

DEC 10 1991

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)
TRANSPORTATION COMMISSION,)
))
Complainant,)
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v.)
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SNO-KING GARBAGE COMPANY,)
INC., G-126)
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Respondent.)
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.)

DOCKET NO. TG-900657
FOURTH SUPPLEMENTAL ORDER

WASHINGTON UTILITIES AND)
TRANSPORTATION COMMISSION,)
))
Complainant,)
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v.)
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NORTHWEST GARBAGE CO.,)
INC., G-43)
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Respondent.)
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.)

DOCKET NO. TG-900658
FIFTH SUPPLEMENTAL ORDER

PROCEEDINGS: On June 29, 1990, Sno-King Garbage Company, Inc., G-126, (Sno-King) and Northwest Garbage Co. Inc.,¹ G-43, (Northwest) filed tariff revisions to become effective August 1, 1990. The revisions affect rates for garbage and recycling services. The Commission suspended the filings on July 30, 1990, to allow further investigation. It allowed temporary rates to become effective, subject to refund.² The companies waived the suspension deadlines until December 31, 1991.

¹On December 13, 1990, the Commission granted Northwest the authority to change its name to Waste Management Northwest, Inc. For ease in understanding, we will use "Northwest" to designate the carrier.

²The Commission approved amendments to the suspended filings for a fuel surcharge for Sno-King by order dated December 7, 1990, and to establish yard waste collection rates for Northwest by order dated February 22, 1991.

HEARINGS: The Commission held hearing sessions in Olympia on September 10, and December 10, 11 and 12, 1990, and March 4 and April 17 and 18, 1991. Chairman Sharon L. Nelson, Commissioners Richard D. Casad and A. J. Pardini, and Administrative Law Judges Rosemary Foster and Heather Ballash presided. On March 15, 1991, the Commission heard testimony from members of the public at a hearing session in Everett, Washington.

APPEARANCES: Robert E. Simpson, Marjorie R. Schaer and Anne Egeler, Assistant Attorneys General, Olympia, represented the Staff of the Commission. Craig Gannett, attorney, Seattle, represented the respondents. Counsel represented the intervenors as follows: James Sells, attorney, Bremerton, Washington Waste Management Association (WWMA); Richard A. Finnigan, attorney, Tacoma, Rabanco. Patrick W. Dunn, attorney, Seattle, Pierce County Haulers. Kathryn Killinger and Mary Perry, Deputy Prosecuting Attorneys, Seattle, intervenor King County.

SUMMARY: The Commission will use the Lurito-Gallagher operating ratio methodology for determining solid waste collection company revenue requirements. It also will apply the Lurito-Gallagher methodology to recycling services. The Commission will use the actual reasonable capital structure and debt cost of the solid waste collection company when applying the methodology.

The Commission authorizes the companies to refile rates for various services, including \$2.00 for occasional extra can service, and \$3.45 for once-a-month service. The Commission orders respondents to return to consumers any excess collections under temporary rates.

MEMORANDUM

I. Procedural History

Sno-King Garbage Co., Inc. and Northwest Garbage Co., Inc., respondents, filed tariff revisions to increase solid waste collection rates and to establish recycling rates. The Commission suspended the filings during investigation of their reasonableness. The Commission authorized temporary rates, subject to refund. It consolidated the cases on August 15, 1990.

The Commission held hearings as set out above. The parties filed briefs on May 30, 1991. For ease in reference, Appendix A contains the rates proposed by the companies and by the Commission staff.

II. Background

Waste Management of Washington (WMW) owns both respondents, Sno-King and Northwest Garbage.³ WMW is in turn a subsidiary of Waste Management, Inc. (WMI), a publicly traded international corporation. The respondents serve customers in parts of King and Snohomish Counties. Proposed rates reflect increases in the Snohomish County landfill charges from \$35.00 to \$62.50 per ton and the beginning of recycling programs.

In 1989, the Washington State Legislature passed the "Waste Not Washington" Act (Chapter 431, Laws of 1989). The law was to promote integrated solid waste management. It requires the Commission to allow certificate holders to use rate structures and billing systems consistent with the Act's priorities.⁴

III. Appropriate Methodology

The parties pose questions about the proper rate setting methodology for solid waste collection and recycling services.

The Commission must use some analytical framework, or methodology, for setting the allowed rate of return⁵ for the companies it regulates. Stock market data underlie most rate of return methodologies. The data must first be derived, and then used as a proxy for a given company's actual cost of capital. Determining the required rate of return for solid waste collection companies represents a challenge because all Washington State companies, except Waste Management, are privately held and have no publicly traded shares.

³It also owns Arrow Recycling and Reclamation, a company relevant to this proceeding.

⁴The stated priorities include waste reduction; recycling, with source separation of recyclable materials as the preferred method; energy recovery, incineration, or land filling of separated waste; and energy recovery, incineration or land filling of mixed waste. RCW 81.77.010(8).

