Staff Report on the
2013 Refuse Rate Application

May 10, 2013

Attachments

1. Introduction

On March 14, 2013, Recology San Francisco, Recology Sunset Scavenger, and Recology Golden Gate (collectively the “Companies”) filed an Application with the Chair of the Refuse Collection and Disposal Rate Board requesting changes to the Companies’ residential refuse collection and disposal rates. The Application was referred to the Director of Public Works (the “Director”) for hearings, reports and recommendations as required by the 1932 Refuse Collection and Disposal Ordinance, as amended (the “1932 Ordinance”).

This Report summarizes the Application, the public process responding to the Application, and the results and recommendations of the staff review. This report will be the subject of additional hearings by the Director, to be held in May 2013. At those hearings, staff will also introduce supporting documents referenced in this report.

2. Summary of the Companies' Application

The Companies' "2013 Rate Application" consists of the Application, supporting analyses prepared by independent experts, proposed rate schedules, descriptions of program and costs, historical information, revenue and expenditure forecasts, and assumptions underlying such forecasts. In addition, the Companies submitted audited financial statements for Recology San Francisco (“RSF”), Recology Sunset Scavenger (“RSS”), and Recology Golden Gate (“RGG”) for fiscal years 2007 through September 30, 2012.

Consistent with the 2006 Rate Order, the Companies have followed a “combined approach” that aggregates the revenues and expenses of the two collection companies for purposes of calculating the proposed rate increase. Staff continues to support this approach. The Companies calculate rates based on a 91% operating ratio (an allowed 9.9% profit), with an additional 2% operating ratio available for achieving zero waste goals. It should be noted, however, that the Application contains a number of “pass-through” items upon which the Companies are not allowed to calculate any profit, so their effective profit margin is lower. Staff considers the proposed operating ratio reasonable and consistent with rates allowed in other jurisdictions (Exh. 66).

The Companies are requesting an average increase in residential collection rates of 21.51%, and an increase in the transfer station tip fee of 6.45% (from $140.76 to $149.84 per ton). The Companies propose significant changes in the residential rate structure. Currently, residential charges are based solely on the volume of trash (black bin) service, although service includes collection and processing of recyclable (blue bin) and compostable (green bin) materials. The Companies propose to add a fixed monthly charge of $5 per residential unit, as well as a monthly charge of $2 for each 32-gallon blue and green bin (larger bins would be charged for each multiple of 32-gallon capacity); the charge for the black bin would continue to be volume-based. According to the Companies, a typical household, with three 32-gallon bins, would see a monthly increase of $6.60, from $27.91 to $34.51 per month (Exh. 1, Letter, p. 2).

The Companies also propose changes in the way apartment customers’ service charges are computed, similar to the discounted-volumetric structure currently employed in the commercial sector. Under the proposal, apartment customers would be charged for each type of service (trash, recyclables, and compostables) based on volume; these charges would then be discounted based on the amount of diversion service (i.e., blue and green bin volume) that is provided. Apartment customers would also be charged a fixed monthly fee of $5 per unit. The Companies propose a cap on apartment rates; for the first year no apartment bill for equivalent service would increase more than 25%. For the second year the cap would rise to 50%. There is no cap in the third year.

The Companies claim that the proposed structure is a step toward aligning the rates charged with the cost components of residential and apartment services. The new structure is also designed to mitigate against the impact of declining trash volumes on total revenues, as the City moves towards its goal of zero waste.

Unlike prior rate applications (in 2001 and 2006), the Companies are proposing a single-year rate for the rate year beginning July 1, 2013 (rate year 2014 (RY14)). The Companies propose that the base year rates be adjusted by a cost-of-living factor in future rate years, until a new application is submitted. The Companies anticipate submitting a new rate application within two to three years, depending on a number of factors. Future ratemaking procedures are discussed later in this report.

3. Procedures

The burden of proof is on the Companies to demonstrate, through evidence on the record, that the rate increase they seek is "just and reasonable." Pursuant to the 1932 Ordinance, DPW Order No. 181,252 ("Rules of Procedure"), and DPW Order No. 173,617 ("Rate Adjustment Standardized Format"), in response to the filing of the Application, the Director has begun a series of workshops and public hearings. An informational workshop was held on the draft application on January 17, 2013, and a technical workshop was held on the final Application on March 21, 2013. Both workshops were publicized through press releases, notifications to neighborhood groups and various apartment associations, along with postings on DPW's web site and the Ratepayer Advocate's web site. The Director held public hearings on April 12, 15, 22, and 24, 2013. These hearings were advertised in the San Francisco Chronicle and notice was posted at the San Francisco Main Library Government Information Center and on the DPW website. The hearings were transcribed.

At these hearings, the Companies and City staff were given the opportunity to present testimony and cross-examine witnesses. The independent Ratepayer Advocate also conducted cross-examination, and public comment was taken at each hearing. The hearing record consists of the documents filed by the Companies, staff, the Ratepayer Advocate, and the public in support of their positions in marked exhibits, as well as the hearing transcripts. Exhibits are referred to by number in this report. Attachment A contains the list of exhibits that have been entered into the record as of the date of this report.

4. Staff Review

Staff from the Department of Public Works (DPW) and the Department of the Environment (SFE), who have considerable expertise in municipal solid waste management, recycling, and planning, with assistance from the City Attorney's office and outside advisors and consultants, conducted a thorough review of the Application, beginning with the draft (or initial) Application submitted by the Companies on December 11, 2012. During the 90-day review period for the draft Application, staff examined every schedule and line item of the rate model, as well as the documentation and justification for the requested increase. Upon request, the Companies provided additional documentation and clarification in response to numerous rounds of staff and consultant questions. Staff tested the model to validate that computations were correct, double-counting was eliminated, and that the calculations were accurate.

City consultants with specialized financial expertise reviewed the rate model and projection methodology used by the Companies to derive the base year for the rate application (RY14) from audited financial results for the Companies' most recently completed fiscal year (June 30, 2012). The consultants identified the various adjustments and inflation factors applied by the Companies, and determined their reasonableness.

Both staff and consultants reviewed historical revenues, expenditures, and tons to determine trends and identify potential anomalies. Those findings were then used to validate or adjust projections. Staff also compared elements of the Application to information that SFE has collected through years of working on waste-related issues and to information obtained from outside sources, including other jurisdictions, to evaluate the Companies' Application.

Based on the initial review, staff made a determination of completeness of the draft Application, and requested that the Companies revise and/or provide additional information in the final (or revised) Application. The Companies' final Application, submitted March 14, 2013, reflected staff findings as well as several corrections of their own; changes between the draft and final Application were summarized in a table (Exhibit 53). Taken together, the Companies revised their request as follows:

Item	Draft Application	Final Application
RSF rate increase (%)	13.26%	6.45%
RSF tip fee ($/ton)	$159.43	$149.84
RSS/RGG average rate increase (%)	23.75%	21.51%

Staff and consultants continued to review the final Application, including validating that the changes requested in the draft Application were made, and testing other assumptions used by the Companies, particularly with respect to tons of materials handled and revenue projections. During the public workshop and the four Director's hearings, staff questioned the Companies extensively on their methodology and assumptions, presented additional information, and considered the comments of the Ratepayer Advocate and members of the public. Collectively, that process and information has informed the staff's recommended adjustments, which are summarized in the next section and detailed in subsequent sections of this report.

5. Summary of Staff Recommendations

After extensive review, staff is proposing a number of changes in the Companies' rate schedules that affect both the tip fee charged by Recology San Francisco and the collection charges levied by Recology Sunset Scavenger and Recology Golden Gate.

