~Settlement are consistent with law and policy and reasonably resolve the issues in this proceeding. Each of the adjustments are supported by an appropriate record and will result in rates that are fair, just, reasonable, and sufficient.
- 63 (7) The Commission convened an evidentiary hearing on March 11, 2015, to address the remaining contested issues.
- 64 (8) With regard to the shared utility expenses adjustment, Staff's three-factor allocation proposal is consistent with generally accepted allocation principles and is more reasonable than WCI's position assigning direct costs as shared expenses.
- 65 (9) We accept Staff's proposed utility expense Adjustment R-6D allocating \$15,424 of shared utility expense to WCI's regulated operations as fair, just, reasonable, and sufficient.
- ~~66 (10) Staff's use of the capital structure and actual costs of debt of Heirborne Investments, LLC (HBI) and Heirborne Investments II, LLC (HBII) is appropriate to calculate the allowed return on equity for the land rents WCI pays to its affiliates HBI and HBII.~~
- ~~67 (11) The discounted cash flow methodology proposed by Staff for calculating returns on the land WCI rents from its affiliates is reasonable.~~

¹¹⁶ See *supra* ¶ 7 n.8.

- ~~68 (12) Staff's approach employing the landlords' actual cost of debt, in this case, 2.2 percent for HBI's rents and 4.3 percent for HBII's rents, is easily verifiable, captures the combined landlords' risk profile, and connects a fair return to that risk profile.~~
- ~~69 (13) Staff's three factor allocator is consistent with the regulatory principle of cost-causation allocation and should be applied to allocate depreciation and average net investment among tenants of HBI and HBII's facilities.~~
- 70 (14) The rate case expenses *that* WCI has requested *for* recovery are excessive *and would produce a level of normalized costs for such expenses that is unreasonable.* The Commission finds that Staff's proposal to allow 100 percent recovery of the expenses from the informal audit process in Docket TG-131794 and 50 percent recovery of the expenses from the formal adjudications in Dockets TG-131794 and TG-140560, ~~as described in paragraph 69,~~ is reasonable. The rate case costs will be amortized over a ~~four~~ *five* year period *with the resulting amount recoverable in prospective rates as a normalized expense level for rate case expense, subject to review in future rate cases. The amount of this expense to be reflected in WCI's compliance filing should be no more than \$60,671 in annual rate case expense.*
- 71 (15) RCW 81.20.020 provides that the public service company subject to a Commission investigation shall pay the costs incurred by the Commission for such an investigation up to one percent of its gross intrastate operating revenues for the preceding calendar year.
- 72 (16) The Commission incurred \$84,305 investigating Dockets TG-131794 and TG-140560.
- 73 (17) *WCI should be required to pay costs of investigation in the amount of \$21,909.41, which is less than one percent of its intrastate gross operating revenues for calendar year 2013, and one-half the amount authorized by RCW 81.20.020.*
- 74 (18) *Neither the Company's nor Staff's land rent adjustment proposals are adequately supported in this case. As a consequence, there will be no adjustment to the level of land rent from the level approved in WCI's 2009 rate case and the amount of \$80,250 is authorized for recovery in rates determined for purposes of the Company's compliance filing.*

ORDER

THE COMMISSION ORDERS That:

- 75 (1) The proposed tariff revisions filed by Waste Control, Inc., on April 3, 2014, and
suspended by prior Commission order, are rejected.
- 76 (2) The Partial Settlement Agreement, filed by Staff and WCI on October 14, 2014, and
attached to this Order as Appendix A, is approved and adopted without condition.
- 77 (3) WCI is authorized and required to make a compliance filing including such new and
revised tariff sheets as are necessary to implement the requirements of this Order.
- 78 (4) The Commission Secretary is authorized to accept by letter, with copies to all parties to
this proceeding, a filing that complies with the requirements of this Order.
- 79 (5) The Commission shall render a bill in the amount of \$21,909.41 to WCI pursuant to the
requirements in RCW 81.20.020.
- 80 (6) The Commission retains jurisdiction over the subject matters and parties to this
proceeding to effectuate the terms of this Order.

Dated at Olympia, Washington, and effective August 6, 2015.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

PHILIP B. JONES, Commissioner

ANN E. RENDAHL, Commissioner

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.

**Appendix A
(Partial Settlement Agreement)**