⁵"Rate of return" is the measure of earnings on capital supplied by an investor. For regulated companies, the Commission establishes the rate of return an investor would require, and the market would pay, for investments in the business. The company's rates are then set at a level to allow it the opportunity to earn that return.

A. THE LURITO-GALLAGHER METHODOLOGY

In its January 28, 1988, order in Docket No. TG-2016, et al, the Commission considered several ratesetting approaches for solid waste collection. It decided that the Lurito-Gallagher method⁶ was the most appropriate available methodology for setting solid waste collection rates. The Commission has used that methodology since that time to calculate proper rates for companies of all sizes.

The L-G approach rests on the assumption that a firm's capital turnover ratio (revenues to capital investment) measures risk and thus indicates the company's required rate of return. A basic assumption is that earnings volatility affects risk. Lurito and Gallagher derived their formula from an analysis of 198 regulated companies during the period 1968-1977. They developed a curve that relates a firm's investment and revenues to a needed profit margin. Capital-intensive operations require a lower return on investment than less capital-intensive operations. The results are consistent with the theory that earnings fluctuation increases as margins decrease, in turn increasing financial risk and the required return on equity.

B. THE CAPM PROPOSAL.

Respondents advocate the market-based Capital Asset Pricing Model, or CAPM approach, to determine their cost of capital. CAPM sees stock price volatility as a measure of risk.

CAPM assumes that an investor requires a return relative to the risk each stock adds to the investor's portfolio. Three factors bear on a calculation of risk. First is the riskless rate, such as the rate for short-term treasury notes. Second is the market risk premium, or the stock market's overall risk compared with the risk-free rate. Finally, the formula compares the individual company's risk with market risk. It quantifies the latter in a measure called "beta," which reflects the firm's stock price volatility compared with the market.

⁶The title of this approach refers to its authors, Dr. Richard Lurito and Mr. Kenneth Gallagher. We will occasionally call it the "L-G" methodology. It is also known as the Modified Operating Ratio method (MORM). The method compares revenues and investment to determine proper capital turnover ratio and operating margin. Dr. Lurito and Mr. Gallagher testified in this proceeding.

In the formula, a firm's required rate of return equals the risk-free rate, plus the market premium multiplied by the firm's beta. The proposed CAPM formula is:

Required Return on Equity = Riskless Rate + (Beta x Market Risk Premium).

Respondents propose to use the CAPM approach for residential recycling as well as for their solid waste operations. Their approach assumes that the risk of the recycling operations is comparable to the risk of parent WMI's overall business operations.

Commission staff challenges the CAPM approach, asserting that it suffers from several deficiencies. Staff contends that risk associated with respondent's recycling programs is not comparable to the risks associated with Waste Management's overall operations. Those include risks related to international operations, chemical waste disposal, low-level nuclear waste disposal, and medical waste disposal. Commission staff argues that the CAPM method tends toward "gold plating". Staff contends that the approach is inapplicable to other Washington solid waste collection companies because they have no traded shares.

The Waste Management Association urges that adopting the CAPM approach would cause excessive rates for customers. It also contends that the CAPM approach is not usable for smaller, privately-owned companies operating in the state.

Rabanco opposes the CAPM approach. It would keep Lurito-Gallagher, with some changes. Pierce County haulers oppose CAPM and recommend retaining Lurito-Gallagher. They urge adjusting L-G to reflect risks associated with recycling. The Pierce County haulers contend that a franchise reduces the risk of a business and therefore requires a lower return and lower customer rates.

The Commission believes that CAPM may be a valid method for measuring the cost of capital in some settings. However, for application here it suffers from several flaws. First, the respondents have not shown that the Washington operation risks are the same as the risks of Waste Management, Inc.'s overall operations. Because solid waste collection companies have a quasi-monopoly under Chapter 81.77 RCW, their operations appear to be considerably less risky than WMI's unregulated operations.

Too, CAPM must have market data to determine beta, the volatility of a particular firm's stock price compared with the market average. In Washington state, only WMI subsidiaries have ownership resting in a publicly traded company. The Commission thus cannot use CAPM directly for other solid waste collection companies.

Respondents criticize the Lurito-Gallagher methodology. They urge that the criticisms show fatal flaws, and therefore the Commission must adopt CAPM.

They contend first that an unwarranted assumption underpins the theory -- that capital turnover does not measure risk. The Commission disagrees. Capital turnover is related to earnings volatility, which is directly related to risk. The L-G methodology thus does have a reasonable basis. It also provides results that are reasonable.

Respondents contend that averaged data mask the curve. The Commission does not consider averaging to be a flaw. Indeed, averaging can correct aberrations due to unusual years, anomalous firms, and differing industries. Respondents contend that random numbers will give equivalent results. They did not show that to be true.