For Recology San Francisco (the operator of the transfer station complex and the recycling facility), the most significant changes are as follows:

Staff Recommended Changes for RSF	Value of Change
Remove Brisbane tax from operating ratio calculation	$259,350
Reduce staffing at recycling facility (2 sorter/materials handlers)	$137,574
Reduce compostables tip fee	$568,060
Adjust lease terms from 7 to 10 years for stationary equipment	$237,279

These reductions also result in lower diversion incentives, profit, labor costs, payroll taxes, workers' compensation and other labor-related expenses. The total reduction at Recology San Francisco is $1,476,245; these changes reduce the proposed tip fee from $149.84 to $147.23 (an increase of 4.60% over the current rate). The lower tip fee flows through to the collection companies, as summarized below.

For Recology Sunset Scavenger and Recology Golden Gate, the most significant changes are as follows:

Staff Recommended Changes for RSS/RGG	Value of Change
Intercompany disposal (lower tip fee)	$441,972
Intercompany processing (lower tip fee)	$900,083
Reduce shops and clerical staffing (2 positions)	$135,687
Lower price for CNG fuel	$733,743
Reduce Pay Per Setout test (revenue and expense adjustments)	$333,441
Lower apartment migration assumption (increases revenues)	$548,701
Increase projected apartment revenues for new units (increases revenues)	$1,272,797

In total, staff recommends a reduction of $2,879,561 in expenses for RSS/RGG, and an increase of $1,961,159 in revenues used to calculate the required rate adjustment. The cumulative changes recommended by staff reduce the average residential rate increase to 19.14%. For a typical residential household with three 32-gallon bins, the monthly rate would be $33.87.

In addition to these changes, staff recommends retaining the caps on apartment customers at 25% in RY14 and 50% in RY15, to mitigate unintended rate shock and allow time for them to reconfigure their services, to the extent possible. Staff is proposing returning to the rate base some revenue realized from lifting these caps. Staff is also proposing modest changes to the cost-of-living-adjustment mechanism that would be applied in future rate years, and to the zero waste incentives calculation, as described later in this report.

Attachment B provides a more detailed list of the changes being proposed by staff, along with the resulting rate calculation schedules for the Companies (Schedules B.1 for RSF and RSS/RGG).

6. Residential and Apartment Rates

This section describes proposed changes in residential and apartment rates.

6.1 Residential Rate Structure

The Companies propose to institute a fixed $5 charge per residential unit and $2 charge per 32-gallon bin for recycling and composting collection (Exh. 1, Letter, p. 2, Narrative Summary, p. 10, RSS/RGG Sch. C, p. 3). Staff agrees that the current rate structure, based on applying total costs only to shrinking black bin trash, is not sustainable. We recognize there are fixed costs not dependent on the volume of refuse collected from a household and agree that, especially with the adoption of San Francisco's Mandatory Recycling and Composting Ordinance in 2009, households will still be incentivized sufficiently under the proposed rate structure to recycle and compost. Staff therefore supports the proposed residential rate structure.

6.2 Twenty-gallon Rate

The Companies propose charging residential 20-gallon trash customers 20/32 (62.5%) of the 32-gallon rate, rather than the previously established 77%, making all volumetric charges proportional (Exh. 1, Narrative Summary, p. 10, RSS/RGG Sch. C, p. 3). Staff has long supported this ratio and agrees that now is a good time to institute it. Thirty-two-gallon trash customers can more than offset the proposed rate increase by shifting to a 20-gallon trash bin (Exh. 7).

6.3 Apartment Rate Structure

The Companies propose changing the apartment rate structure to a discounted-volumetric charge patterned on the current commercial rate structure. For apartment customers, it would include a $5 per dwelling unit fixed charge and a capacity charge for all three bin types (black, green and blue) with a diversion discount, up to 75%, equal to diversion volume percentage minus 10% (Exh. 1, Letter, pp. 2-3, Narrative Summary, p. 11, RSS/RGG Sch. C, pp. 3-4).

Staff concurs that the current apartment rate structure of applying volumetric rates only to black trash bins is not sustainable as the City get closer to zero waste to landfill. Apartment buildings have also increased their use of green and blue bins, especially since the adoption of San Francisco's Mandatory Recycling and Composting Ordinance, with a corresponding reduction in the use of black bins. The base on which revenues are generated must be expanded beyond the black bin trash stream while maintaining incentives for diversion.

The similar commercial rate structure instituted in conjunction with the 2006 rate process helped motivate business customers toward more diversion services and is now successfully institutionalized in that sector. Staff believes a discounted-volumetric rate will function in a similar fashion in the apartment sector, continuing to incentivize apartment customers to increase diversion while allocating program costs more sustainably.

6.4 Pay Per Setout

The Companies included costs and revenue credits in the application for a Pay Per Setout test. The test gives curbside customers the opportunity to put their black trash bin out only when necessary and receive a discount for each week they do not have the black bin collected (Exh. 39). Staff agrees with the concept and goals of this program. Developing and evaluating new collection, routing, tracking and billing systems are critical as San Francisco moves towards zero waste.

The Companies propose to add three test groups in RY14 to the existing RY13 group. Staff believes two new groups in RY14 is sufficient for testing purposes and recommends eliminating one group and its related costs and revenue credits.

The Companies propose to amortize rollout costs over 3 years (Exh. 39). But these are one-time costs associated with an ongoing rate and carts leased over a 7 year term (Exh. 1, RSS/RGG Sch. H.2, p. 1). Thus staff recommends rollout costs be amortized over 7 years.

7. Revenues

The Companies attribute fully 16.1% of the 21.5% proposed rate increase (or 75% of their request) to a revenue shortfall due to a combination of migration to diversion service and the economic downturn (Exh. 1, p.23). To date, charges in the residential and apartment sectors have only been levied on trash, or black bin, service. Collection and processing of the other two material streams--recyclables and compostables--requires an equivalent level of effort, and therefore expenditure. As customers have been shifting away from larger trash containers, or to less frequent collection, in an effort to save money and to comply with the Mandatory Recycling and Composting Ordinance, revenues collected by the Companies have gone down. Likewise, in the commercial sector, where there is a diversion discount, customers have been shifting away from the non-discounted trash service.

Staff concurs that the base on which revenues are generated is shrinking while overall programs and services for collecting the three waste streams, as measured by tons disposed and processed and collection routes required, are staying essentially flat. Staff wants to emphasize to all interested parties and the public that a revenue shortfall, caused in large measure by changes in the economy and behavior encouraged by adopted City policies, more than any cost increases, is driving the requested increase in refuse collection rates. Staff also notes that other jurisdictions throughout California are grappling with the issue of a shrinking rate base (i.e., trash volume) and are considering changes in refuse rate structures similar to those being proposed by the Companies.

RSS/RGG Schedule F.1 shows that revenues were lower in RY12 than they had been in RY11 in all three sectors (residential, apartment and commercial). Exhibit 48 submitted by the Companies shows this downward trend has generally continued through the first nine months of RY13. This is despite the fact that most economic indicators (population growth, employment, office vacancies, hotel occupancy) are improving (Exh. 49). As a result of all of the construction activity, staff expects a large number of new residential units to be occupied in RY14 and is recommending an adjustment to apartment revenues as discussed below.

7.1 Apartment Revenue Projections

The San Francisco Controller's Office Development Pipeline February 2013 (DP-2/13) Residential Summary (Exh. 67) shows 11 apartment buildings projected for completion in RY13. These buildings will include a total of 2,847 new residential units. Staff research indicates these buildings will be occupied in RY14.

These new apartment units represent 2.5% of the 113,929 existing units in the Apartment Detail screenshot the Companies provided during analysis of the draft application (Exh. 68). Multiplying Apartment Annual Revenue of $50,911,892 (Exh. 1, RSS/RGG Sch. F.1) times 2.5% yields a revenue increase of $1,272,797.

7.2 Apartment Migration

The application includes Apartment – Migration, -2.5% Base Revenue Lost due to Service Changes (Exh. 1, RSS/RGG Sch. B.3, p.3). The Companies have not provided sufficient evidence to support this projection.

Available evidence indicates that the Companies have over-stated projected apartment migration. SFE and the Companies have initiated composting collection, supported by outreach and education programs, at over 2,000 apartment buildings in the past two years. Out of the 8,617 apartment buildings in San Francisco, fewer than 200 buildings do not have composting collection and they will start it before RY13 ends. Service changes associated with starting composting have been substantial and are essentially complete.

Staff does not believe the new apartment rate structure and overall rate increase will have as much impact on revenue as rolling out composting to apartments has already had. Exhibit 1, RSS/RGG Sch. F.1, shows an apartment revenue average annual increase of 3.6% from RY7 to RY13 and an average annual decrease of 1.4 % from RY11 to RY13. Staff therefore recommends RY14 apartment revenue migration of no more than 1.4%. This change would produce a reduction of $566,521 from $1,287,547 Apartment - Migration in Exhibit 1, RSS/RGG Sch. B.1-3.

7.3 Apartment Rate Caps

The new apartment rate structure, combined with the overall increase, results in rate increases of over 25% to approximately 73% of apartment buildings (Exh. 54). To mitigate rate increases and allow time for apartment owners to understand the new rate structure and right size their service levels, the Companies have proposed capping apartment rate increases for individual apartment customers at 25% in RY14 and 50% in RY15. The Companies state that the changes to service levels and configuration will offset any additional revenue generated by the removal of caps (Exh. 1, Letter, p. 3, Narrative Summary, pp. 11-12, RSS/RGG Sch. C, pp. 3-4). It is very difficult to project the amount of right sizing that will be accomplished. But staff does not believe that all revenue from removal of the caps will be offset by service adjustments.

The Companies presented an exhibit showing that a total of $4,571,055 in revenue could be realized when the caps are removed, if there is no migration (Exh. 54). To mitigate such a revenue windfall, staff recommends $2,285,527, one-half of the total potential excess revenue, be returned to the rate base in the annual COLA adjustment process. This will mean that all classes of ratepayers will benefit from removal of the caps on apartment rates and apartment customers will continue to be incentivized to right size their service.

7.4 Recycling Revenue and Purchases

In the draft application (RSF Sch. F.3), staff observed that projected prices per ton for recyclable commodities in RY14 did not exactly match up with the average of the actual prices received in the five most recent Recology annual reports (RY8-12). In the final application, the prices were adjusted to accurately reflect the five-year average, resulting in a $1,116,907 increase in projected recycling revenue for RY14.

Staff also discovered that processing expenses were double-counted in the draft application by putting them in both RSF Schedules D and F.3, p. 2, including $1,038,625 in RY14. Staff verified that these expenses were properly apportioned between the two schedules in the final application.

In the draft application (RSF Sch. K.2), staff questioned the Companies as to why three commodities were purchased at higher prices than sold. For HDPE and Whole Bottle Glass it was determined that the purchased items were more valuable California Redemption Value (CRV) containers only, whereas the materials sold were a mixture of CRV and non-CRV containers. For Mixed Paper, the purchased products were a higher quality commercial grade of Mixed Paper. At the April 24 hearing, Mr. Braslaw also confirmed that in the final application (Exh. 1, RSF Sch. K.2) the RY12 Mixed Paper purchase price should be corrected from $234 to $113 and Cardboard from $144 to $145, resulting in purchases of $28,217 and $3,564,578 respectively (Tr. p. 580). These changes will not result in any change to the rates.

8. Program Expenses

This section presents staff findings and recommendations with respect to the Companies' program expenses.

8.1 Collection Companies Labor

The Companies propose to add 1.7 General & Administrative Regular Payroll - FTE Union - Clerical in RY14 (Exh. 1, RSS/RGG Sch. G.1, p.10). At the April 22 hearing, Mr. Braslaw confirmed (Tr. pp. 319-320) that Total General & Administrative staff had increased in RY13 by 3.3 FTE and 2.5 more were projected to be added in RY14, and further that 1.0 of those RY14 FTEs had already been hired. Mr. Braslaw explained that those positions included customer service representatives (CSRs) dealing with calls about service and rate changes, including Pay Per Setout (PPS).

At the April 22 hearing during public comment (Tr. p. 425), a member of the public noted the prior consolidation of CSRs to one call center as a means of increasing efficiency and productivity. The Companies did not indicate any specific staff reductions or increases in workload, and no information was presented to show that current staffing was not maintaining customer service quality. Staff recommends reducing PPS by one third, which will also reduce CSR workload. This recommendation translates into a reduction of one FTE from General & Administrative Regular Payroll Union-Clerical in RY14, from 24 to 23.

Exhibit 1, RSS/RGG Sch. G.1, p.11, shows an increase of 4.6 FTE in the Truck & Garage Regular Payroll Union - Shop in RY13 and 1.9 FTE in RY14. The Companies confirmed at the April 22 hearing that the 4.6 FTE had been hired to address preventive maintenance generally and increased maintenance that is required for the new CNG vehicles (Tr. pp. 315-317). The average number of FTEs has been 45.7 over RY10-12. The 51.3 FTE proposed for RY14 is a 12% increase over the RY10-12 average. Exhibit 1, RSF Sch. E., pp. 1-3, shows collection tonnage is relatively flat and the Companies agreed with that observation at the April 22 hearing (Tr. p. 313). Staff recommends Truck & Garage Regular Payroll Union - Shop be reduced by one FTE in RY14, from 51.3 to 50.3.

8.2 Recyclables Processing Labor

In the draft application (RSF Sch. G.1, pp. 8-9), the Companies increased the number of Recycle Central Total Payroll Sorter/Material Handlers from 85.9 in RY12 to 90 in RY14 and Regular Payroll FTE from 63.5 to 67.5, even though recyclables tons are not increasing.

In the final application (Exh. 1, RSF Sch. G.1, p. 8), the Companies reduced the number of Total Payroll Sorter/Material Handlers to 88 in RY14, but there is no corresponding reduction in Regular Payroll FTE. At the April 22 hearing, Mr. Crosetti agreed with staff that Regular Payroll FTE Sorter/Material Handlers should be reduced from 67.5 to 65.5 in RY14 (Tr. pp. 321-322). Staff recommends a corresponding reduction in labor costs.

8.3 Health and Welfare Benefits

Health insurance costs include medical, prescription, drug, dental and vision coverage, as well as long-term disability and life insurance. The projections in the Application for the base health insurance costs are based on RY13 costs inflated by 6.6% for the second half of the year (health insurance rates are set on a calendar year basis and adjusted for rate years). RY14 health insurance costs assume a 6.2% increase from the RY13 projections. The 6.6% and 6.2% inflation factors were developed by the Companies' third party actuary, Mercer. In addition to the base health insurance cost, this expense also includes a reinsurance fee associated with the Affordable Care Act set at $110 per covered life; a Retirement Security Program which provides postretirement benefits; and a Supplemental Retirement Security Program. The Companies report this last benefit, with an associated cost approximately $300,000, was provided in exchange for the elimination of the Rule of 84 benefit program which provided a savings of $3.7 million.