Respondents contend that Lurito-Gallagher is inapplicable to solid waste collection companies because those companies have turnover ratios at the high end of surveyed companies. The Commission acknowledges that to be so, but that does not invalidate the methodology. The firms are well within the range of surveyed companies.

Respondents urge that applying the Lurito-Gallagher curve to recycling would discourage investment in new equipment. They say that a company with smaller capital investment earns a higher return on equity. They contend that the MORM is biased against new recycling projects because it produces returns on recycling equity half the level of returns on solid waste collection operations. The Commission does not find these arguments persuasive.

The Commission uses operating ratio analyses for transportation companies because utility rate of return principles may not accurately reflect market requirements or the risks of such companies. Transportation operations' allowed rates of return can exceed those allowed for utility companies. That merely reflects risks of operation, the realities of the market, and differing ratios of investment to revenues.

The Lurito-Gallagher methodology is attractive precisely because it offers a reasoned analysis of the relationships between risk, investment ratio and earnings volatility. As the ratio investment to revenues rises, a lower rate of return becomes a larger proportion of revenue. Expenses become a smaller proportion of revenue. Net operating income becomes less volatile; stability increases, and required rate of return falls. A successful consultant owning only a computer and a telephone earns a much

larger return on her small investment than a public utility on its massive investment. Yet each may earn a rate on investment that is both appropriate for its business and required by the market. Lurito-Gallagher allows a reasoned measure of return requirements appropriate to the industry and its capital intensity.

The Commission rejects respondents' challenges to Lurito-Gallagher. We will continue to use it, and of course will monitor the formula and its applications.

The Commission rejects respondents' proposal to use the CAPM methodology in setting their rates.

C. PROPOSED LURITO-GALLAGHER AMENDMENTS

We have rejected the proposed CAPM methodology. Now we must consider whether to use the Lurito-Gallagher methodology with or without the amendments suggested on this record. We also must decide whether to apply the methodology to residential recycling activities that respondents conduct.

Dr. Lurito and Mr. Gallagher suggested three changes to the regression analysis formula the Commission adopted in 1988.

(1) Adjust the formula to reflect a current equity return requirement 75 basis points over the 1968-77 period.

(2) Determine an "equilibrium" equity rate of return, using the formula and the study group's average capital structure and debt cost.

(3) Use the actual, or attributed reasonable, capital structure and debt cost of the company seeking rate relief to derive the proper earnings requirement.

Commission staff witnesses recommended capping the equity portion of the capital structure at 60%. Larger equity ratios, they said, are not reasonable for ratemaking purposes.

Lurito and Gallagher also recommend applying the modified operating ratio approach, changed and updated considering Commission experience, to residential recycling activities.

The Washington Waste Management Association (WWMA) recommends the L-G methodology, using individual company interest and tax rates. The Rabanco companies also support the operating ratio method, with changes recommended by Commission staff. Rabanco expressed concern about the impact of this ratemaking method on recycling programs that have large start up costs, and

high interest costs. It supported the methodology, however, despite those concerns. Pierce County haulers also support using individual company debt costs and capital structure in the L-G methodology.

The Commission accepts the Lurito-Gallagher operating ratio method, changed to reflect reasonable individual company capital structure and debt cost. We will apply it to both solid waste collection activities and residential recycling activities. Our experience indicates that the methodology applies validly to both large and small companies.⁷ The Commission accepts the witnesses' recommendation to add 75 basis points to the equilibrium rate of return, acknowledging changed market conditions between that period and the present.

If a company does not have a reasonable debt-equity ratio, or presents insufficient information, we will attribute a reasonable capital structure. The Commission also will use the company's actual embedded cost of debt when that cost is known and when it is reasonable. When the cost is not reasonable, or when a company fails to present enough information, the Commission will attribute a reasonable cost.

D. RESPONDENTS' CAPITAL STRUCTURE

Respondents propose using a capital structure of 40% debt and 60% equity. Dr. Siegel, respondents' witness, based his recommendation on WMI's actual capital structure as of August 27, 1990, near the time respondents filed their tariff changes.

Commission staff also proposes using a 40/60% debt/equity ratio. This approach is consistent with the staff recommendation to consider the company's actual capital structure and capital costs to calculate the equilibrium profit margin.

The Commission accepts the proposed capital structure. It does not exceed the recommended reasonable limit. We accept the respondents' testimony that the figure states the parent's actual consolidated capital structure. In any future filings, however, the Commission will require more detailed, documentary evidence proving the parent's capital structure. Lack of that information may require us to attribute a reasonable capital structure.

⁷On cross examination, Commission staff said that it might attempt to apply the modified operating ratio method to water companies regulated by the Commission. We are skeptical about extending this method to water companies without a strong showing that it will apply validly to that industry.