Overall health insurance costs for the combined Companies for RY14 are projected to increase by 24% as compared to RY12 (9.1% in RY13 and 13.6% in RY14). As with other employee benefits, a portion of this increase is due to projected increase in staffing positions as well as the impact of the reinsurance fees and supplemental retirement security program; however, the Companies' RY14 projected health insurance expense is 30.3% of payroll, which is more than both the 3-year and 5-year averages (29.0% and 28.3%, respectively).

The Companies' health insurance costs are rising faster than any other major expense and staff is extremely concerned about this trend. The Companies reported that they have implemented changes to the non-union health and benefits in an effort to control costs, including increased co-payments and benefit reductions. Union programs are governed by contractual obligations and program changes are limited under the current collective bargaining agreements. When those agreements are renegotiated, however, it is staff's expectation that the Companies will aggressively pursue changes to union health and benefits in an effort to control those costs, including increased co-payments and benefit reductions similar to the steps taken to control non-union costs at the Companies and those taken by the City for its own employees. It is also staff's expectation that its review of any future applications will consider the reasonableness of overall negotiated benefits and co-pays when determining what portion of those expenses are appropriate to include in the rate base. In future rate reviews staff may also consider recommending excluding health care cost increases that are above a reasonable amount from the operating ratio.

Staff recommends reducing the reinsurance fee required by the Affordable Car Act from $110 to $63 in RY14, consistent with guidelines issued by the Department of Health and Human Services (Exh. 69). Total reduction is $175,075.

8.4 Liability Insurance

Liability insurance premium projections are based on information provided by the Companies' insurance brokers and actuaries along with projected claims costs associated with fleet operations. Claim costs are allocated to the individual companies based on their individual claims experience. Other costs are allocated based on a series of measures developed to reflect each participating company's relative size and risk profile. The Companies combined liability insurance expense is projected to increase an average of 8.8% between RY12 and RY14. This projected increase in liability insurance is due in large part to the Company's loss rate, which is projected to increase annually at 10% based on an average of the 4-year and 6-year trends developed by the Company's actuary. The Company's actuary, who works with more than 250 self-insurance programs, reported that the Company's loss trend and projected increase in liability insurance are consistent with what they are seeing throughout the broader business sector. The RY14 projected expense for the Companies is 4.3% of the payroll expense, which is less than both the 3-year and 5-year averages (4.4% and 5.7%, respectively).

Recology's safety manager, who joined the Company two years ago, reported that the Company is in the process of reorganizing its safety program in an effort to control costs, including liability insurance. Staff does not recommend adjustments to this line item.

8.5 Workers Compensation

Workers compensation expense covers the cost associated with workers injured on the job. The Companies participate in a risk pool with all other Recology operating companies with compensation rates and allocations established based on the specific historical experience of each Company as prepared by Recology's third-party administrator.

The Companies reported that workers compensation costs have risen over the past several years due to increases in the indemnity payments and double digit inflation increases in the costs of medical care. Changes in legislation that led to decreases in some areas of workers compensation costs have been undercut by increases in benefits attributed to recent court decisions and more liberal rulings regarding disputes and appeals. Although they are continuing to focus on safety training, return-to-work programs, and improvement of work processes, the Companies reported that workers compensation costs remain high and are expected to increase during the rate period.

Overall workers compensation costs for the combined companies are projected to increase by 12.1% in RY13 and 7.2% in RY14 based on actuarial projections and broker estimates. The combined projected RY14 workers compensation expense for the Companies is 8.9% of payroll. This figure is generally consistent with historical trends, with the workers compensation expense for the combined companies averaging 8.9% of payroll for RY7 through RY12, although slightly higher than the 3-year and 5-year trends, which are both 8.8% of payroll.

Staff is concerned about increasing workers compensation costs and seeks assurances from the Companies that their safety programs are effective and that the Companies are doing everything in their power to minimize accidents and injuries and associated workers compensation costs. DPW has been able to reduce its Loss Workday Case Rate from 10 to 1 by simply implementing a return-to-work policy and has also reduced its total Recordable Injury Rate from 18 to 8. Staff understands that the Companies hired a new Safety Director two years ago and are in the process of implementing a number of changes to its safety program. DPW safety personnel have expressed a strong desire to collaborate with the Companies to determine if there are opportunities for the Companies to undertake some of the actions the DPW has taken to improve their safety record and reduce Workers Compensation costs. We strongly encourage the Companies to undertake such a collaborative effort.

8.6 Pension Contributions

Pension costs are based on contributions required to meet Employee Retirement Income Security Act (ESIRA) pension plan funding requirements as determined by the Companies' pension plan actuary. The Companies' pension contributions, through their parent company, Recology, Inc., have increased during the past few years in an effort to improve the funding status and financial health of the Recology-sponsored pension plan. The Companies share of the contribution in RY12 was $20 million, up from an average of $10.9 million during the last five-year rate period. The Companies combined RY14 pension expense is projected to be approximately $18 million, a decrease of more than 18% as compared to the RY12 actual expense (approximately $28 million), but an increase of approximately $4 million as compared to the RY11 actual expense. As projected, the RY14 pension expense represents 18.2% of payroll, which is less than both the 3-year and 5-year averages, which are 21.9% and 20.5%, respectively.

Pension benefits for RSF employees represented by Operating Engineers Local 3 are provided under a separate union sponsored plan. The plan is funded as a cost per hour for each participating employee. The Application projected that hourly cost to increase 13% in RY13 and another 6.6% in RY14 based on information provided by the union. A review of the executed union agreement, however, supported a RY14 pension funding rate of $10.11 per hour versus the Company's $10.35 per hour.

Recology has frozen its pension plan with respect to new non-union personnel, who now participate in a defined contribution plan that is not subject to fluctuating funding requirements. Union pension obligations are governed by contractual obligations and program changes are limited under the current collective bargaining agreements. When those agreements are renegotiated, however, it is staff's expectation that the Company will aggressively pursue changes to the union pension plan in an effort to control those costs as the City has done with its own employee pension plan over recent years. The City's efforts to control pension liabilities and annual employer contributions to the pension plan have included requiring employee contributions to the pension plan (between 7.5% and 11.5% of salary is deducted from bi-weekly paychecks), increasing the age at which full benefits can be realized to 65, and basing retirement compensation on 75% of the average of the final three years salary. The Companies may also consider freezing the union pension plan, and implementing a defined contribution plan similar to that implemented for new non-union personnel. It is also staff's expectation that its review of any future applications will consider the reasonableness of overall negotiated pension benefits when determining what portion of those expenses are appropriate to include in the rate base.

Staff recommends reducing the Local 3 funding rate from $10.35 to $10.11 per hour, based on a review of the applicable union agreement. Total reduction is $21,783.

8.7 Toxics Programs

Currently, the Companies provide San Francisco residents with safe and convenient disposal options for home generated sharps through 66 pharmacy locations throughout the City. In the past year, the City launched a Safe Medicine Disposal pilot program for residents and has been collecting unwanted and expired medicine at 13 pharmacies and one community center that do not collect sharps. Over the course of the year, staff has received requests from residents as well as a majority of the pharmacies participating in the safe medicine disposal program to allow residents to safely dispose of their home generated sharps at the same locations. The Companies included modest costs in their application to expand the safe needle disposal program to 10 of these sites (RSF Sch. C, p.4). Staff believes that expanding the safe needle disposal program to include 10 additional sites will meet the needs of the residents and make the program more convenient, and therefore supports this addition.

Through the Household Hazardous Waste Facility drop off program, the Door-to-Door HHW collection program and the Curbside and Apartment battery recycling programs, the Companies collect primary (alkaline) and secondary (rechargeable) household batteries. Currently, the Companies co-mingle these batteries and ship them offsite for recycling. The secondary battery industry voluntarily created a non-profit entity, Call 2 Recycle, which operates a free rechargeable battery and cell phone collection and recycling program in North America. Call 2 Recycle has offered to reimburse the City for costs incurred to manage secondary batteries collected by the Companies. However, the Companies will first need to sort the primary and secondary batteries in order to seek reimbursement from Call 2 Recycle. In addition, product stewardship-based legislation is being considered at the State level for primary batteries. If passed, the legislation would likely result in reimbursement for management of primary batteries collected by the City which would also require the Companies to sort primary and secondary batteries. In order to obtain these manufacturer reimbursements and reduce costs to ratepayers for managing batteries, the City supports the addition of one Union - technician FTE position (RSF Sch. G.1, p.11) to complete the sorting of batteries.

8.8 Abandoned Materials Collection

The Application includes a provision for Recology to assume responsibility for responding to 311 calls for abandoned materials. Under the proposal, Recology would divide the City into five zones and utilize two trucks per zone, one packer and one box truck (DPW currently uses only a packer truck on each route). By operating the program in a similar manner to the existing Bulky Item Recycling program (with box trucks for mattresses, electronics, appliances, and other potentially recoverable items), the Companies anticipate generating greater diversion of materials than DPW can achieve with a single packer truck on each route. Assigning two trucks per zone potentially allows for higher service levels, as the trucks can operate independently depending on the materials to be collected (Tr. p.299). Drivers will also be instructed to collect any abandoned materials along their routes, even if it is not in response to a 311 call. Recology has set a goal of responding to service calls within four hours on weekdays and within eight hours on weekends.

Staff concur that the Companies are better positioned to deliver more effective collection of abandoned materials, and find the incremental costs for staffing, vehicles and supplies reasonable. Staff recommend that DPW and the Companies agree upon a mechanism using 311 call center data for tracking the Companies' actual response time, service levels, and amount of materials collected to evaluate the effectiveness of the program. Staff also encourages the Companies to continue to evaluate alternative program configurations that could increase service levels in each zone or reduce response time within the same level of resources, including development of strategies to move more materials into the Bulky Item Recycling program.

Staff also recommends establishing incentives to ensure that the Companies meet their response time goals. DPW staff proposes that beginning in RY16, the following offset would be applied to the cost-of-living adjustment if the Companies fail to meet the response time goals:

Percent of calls meeting response time standard	**Offset**
> 90%	None
> 85% ≤ 90%	$150,000
> 80% ≤ 85%	$200,000
≥ 75% ≤ 80%	$250,000
< 75%	$300,000

The maximum potential offset ($300,000) is equal to 10% of the Companies' estimated cost for collection of abandoned materials, less the disposal charge and operating ratio (Exh. 41). Response time performance will be collected through the City's 311 call center and database. The Companies would forfeit the maximum offset if they fail to meet the response time goals for fewer than 75% of the 311 calls in the preceding year. The Companies' response time for the one-year period beginning April 1, 2014, would be used to determine the offset (if any) applied to the RY16 rates.

8.9 Public Litter Cans

Staff questioned the RY14 "City Cans Allocation" in RSF Sch. E, p. 3, of both the draft and final applications. The tons were reduced from 28,752 in the draft to 21,008 in the final. At the request of staff, the Companies conducted an audit and found the total number of public litter cans to be 3,222. As a result, at the April 24 hearing, Mr. Quillen stated that the Public Litter Can allocation should be reduced to 20,517 tons in RY13 and 19,365 tons in RY14, and Fantastic 3 Trash increased correspondingly to 158,980 tons in RY14 (Tr. p. 581). These changes result in a slight decrease in the tip fee due to the increase in the projected tons which will receive revenue.

8.10 Composting Tip Fee

Exhibit 1, RSF Sch. C, p. 8, states that the processing fees for compostables are based on tipping fees charged by the compost facilities used by RSF, including Recology Grover and Jepsen Prairie Organics (Recology Organics Facilities), and that these fees are set at market rates. Exhibit 1, RSF Sch. J.1, shows the Transfer Station Compostables tipping rate of $48.64 per ton.

The Companies provided a study (Exh. 45) of available food scraps composting facility sites in the Bay Area, their capacity and tipping fees, to support this rate. The sources cited for the food scrap tipping fees shown in the study are "personal communication," except for one rate based on a proposal submitted in 2008. This study does not show any rates for the Recology Organics Facilities, or for other facilities stating that those rates would be "negotiated on a case-by-case basis." Staff does not consider this study to demonstrate that the proposed compostables rate per ton is a market rate.

The Companies then provided, as requested by staff, rates per ton that Recology Organics Facilities charge customers based on the percentages of food scraps (Exh. 57). "Customers with a large percentage of food waste" are charged $45.00 to $50.20 per ton, which is the highest cost range for all types of customers and includes "San Francisco plus 6 other customers" for a total of 189,000 tons per year. San Francisco represents 156,060 tons per year of compostables to be charged $48.64 per ton (RSF Sch. J.1) or 83% of this customer category tonnage.

Staff agrees that compostables with a "large percentage of food waste" require more processing and therefore produce greater costs, than material with a "small to modest percentage of food waste." However, staff does not believe that there is an overall diseconomy of scale, as described by Mr. Yamamoto at the April 24 hearing (Tr. pp. 516-522), for processing the much greater quantities of material from the Companies than from other customers in the same category of "large percentage of food waste." The Companies have not provided a detailed explanation of their diseconomy of scale premise or documentation to support it. Much of the infrastructure and operations used or needed by the Recology Organics Facilities has a large fixed cost component that does not continually increase with processing growing quantities of similar material. Staff believes there are cost efficiencies that can be gained in processing larger quantities. Lowering fixed costs per ton for processing increasing quantities of similar material is standard in composting and related industries.

Therefore, staff recommends that San Francisco, being the largest Recology Organics Facilities customer and representing 83% of the "customers with a large percentage of food waste," receive the most competitive rate in that customer category of $45 per ton. This reduction would reduce the processing expense for compostables in RSF Schedule J.1 by $568,081, from $7,590,781 to $7,022,700.

Staff accepts that the compost prices in Exhibit 61 are for the landscaping market and not the agricultural market where the large majority of food scraps based compost is sold at lower prices (Tr. pp.503-504). Staff accepts that revenues from the sale of finished compost products are about 10% of total composting facility revenues and thereby, only offset a small portion, such as 10%, of total composting facility expenses (Tr. p. 347). Staff accepts that the composting tip fees incorporate, on an annual basis, compost product sales revenue, which helps keep fees lower and more competitive while also reflecting the marketplace (Tr. p. 349).