E. RESPONDENTS' COST OF DEBT

The Commission must find the respondents' appropriate costs of debt in order to apply the formula, to determine revenue requirements, and to set rates.

Respondents propose a debt rate of 9.4%. They urge that it represents the cost of high quality, medium-term debt in August, 1990. Commission staff proposes a 9% debt cost, based on WMI's internal financing rate for its subsidiaries. This is consistent with the Lurito-Gallagher recommendation to reflect the solid waste collection company's actual reasonable debt costs.

The Commission will adopt the staff suggestion to use the company's actual embedded cost of debt for the reasons stated. The Commission directs the respondents, however, to provide actual and verifiable documentation of embedded debt cost in any future proceeding.

IV. Results of Operation and Rate Base Issues

A. RECYCLING ISSUES: SNO-KING AND NORTHWEST

1. Stipulated Recycling Figures

During the hearing, the company and Commission staff agreed to update Exhibit 101 with current recycling cost figures⁸ as they became available. The Commission staff's case shows a recycling figure of \$3.23 per customer. The most recent update of the exhibit shows a recycling figure of \$3.86.

The Commission accepts \$3.86 as the most recent and most accurate figure now available for recycling services. The most recent update states that Commission decisions on rate design issues may affect this amount. Respondents may make corrections, if it supports the corrections, in refiled tariffs.

It appears to be implicit in the stipulated calculations that recycling rate element includes a component for lost solid waste collection revenues. This shifts cost factors from the solid waste collection element to the recycling rate element. Perhaps the shift is justifiable. This practice is ordinarily improper, however, unless the Commission specifically approves it. At the very least, the Commission and the public should know the actual costs and revenues of each service, and changes in those costs and revenues resulting from changes in consumer behavior.

⁸The term "cost" here includes all necessary returns to the operator and thus constitutes an appropriate rate for service.

More important, although reduced solid waste collection resulting from recycling will lower solid waste revenues, the costs of collection and disposal also will fall. The presentations are not clear about those cost savings. Staff testified that it considered cost savings and found them minimal. We accept that for this proceeding. In the future the parties must present complete, accurate information about the experience in each service, so we may set proper rates for each service.

We will accept the stipulation for this proceeding. Respondents' recycling charge is one element of a total collection rate. The same methodology produces each element. Because of these factors, it is less important in the short run that we allocate cost or revenue elements between recycling and solid waste. The total rate will be consistent.

Allowing the lost revenues, however, fails to consider offsetting cost savings and can lead to improperly high rate levels. In a later proceeding we will require an accounting. If a company intends to use revenue loss as a cost component, it must justify doing so and receive Commission permission.

2. Woodinville Facility

Waste Management began using a Woodinville facility about five years ago. It was originally designed as a garbage transfer station, but that use did not prove feasible. Respondents now use it for recycling and other activities. Arrow Recycling and Reclamation, another WMI subsidiary,² initially leased the facility and now owns or controls it.

The companies want to include the facility in rate base at a value exceeding \$1.25 million. They derive their figure by using an original capital cost of \$2,000,000, and apply straight-line depreciation with a 30-year life. Then they assign 10% of the facility to municipal contracts. The result is about 30% of respondents' total recycling rate base.

The \$2,000,000 capital valuation includes remodeling costs to make the building usable as a recycling facility. WMW will use part of the facility for recycling activities not under Chapter 81.77 RCW authority. In addition, part of the facility is a competitive buy-back recycling center, open to the public.

²The ownership presents affiliated interest issues which we discuss later in this Order.

Respondents did not assign the building among various uses on a square footage basis. They did not present a comparison of the building's present used space with the original design capacity or with the space now used for various purposes. Respondents did not present estimates of reasonable construction costs for a new transfer facility. They did not submit verifiable documentary evidence of the building's construction or remodeling expenses. Finally, the record does not show whether the Commission staff reviewed facility-related capital or operating costs or the results of any such review.

These unanswered questions regarding the prudence of decisions affecting the Woodinville facility's construction and use are to be deplored. The Commission accepts the record information for this proceeding. It insists, however, that the respondent provide more information about this building. The Commission expects the staff to submit the results of a staff inquiry into the building's cost and its use. If staff has not yet studied the portion appropriate for ratepayer support, we expect it to do so as part of the next proceeding involving any affected WMI subsidiary.

B. SOLID WASTE ISSUES: SNO-KING

Commission staff recommended lower rates than Sno-King requested for Snohomish County services. The difference occurs in part because staff removed costs associated with the pilot recycling program and the yard waste program. According to Commission staff, allowing the costs of these programs as proper expenses would allow the company double recovery. The company did not contest the Commission staff position.