8.11 Trash Processing

Staff estimates that on average half of the materials in the residential and commercial trash bins are compostable or recyclable. Staff believes that to continue making progress toward zero waste it is crucial that the Companies continue their testing and experience with processing trash to recover compostable and recyclable material, while also increasing landfill diversion with these efforts. Staff is encouraged by the progress the Companies have made in testing low temperature mechanical/biological processing technologies to separate compostable (or digestible) materials from trash and the resulting benefits of anaerobic digestion of this material by the East Bay Municipal Utility District (EBMUD) to produce a truly renewable source of energy. Staff has evaluated the Companies' proposed trash processing as described in Exhibit 1, Narrative Summary, p.7, and RSF Schedule C, p. 3. Staff finds the costs of the proposed trash processing equipment (RSF Sch. H.2), staffing (RSF Sch. G.1, part of Transfer Station) and outside processing for recovered compostables (RSF K.1) to be reasonable. Staff supports this project as a critical next step toward developing a future integrated zero waste facility.

8.12 Leases

Staff asked the Companies to change the lease terms for all stationary equipment (Exh. 1, RSF Sch. H.2) from 7 to 10 years to match the assumptions in Exhibit 1, RSF Schedule C, p. 10. Mr. Braslaw confirmed at the April 24 hearing (Tr. pp. 578-580) that the Companies agree to change these lease terms. Staff recommends this change be made in RSF Schedule H.2 for the operating equipment on lines 28

(Automate ph neutralization for Compostables Annex run-off) through 33, 35-36, 38-39 and 44-46. Staff calculates that these changes reduce total operating equipment expenses by $237,700, from $1,408,455 to $1,170,755.

DPW's certified public accountant, an independent auditor engaged by the City, analyzed equipment lease costs for reasonableness (Exh. 70). The consultant found that lease rates charged by Recology's leasing subsidiary, an affiliated company, were at market interest rates. The consultant also found that monthly lease payments were appropriate and recommended no further adjustments to lease expenses.

8.13 CNG Vehicles Fuel and Facility Upgrade

The Companies propose continuing to replace existing biodiesel collection vehicles with compressed natural gas (CNG) vehicles. Exhibit 1, RSS/RGG Schedule L.3, indicates that the Companies purchased 40 CNG collection vehicles in RY12 and intend to purchase 28 more in RY13. The Companies have not sufficiently demonstrated that they have actually made any of the purchases.

The California Energy Commission's (CEC) Program Opportunity Notice 11-603 offers a rebate of up to $32,000 per CNG vehicle. The program started in February 2012 and is scheduled to run until April 2014. The Companies have not documented how many rebates, if any, they have received under this program. Staff recommends the Companies document any CEC funds received or secured for trucks to be purchased in RY13 and their efforts to access CEC funds for trucks to be purchased in RY14.

CNG fuel use by the Companies has risen from RY12 and RY13. The Companies have fueled their CNG collection trucks at nearby commercial stations during RY12 and 13, paying rates of $2.27-2.32/gallon. In March 2013, RSS began operating a CNG fueling station in its yard. It is a temporary fixed system taking natural gas directly from PG&E through the existing gas line on site.

This gas, already partially compressed, is purchased at $.74 per gasoline gallon equivalent (GGE) (Exh. 71 PG&E Gas Schedule G-NGV1). The system converts PG&E pipeline gas to vehicle fuel using a compressor rented from Clean Energy for $11,000/month. The cost of electricity used to run the compressor adds $0.03/ GGE. The effective price for fuel delivered in this way is then $1.01/GGE. Staff recommends reducing RY14 CNG/Natural Gas price per gallon from $2.37 to $1.01 to reflect the shift to the new fueling system and reducing total CNG expense from $1,278,602 to $544,869 in Exhibit 1, RSS/RGG Schedule L.3.

Exhibit 1, RSS/RGG Schedule H.3 shows RY13 Facility Upgrade-Maintaining/Servicing CNG Powered Equipment costs of $778,817. This amount is for facility upgrades at both RGG and RSS to service specific aspects of CNG vehicles indoors. Staff understands that neither upgrade has been completed yet. Staff recommends that the improvements at RSS be completed in RY13. The Companies are fueling the CNG vehicles at RSS and should perform this specific maintenance there as well. The improvements at RGG, however, should be delayed until a larger portion of its fleet is converted; currently less than 10% of RGG's fleet is CNG. This change would reduce RY13 costs by $283,097 and RY14 depreciation by $18,873.

8.14 Licenses and Permits

In Exhibit 1, RSF Schedule L.2, the stated expenses for General & Administrative Licenses & Permits are $14,865 in RY13 and $15,192 in RY14. At the April 24 hearing, Mr. Braslaw stated that a one-time RY12 expense of $12,000 was incorrectly carried into RY13 and RY14 (Tr. pp. 580-581). After subtracting this amount and applying the inflation rates, staff recommends allowing expenses of $2,625 in RY13 and $2,682 in RY14, for a savings of $12,510 in RY14.

8.15 Management Fees

Recology's draft Application included a corporate inflation factor of 3.7%, which was reduced to 3.4% through the draft Application review process. At that time, staff recommended the inflation factor be further reduced to 3.2% to reflect a 2.2% projected increase in payroll and payroll taxes for RY14 versus Recology's 2.8% projected increase. The 2.2% projected increase recommended by staff is based on the State's 2014 projection of the change in the San Francisco-San Jose-Oakland CPI, which is the benchmark used for calculating indexed adjustments to labor and payroll expenses. Staff recommends setting the Corporate inflation factor to 3.2% versus the Company's 3.4% figure.

DPW's certified public accountant analyzed allocated Recology corporate costs to assess the appropriateness and reasonableness of allocated corporate charges (Exh. 70). The consultant analyzed the following allocated corporate costs in Exh 1, Sch. D all companies:

- Corporate Administration
- Human Resources
- Finance
- Information Technology
- Environmental Compliance
- Sustainability

Based on this review, the consultant determined that certain Recology corporate costs were improperly allocated to the Companies and therefore recommended a reduction in Recology's allocated cost basis of $98,151. When allocated to the San Francisco companies, which have an allocation factor of 37.6%, this results in a reduction of $36,905 to management expenses. Staff concurs with this recommended adjustment.

8.16 Brisbane Tax

The Companies include a new Brisbane recycling fee of $2.1 million for RY14 (RSF Sch. L.2 Licenses & Permits). At the April 15 hearing (Tr. pp. 13-17), the Companies confirmed that this is the business license tax on large recycling establishments adopted by the Brisbane voters in 2011 and City Council in 2012 (Exhs. 31-32). The Companies believe there is no way to avoid this tax and still provide San Francisco with current and expanded levels of service at the transfer station (located on property that borders both San Francisco and Brisbane). The Companies also verified the tax is treated as an operating ratio expense in the application (Tr. pp. 48-49). There is little risk that the Brisbane voters or City Council will modify this tax and it has a built in Consumer Price Index adjustment. While staff agrees that the tax appears to be unavoidable, nevertheless it should be treated as a pass-through cost, as are other business license fees and taxes imposed by other counties (primarily in Alameda), and moved to RSF Schedule F.2 and adjusted annually via the Cost of Living Adjustment mechanism.

9. Adjustments in Future Rate Years

The Application includes several mechanisms for adjusting rates in future years. These adjustments would be utilized until there is a new application and rate proceeding.

9.1 Cost-of-Living Adjustment Mechanism

The City and the Companies established the current Cost of Living Adjustment (COLA) mechanism as part of the last rate application process to allow recovery of cost increases due to inflation. That mechanism incorporates a weighted COLA formula tied to either known (fixed) cost increases, or published indices such as the Consumer Price Index (CPI), the Producer Price Index (PPI), and a fuel index. The Companies have proposed two modifications to the current COLA mechanism:

- Changing the labor component to adjust labor rates consistent with the labor rate adjustments specified in the current labor agreements; and
- Segregating Health & Welfare costs from the labor component into a separate component to be escalated annually based on a five-year weighted average of cost increases as calculated by the Companies' health insurance carrier (Mercer).