The Commission adopts the Commission staff adjustment to prevent double recovery of costs associated with pilot recycling and yard waste programs. Accepting the staff positions may require refunding¹⁰ to customers any excessive portion of payments made under temporary rates. Respondent shall make any needed refund in the first billing after new rates become effective. Respondent shall implement refunds consistently with Mr. Nikula's recommendation in Exhibit T-93. The Commission authorized temporary rates beginning August 1, 1990. The Companies increased their rates only for solid waste during August and September. They began the recycling programs after October 1, 1990, then added the recycling charges and billed the rate as a total including both

¹⁰Rather than mailing a refund payment to customers, respondent may apply a negative surcharge to statements for service. The amount and form of any adjustment must be approved by the Commission. The term "refund" in this order includes negative surcharge.

recycling and solid waste collection. For August and September, 1990, respondent shall refund amounts by which charges collected exceed those authorized. For the period October 1, 1990, to December 31, 1991, respondent shall refund any amount by which the total of the temporary rates charged exceeds the total of the rates we find proper.

C. SOLID WASTE ISSUES: NORTHWEST

1. Uncontested Issues

The company does not contest most of the Staff-proposed results of operation. Table 1 shows uncontested adjustments.

TABLE 1

Northwest

Uncontested Results of Operations

Net Income Before FIT:

Actual unallocated \$1,190,547

Uncontested adjustments:

1. Pilot program	\$ 59,299
2. Reclassify Wages	109,851
3. Miscellaneous income	0
4. Tire inventory	(17,257)
5. Reclassify disposal fees	0
6. Allocate overhead	(192,478)
7. Reclassify non allowable costs	18,110
8. Adjust revenue accounts	0
9. Allocate- King and Snohomish	0
10. Amortize pilot program	0
11. Audit assessment	0
12. Reclassify revenue-King County	0
13. Reclassify revenue-Container	0
14. Legal and Professional	21,000
15. Building improvements	4,089
16. Miscellaneous expenses	15,600
A. Snohomish dump fees	(4,367,828)
B. Wages	(187,462)
C. Licenses	(3,323)
D. Revenue sensitive expenses	(4,520)
F. Rate case notification	(13,044)
G. Non-recurring expenses	36,347

Total Uncontested adjustments (\$4,521,616)

2. Bad Debt adjustment

Regulation allows the company to account for bad debts in its results of operation. At issue is the proper accounting method to do so.

The company booked bad debt expenses using the reserve method. It accrued bad debts based on an expected level of write-off. The company urges us to accept the test-year accrual as the proper expense for ratemaking purposes. The company would use an uncollectibles rate of 0.6%.

Commission staff proposes to adjust this expense to the actual net write-offs for the test year. Staff contends that the company's accrual method results in an excessive expense. It urges that its method is preferable because it uses the amount actually written off by the company, rather than an estimate. The staff approach uses an uncollectibles rate of 0.347%.

The Commission adopts the 0.347% uncollectibles expense level recommended by Commission staff. This figure is closer to the company's historical bad debt expense level. This level is not unusual or otherwise inappropriate. The record fully supports it.

3. Affiliated Interest Adjustment: Arrow

Commission staff recommends an affiliated interest adjustment. It urges Commission to adjust Northwest's proposed solid waste collection rates for customers in King and Snohomish Counties. Staff bases the adjustment upon excessive profits earned by the company through its affiliate, Arrow Recycling and Reclamation (Arrow). The issue arises from Arrow's prior service to Northwest in repairing and maintaining some of Northwest's assets, using the Woodinville facility. Northwest capitalized the payments for service because repair extended the assets' lives. The staff adjustment would recalculate the investment, and associated depreciation expense, to a level removing excess profits from the transaction.

The adjustment would reduce Northwest's rate base by \$73,522 and reduce allowable depreciation expenses by \$15,071. In calculating the adjustments, staff would treat investment in the building as debt-supported. Commission staff argues that including the entire building in rate base is excessive, as Arrow used only a portion of it. It treats the capital as debt -- with a lower return requirement than equity capital -- in part to substitute for knowledge of actual building use.

Respondent would place 100% of the building and land in Arrow's rate base as used and useful since 1987. Commission staff contends that the building and land were not fully used or useful during that period. Respondent opposes the adjustment, arguing that the staff's proposal would deny Arrow its required return on equity. Respondent urges using WMI's 40/60 debt/equity ratio if the Commission adopts the adjustment.

The Commission will adopt the Commission staff's proposed affiliated interest adjustment. The record does not support the entire amount that Northwest paid Arrow for the services. Arrow's partial use of the facility does not support capitalizing the entire building and land investment with a full return. The staff proposal is a proper means, short of rejecting the element entirely, to balance ratepayer and company interests.

4. Deferred Taxes

When calculating book income and taxable income, the company must deal with various timing differences. The most notable of these involves depreciation. In calculating FIT expense on a per-book basis, WMI uses book income times its consolidated effective tax rate. WMI records the difference between the taxes actually paid, and tax expense per books, as deferred FIT.

During the deferral period, the company has use of the money. The Commission has ruled in prior cases that ratepayers should not have to pay a return on the deferred taxes' portion of company capital. It reasoned that the ratepayers paid rates set at a level to pay the taxes and in effect advanced the money to the company.

Commission staff recommends an end-of-period deduction from Northwest's net investment. WMI showed \$572,181 in deferred taxes on WMI's rather than Northwest's accounting records. Of the total, \$77,473 arose from nonregulated operations. \$428,219 arose from the Snohomish County regulated operations and \$66,489 arose from King County regulated operations. Staff proposes no rate base reduction for recycling activities. Respondent did not challenge this proposed adjustment.

WMI booked deferred taxes on the parent company's books. Ratemaking treatment that fails to recognize these deferred taxes as part of the operating company's capital is improper. It would require ratepayers to pay the overall required return on the deferred taxes that they earlier paid to the company through rates.

In the past, the Commission has either reduced rate base or imputed zero cost capital to deferred taxes provided by the ratepayers. The staff's proposed rate base reduction adjustment is

consistent with previous Commission treatment. The Commission expects the parties to consider deferred taxes in future rates for recycling operations.

Table 2 summarizes the Commission's findings on Northwest Garbage Company's solid waste results of operation.

TABLE 2

Northwest

Results of Operation

Net unallocated operating income before FIT:

Actual net operating Income	\$1,190,547
Uncontested adjustments	(4,521,616)
Contested Adjustments:	
H. Bad Debts	16,654
I. Affiliated interest-Arrow	15,071
Pro forma net operating income before rates	(\$3,299,344)

Rate Base

Actual unallocated rate base	\$3,975,211
Contested Adjustments:	
I. Affiliated interest-Arrow	(73,522)
Deferred FIT	(572,181)
Pro forma unallocated rate base	\$3,329,508

Accepting the staff positions on the bad debt, affiliated interest, and deferred tax adjustments may produce revenue levels requiring Northwest to refund the excess rates customers paid under temporary rates. Respondent shall make any required adjustment for customers in the first billing under rates this order authorizes. Any refunds shall conform with the recommendation of Commission staff witness Nikula in Exhibit T-93. The Commission authorized temporary rates beginning August 1, 1990. The Companies increased their rates only for solid waste during August and September. They began the recycling programs after October 1, 1990, then added the recycling charges and billed the rate as a total including both recycling and solid waste collection. For August and September, 1990, respondent shall

refund amounts by which charges collected exceed those authorized. For the period October 1, 1990, to December 31, 1991, respondent shall refund any amount by which the total of the temporary rates charged exceeds the total of the rates we find proper.

Table 3 shows Northwest's revenue requirement.

TABLE 3

Northwest

Calculation of Revenue Requirement

Pro forma Unallocated Net Operating Income	(\$3,299,344)
Snohomish County	(3,136,715)
King County	251,672
Non Regulated	(414,301)
Pro Forma Unallocated Rate Base	\$3,329,508
Snohomish County	2,509,735
King County	385,973
Non Regulated	433,800
Revenue Sensitive Expense Rate	
Snohomish County	0.027638
King County	0.027718
FIT Rate	34.00%
Capital Structure:	
Debt	40.00%
Equity	60.00%
Debt Cost	9.00%
Revenue Requirement for Snohomish County:	
Equilibrium Turnover	533.27
Equilibrium Operating Ratio	95.88%
Equilibrium Equity Return	33.48%
Northwest Equity return ¹¹	33.73%
Required Operating Ratio to Achieve Return	93.72%
Revenue Deficiency/(Surplus) Snohomish County	\$4,110,182

¹¹This reflects witnesses' recommendation to add 25 basis points for publicly traded companies.

Revenue requirement for King County:

Equilibrium Turnover	414.41
Equilibrium Operating Ratio	95.11%
Equilibrium Equity Return	30.25%
Northwest Equity return ¹²	30.50%
Required Operating Ratio to Achieve Return	92.64%
Revenue Deficiency/(Surplus) King County	(\$134,493)

V. Rate Design and Cost of Service

A. EXTRA CANS AND ONCE-A-MONTH SERVICE RATES

Respondents recommend a \$4.00 rate for occasional extra cans. They contend that this rate would promote the goals of Snohomish County's solid waste plan and state law. The higher extra can rate, they say, provides an incentive to recycle. They contend that the rate will encourage customers to use respondents' curbside yard waste service. That will cost \$4.40 a month for weekly collection of a 95-gallon toter.

The respondents also propose to price once-a-month service at \$4.25 per month, up from the current rate of \$3.45 per month. They contend that Snohomish County's health ordinance favors weekly collection over monthly collection. They urge that higher rates will encourage customers to use weekly minican rather than monthly collection. Respondents say \$4.25 for once-monthly service compares favorably with \$4.25 for weekly minican service.