Staff recommends the following changes to the COLA mechanism as proposed by the Companies, which are shown in Exh. 72.

- **Variable Labor COLA Rate** – Apply the Variable Labor COLA Rate (i.e., the change in the CPI) to:
    - Corporate Services Expense (Corporate Accounting, Corporate Management, Human Resources, IT Services and Sustainability), similar to the handling of Professional Fees, with a maximum annual increase of 5% and a floor of 0%;
    - The Labor portion of Freight Charges; and
    - Liability Insurance (currently tied to Fixed COLA).
- **Variable Materials PPI Rate** – Replace the PPI with a CPI adjustment factor. In many cases, line item expenses that are tied to the PPI in the COLA Adjustment Mechanism were adjusted in the Final Rate Application by the CPI (e.g., Bad Debt, Building and Facility Repair, Freight, OS Billing Services, OS Disposal, O/S Equipment Rental, Office, Parts etc.); staff feels that using the CPI to adjust these expenses is appropriate and consistent with the basis for the RY13 and RY14 projections.
- **Fuel Forecasted Rate** – Use the following two indices to adjust fuel prices:
    - CNG Fuel Pricing Index = The CNG Fuel Pricing Index, published by Pacific Gas and Electric Company Analysis and Rate Department, Series G-NGV1.
    - Biodiesel Fuel Pricing Index = California No. 2 Diesel Ultra Low Sulfur Fuel (0-15 ppm) Retail Prices (Dollars per Gallon), compiled and published by the U.S. Energy Information Administration.
- **Fixed Cost Factors** – Treat following expenses as fixed costs with no annual adjustment:
    - Bridge Tolls; and
    - O/S Disposal - Approximately 18% of RSF O/S Disposal related to non-Base Rate fees, with the remainder tied to the CPI.
- **Other** – Set Pension expense to projected increases (annual average increase of 0.31% for RSS/RGG and 1.25% for RSF for RY15 and RY16)

The table below summarizes the factors, index or source, and the weighted value of each factor (based on values in the final Application).

COLA Factor	Source/Index	Weight
Fixed Labor	As per CBAs	41.91%
Variable Labor COLA Rate	SF-CPI (U)	26.36%
Variable H &W Rate	Mercer Analysis	11.75%
Biodiesel Fuel	Weekly California No. 2 Diesel Retail Prices	3.04%
CNG Fuel	PG&E Series G-NGV1	0.76%
Capital Cost Inflation Factor	No Inflation	9.03%
Pension	Weighted Pension Increase Towers Watson	7.15%

Under both the Companies' and staff's proposed adjustment mechanisms, where the Fixed Labor Inflation Factor is tied to the negotiated labor rates in the collective bargaining agreements and the Variable H&W Rate is tied to costs increases as calculated by Recology's insurance carrier, there is no direct incentive for Recology to aggressively negotiate and limit increases in labor and health benefits to the benefit of the City's ratepayers. If an appropriate industry index, such as the Employer Costs for Employee Compensation (ECEC); Private Industry, All workers, Health Insurance CMU2150000000000D, CMU2150000000000P were used, the Companies would be more likely to negotiate health care benefits that are more in line with the industry and the City. As such, staff recommends that the COLA mechanism be reviewed and modified, as appropriate, in the next rate review process.

9.2 Zero Waste Incentives

The Companies propose evolved zero waste incentives based only on landfill tons. The Companies propose tier 1 be RSF Schedule E, p. 6, RY14 353,267 Total Disposal tons plus RSF Schedule E, p. 3, RY14 13,050 Sunset Tunnel & Beatty Trash Diverted tons. They propose tier 4 be the straight line amounts from tier 1 to a 90% reduction in those tons by 2020. Tiers 2 and 3 would be equidistant between tiers 1 and 4. They also suggest that when zero waste incentives are not achieved, the Companies be allowed to propose to utilize those funds for new diversion programs, subject to SFE and DPW approval (Exh. 1, Narrative Summary, pp. 12-13, Tr. pp. 81-88). Exhibit 50 shows the tons for each tier by rate year as proposed by the Companies.

Staff supports most of the methodology proposed by the Companies. As San Francisco has exceeded its goal of 75% landfill diversion and is now focused on meeting its goal of zero waste to landfill (or incineration), staff supports zero waste incentives based solely on actual tons landfilled. But staff feels that, as with past diversion incentives, the first tier should just be RSF Schedule E, p. 6, 353,267 Total Disposal tons. This is not a large decrease from RY13 disposal which is projected to be 367,396 tons. The 13,050 tons that are projected to be diverted from new trash processing should not be added and the operating ratio expenses included in the rate application sufficiently compensate the Companies for any risk associated with this project. With this staff adjustment, the zero waste incentives would be as follows:

Rate Year	Disposal Tonnages			
	Tier 1	**Tier 2**	**Tier 3**	**Tier 4**
2014	353,267	342,418	331,569	320,721
2015	353,267	331,569	309,872	288,174
2016	353,267	320,721	288,174	255,628
2017	353,267	309,872	266,476	223,081
2018	353,267	299,023	244,779	190,535
2019	353,267	288,174	223,081	157,988
2020	353,267	277,325	201,383	125,442
2021	353,267	266,476	179,686	92,895

Staff agrees that as landfilling decreases and additional reductions are harder to achieve, a more flexible new diversion program funding mechanism is desirable. But this must be balanced with zero waste incentives that truly are stretch performance incentives subject to some loss if not attained. Staff thus recommends that the first two tiers not be eligible for reinvestment. If not achieved, they should be rebated to the ratepayers as in the past. The second two tiers are more challenging and can be used to continue driving ambitious new programs, especially if the first two tiers are not realized.

Staff recommends that if tiers 3 or 4 are not achieved, the Companies be allowed to propose to utilize those funds for new diversion programs. At the completion of a rate year, in conjunction with their letter to the Director to withdraw funds from the incentive account for any tiers achieved, they can request funds not to exceed the tiers 3 and 4 amounts not achieved. The proposal shall include a description of the diversion project, a detailed budget and timeline, and the annual landfill tons to be reduced. SFE will evaluate if the proposal should be funded or not. If recommended, DPW may grant approval or reject the proposal and rebate the funds to ratepayer in the normal fashion when a tier is not achieved.