Commission staff recommends \$2.00 rates for both the occasional extra can and once-a-month service, based upon staff's cost of service study. Staff contends that the \$4.00 extra can charge would be a disincentive to recycling because a customer could receive weekly 2-can service for the same charge as one extra can per month. Commission staff opposes the proposed \$4.25 rate for once-a-month service because it is more than twice the company's actual cost of providing the service.

The Commission accepts the Commission staff-proposed \$2.00 rate for occasional extra service. This rate more nearly matches the actual cost of service. For once-a-month service, however, the Commission will direct respondents to continue their \$3.45 monthly charge. This is the rate respondents charged before the Commission authorized temporary rates. The cost of monthly

¹²This reflects witnesses' recommendation to add 25 basis points for publicly traded companies.

service must exceed the cost of an occasional extra can, considering the stop, the labor, and the billing that the carrier must provide. On the other hand, once-a-month service should cost less than weekly minican service, for the same reasons.

B. PASS-THROUGH ADDITIVES

Commission staff recommended and the company agreed that the Commission should change its treatment of revenue-sensitive taxes, expenses and operating margin in its solid waste tariff Item 230, disposal fee pass through charges. These changes would primarily affect drop box customers. Now, the company passes through disposal fees to the consumer, including only the rate actually paid to the disposal site.

The Commission rejects Commission staff's proposal to change the treatment of dump fee pass through charges. The proposed treatment would unnecessarily complicate ratesetting and could result in excessive collections from affected ratepayers. If the company is experiencing a net revenue decline, the way to rectify the shortfall is to propose a general rate increase.

C. LEVELIZED RATES

The respondents initially proposed seven year levelized rates. On rebuttal, they repeated their preference for the levelized rate approach, but also accepted regulation under the traditional rate base/rate of return approach. The respondents' brief now urges the Commission to accept the levelized rate plan.

The Commission has carefully considered the levelized rate proposal and rejects it as inappropriate for public service company regulation. Respondent proved no ratepayer benefits and no general regulatory benefits in its proposal.

D. 90 GALLON COMMERCIAL CART RATE

Commission staff originally proposed a 90 gallon commercial rate different from the company's request. However, on brief Commission staff accedes to the company's proposed \$4.28-per-pick-up rate. The rate appears to be reasonable, and Commission accepts it.

VI. Rate case-related expenses

The magnitude of the companies' rate case costs dismays the Commission. We view with alarm the reported expert witness and attorney fees. As of April 18, 1991, the expenses were:

Fees & Costs

Davis, Wright & Tremaine	\$260,366
Arthur Andersen & Co.	\$64,370
Dr. Daniel R. Siegel	\$159,000
Dr. Lawrence D. Schall	\$76,150
Dr. Robert E. Olley	\$86,996

The companies defend the costs as necessary. They contend that the case's precedential nature and the benefits of a favorable decision for all ten WMW operating companies and their customers in this state support the action.

We do not see any benefit to ratepayers from the amounts spent on expert witnesses and attorney fees in this case. We believe that these costs are exorbitant and imprudent. The company should be aware that we will do whatever is necessary to discourage "gold-plating" of rate case expenses. We will closely scrutinize any attempts to pass these expenses on to ratepayers directly or indirectly in any later proceeding. We question what conceivable benefit would have flowed to ratepayers even if the company had prevailed on its principal issues.

FINDINGS OF FACT

The Commission has discussed the evidence and stated findings and conclusions. The Commission now makes the following findings of ultimate facts. The Commission incorporates by reference the preceding detailed findings about the ultimate facts.

1. The Washington Utilities and Transportation Commission is an agency of the State of Washington. It has statutory authority to regulate rates, practices, accounts, securities and transfer of public service companies, including companies providing solid waste collection service.

2. Respondents Sno-King Garbage Co., Inc., and Northwest Garbage Co., Inc., furnish solid waste collection service within the state of Washington. Respondents are public service companies subject to the Commission's jurisdiction.

3. Respondents filed revisions to their tariffs that would increase rates and charges for solid waste collection services within their Snohomish and King County territories. The revisions bore an August 1, 1990 effective date. The revised rates reflected charges for beginning a curbside recycling program, as well as increased landfill fees. The Commission suspended the tariff revisions and began an investigation into their justness and reasonableness. The Commission authorized temporary rates, subject to refund, pending the outcome of this proceeding. The respondents waived the suspension date until December 31, 1991.

13. The Commission rejects the companies' levelized rate proposal.

14. The Commission takes official notice of the record in Docket No. TG-2016, et al.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and the parties of record.

2. The Commission should accept the parties' stipulation to update Exhibit 101 recycling costs.

3. The Commission should accept the amended Lurito-Gallagher operating ratio methodology. The Commission should use it to calculate respondents' revenue requirements for their Washington State solid waste collection operations.

4. The Commission should reject the respondents' proposed rate revisions. The rates this order authorizes for refiling will be fair, just and reasonable. The Commission should authorize respondents to file tariff revisions consistent with this order no later than ten days after the service of this order, for effect January 1, 1992. Respondents shall provide refunds to customers where required under the terms of this order.

On the basis of the above analysis, findings, and conclusions, the Washington Utilities and Transportation Commission enters the following order.

O R D E R

THE COMMISSION ORDERS the following:

1. The Commission rejects the tariff revisions filed by Sno-King Garbage Co., Inc., and Northwest Garbage Co., Inc., in Docket Nos. TG-900657 and TG-900658. The Commission authorizes respondents to file tariff revisions consistent with this order no later than ten days after the service of this order, with a stated effective date of January 1, 1992.

2. The Commission directs the respondents to make refunds or negative surcharges to customers as described in this order.

3. The Commission retains jurisdiction to enforce this order.

DATED at Olympia, Washington, and effective this 10th day of December, 1991.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Sharon L. Nelson

SHARON L. NELSON, Chairman

R. D. Casad

RICHARD D. CASAD, Commissioner

A. G. Pardini

A. G. PARDINI, Commissioner

APPENDIX A

SNO-KING GARBAGE CO., INC., PROPOSED RATES

Snohomish County, Urban-Suburban

	Temporary rate	Company proposed	Staff proposed
Residential (Includes recycling)	*	**	***
Monthly Rates-weekly service			
Mini-can	\$7.85	\$8.20	\$7.48
1 can	\$11.10	\$11.45	\$8.91
2 can	\$15.10	\$15.45	\$12.91
Once a month service	\$7.85	\$8.20	\$5.23

* includes \$3.60 for residential recycling

** includes \$3.95 for residential recycling

*** includes \$3.23 for residential recycling

Occasional extra can rate	\$4.00	\$4.00	\$2.00
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Snohomish County, Rural (curbside recycling rates not included)
Monthly rates - weekly service, rural

Mini-can	\$4.25	\$4.25	\$4.25
1 can	\$7.50	\$7.50	\$5.68
2 can	\$11.50	\$11.50	\$9.68
Once a month service	\$4.25	\$4.25	\$2.00

Snohomish County
Commercial, weekly service-per pickup
(rent extra)

1 cubic yard container	\$9.61	\$9.61	\$8.76
2 cubic yard container	\$16.10	\$16.10	\$15.58
1-5 cans per can	\$1.76	\$1.76	\$1.49
minimum monthly	\$10.56	\$10.56	\$8.94?

NORTHWEST GARBAGE COMPANY PROPOSED RATES

Snohomish County, Urban-Suburban

	Temporary rate	Company proposed	Staff proposed
Residential (Includes recycling)	*	**	***
Monthly rates-weekly service			
Mini-can	\$7.85	\$8.20	\$7.48
1 can	\$11.10	\$11.45	\$10.73
2 can	\$15.10	\$15.45	\$14.73
Once a month service	\$7.85	\$8.20	\$5.23

 Snohomish County, Rural
 (Curbside recycling rates not included)

Monthly rates - weekly service, rural			
Mini-can	\$4.25	\$4.25	\$4.25
1 can	\$7.50	\$7.50	\$7.50
2 can	\$11.50	\$11.50	\$11.50

 Snohomish County, Lynnwood

	*	**	***
Residential (includes recycling)			
Monthly rates-weekly service			
Mini-can	\$7.85	\$8.20	\$7.48
1 can	\$10.80	\$11.15	\$10.43
2 can	\$14.80	\$15.15	\$14.43

NORTHWEST GARBAGE COMPANY PROPOSED RATES

Snohomish County
Commercial, weekly service-per pickup
(rent extra)

1 cubic yard container	\$9.61	\$9.61	\$7.50
2 cubic yard container	\$16.10	\$16.10	\$14.50
1-5 cans per can	\$1.76	\$1.76	\$1.76
minimum monthly	\$10.56	\$10.56	\$10.56

King County, Urban/Suburban
(Staff recommends rates to be reduced by 11.06%)

Residential
(Includes recycling) * ** ***
Monthly rates, weekly service ****

1 can	\$10.85	\$11.20	\$9.68
2 can	\$12.30	\$12.30	\$10.97

Commercial, weekly service-per pickup
(rent extra)

1 cubic yard container	\$9.61	\$9.61	\$8.77
2 cubic yard container	\$16.10	\$16.10	\$14.66
1-5 cans per can	\$1.68	\$1.68	\$1.49
minimum monthly	\$10.08	\$10.08	\$8.97

- * Includes \$3.60 for residential recycling
- ** Includes \$3.95 for residential recycling
- *** Includes \$3.23 for residential recycling

**** One can determine the staff King County rates by reducing the temporary solid waste rate by 11.06% and then, for residential customers, adding \$3.23 for recycling.