9.3 Toxics Collection Incentives

Commonly generated household hazardous wastes such as spent batteries, fluorescent lamps and unwanted paint may not be disposed of in the landfill. The City has worked with the Companies to introduce safe and convenient collection and recycling options for these wastes. Staff wants to increase capture of these wastes through the introduction of toxics collection incentives. Funds for incentives will be provided by manufacturers of these products and not by San Francisco rate payers. Below are details on how the incentive program will operate:

- Source of the Incentive: As mentioned by the Companies in the rate application, the City is in the process of establishing an Extended Producer Responsibility (EPR) Fund to deposit monies received from manufacturers for the collection and recycling (or safe disposal) of their hazardous and perhaps non hazardous products at the end of their useful life. Examples include hazardous waste products such as paint and batteries, and non-hazardous waste products such as packaging and carpet. The City intends to utilize the EPR Fund to provide incentives to the Companies for reaching capture rate or diversion tonnage targets established by the City. The City is currently in negotiations with PaintCare, a product stewardship organization set up by architectural paint manufacturers, and will deposit monies received from Paint Care into the EPR Fund once an agreement is reached. The City is requesting that PaintCare provide reimbursement to cover approximately $450,000 of expenses for collecting, processing, and, recycling or safely disposing of architectural paint on an annual basis. This amount is expected to vary every year based on collection volumes. And, PaintCare may not agree to provide reimbursement for the full amount requested. The contract with PaintCare is still being negotiated and is expected to be in place by summer 2013. The monies will be received on a quarterly basis after the contract is established. The proposed incentive program is contingent upon agreements reached with manufacturers or product stewardship organizations such as PaintCare. If, for whatever reason, the City does not receive monies from manufacturers or product stewardship organizations, including, but not limited to, PaintCare, the Companies will not be eligible for the toxics incentive described in the rate application. In no event will the amount of the incentive exceed the monies received by the City from manufacturers or product stewardship organizations.

- Accrual of Funds: If the Companies fail to meet either of the tier 1 or tier 2 targets proposed by the Companies and supported by staff (Exh.1, Narrative Summary, p.13), the Companies may propose programs to utilize the funds subject to recommendation by SFE and approval by DPW. The EPR Fund will continue to accrue monies if:
    - The Companies fail to meet targets and do not propose any program to the City; or
    - The City rejects proposals made by the Companies.

  Monies accumulated in the EPR Fund and not utilized by the City for new programs will be rebated to the rate payers during annual rate adjustments or the next rate process.

- Incentive Period: The rate application includes annual targets and corresponding incentives for only for RY14-RY16 and only for three material categories. If a new rate process is not initiated within the three-year period, SFE will propose, subject to DPW approval, additional targets beyond RY16 for the three current material categories and possibly the addition of more material categories to the EPR Fund.

10. Impound Account

The Impound Account is used for a number of pass-through costs on which the Companies are not allowed to make a profit. Historically, these costs include Altamont Disposal Fees (Contract Fees, Incremental Local Enforcement Agency Fee, Open Space Fees and the Annual WDR Fee), fees paid to the Waste Management Authority of Alameda County, Business Tax License fees and funding for City programs that support recycling and other programs relating to and benefiting ratepayers. The proposed funding for the Impound Account includes fixed and variable deposits. The payments for disposal fees, regulatory costs paid to Alameda County and the business tax license fees are based on tons delivered to the Altamont landfill, while the funds for City programs are fixed based on City departments' anticipated costs over the rate period. The actual expenditure of any monies in the Impound Account for City costs is subject to the City's annual budgeting process.

Two of the six per-ton disposal-related fees collected through the Impound Account increase; the other four remain identical to the prior rate period. The two that increase are the fee paid to the Waste Management Authority of Alameda County and the Open Space Fee. Both of these fees increase due to agreed-upon adjustments for inflation.

The Companies have included $17,847,164 for deposit into the Impound Account in RY14 (Exh. 1, RSF Sch. F.2). Of this amount, $3,232,765 is for the various disposal fees and business taxes, $8,893,753 is for SFE and $5,720,646 is for DPW. Monies for the Impound Account are collected from both residential and commercial customers.

10.1 Department of the Environment

SFE's costs include expenditures for zero waste, toxics reduction, green building, environmental justice, and long term planning for disposal capacity, diversion and regulatory requirements (Exh. 12). Funding is also included for SFE to prepare for and participate in future rate proceedings.

The amount requested for SFE from the Impound Account is based on using the last approved amount through the Refuse Rate process as a baseline and increasing it by the Bay Area Consumer Price Index.

10.2 Department of Public Works

For DPW, the $5,720,646 in funding is broken down as follows:

- $3,880,646 for existing programs to remove refuse from City streets and public properties (including mechanical street sweeping, litter patrol and block sweeping);
- $967,000 to expand the Education, Compliance and Outreach program to combat illegal dumping;
- $840,000 to replace public litter cans; and
- $33,000 for staff costs for the future rate review process.

The $3.88 million for existing programs represents less than 19 percent of DPW's annual expenditures for refuse-related services (Exh. 13). When Recology begins collecting abandoned materials (as described in Section 8.8 of this report), DPW will reassign staff to increase the service levels in other program areas, which are understaffed and not meeting the Department's service standards.

10.3 Combined City Departments

The total proposed funding for the City from the Impound Account amounts to 5% of the total operating costs of the collection companies (RSS/RGG). A 2011 study conducted by the San Francisco Local Agency Formation Commission determined that San Francisco ranked 10th in a survey of 14 Bay Area cities in fees and services provided to the City (Exh. 42). According to the study, the proportion of City costs included in refuse rates ranged from 7% to more than 30%; the City of Oakland receives more than $23 million annually and San Jose receives more than $9 million from their service providers.

Because expenditure of amounts included for City departments in the Impound Account is subject to the City's annual budget process, which entails a public process and is subject to the approval of the Board of Supervisors and Mayor, neither the Director nor the Rate Board has final authority over the actual expenditure of these monies. Accordingly, this report concludes only that the total amounts requested by the Companies to fund the Impound Account are just and reasonable and are recommended with the above adjustments. If City department use of these funds as specified in this rate adjustment process is not approved through the regular City budget process, the decision-makers must recommend other appropriate uses of the monies consistent with this report.

Staff recommends that the Director's order include instructions to the Companies that the amounts specified for City departments be guaranteed, and deposits to the Impound Account will not be affected by the Companies' actual revenues or financial performance. The funding levels for City departments will be adjusted annually by the COLA mechanism until the next rate proceeding.

10.4 Revised Allocation Methodology

Staff notes that the Companies have proposed changing how funds deposited in the Impound Account are allocated to the respective collection and processing companies. In past rate applications, the entire value of the Impound Account was allocated to Recology San Francisco, and was factored into the tipping fee. The Companies now propose to allocate only the various disposal fees and business taxes paid to other agencies to Recology San Francisco. Those amounts collected for the City departments would be allocated to the collection companies and reflected in the collection fees charged to residential and commercial customers.

Staff agrees with the revised allocation methodology. It is important to note that the revised methodology has no impact on residential rates; the same amount of costs are being included in the rate application, and no operating ratio is applied, regardless of how the Impound Account costs are allocated.

11. Special Reserve Fund

The 1988 Facilitation Agreement between the City and Sanitary Fill Company (now Recology San Francisco) established a requirement to create a reserve fund to be drawn upon from time to time to pay for "extraordinary expenses" which were not fully covered by the currently effective rates. This Special Reserve Fund was not to take the place of normal ratemaking processes, but to protect the Companies from major fluctuations in the rates for extraordinary expenditures that were not anticipated during the ratemaking process. The Facilitation Agreement requires a minimum balance of $15 million to be maintained through the term of the Agreement. The Facilitation Agreement will expire concurrent with the expiration of the Waste Disposal Agreement between the City, Recology San Francisco and the Oakland Scavenger Company (now Waste Management of Alameda County). That agreement is not anticipated to expire until January 2016, and may expire at a later date, depending on the amount of waste landfilled (Exh. 56).

The Special Reserve Fund has been funded by a 1.3% surcharge on the Companies' volumetric billings to residents and commercial customers. Recology does not apply a cost-of-living-adjustment (COLA) or make a profit on monies collected for this account. Prior rate orders established this fund and set forth procedures for maintaining and making expenditures from this fund. Deposits into the Special Reserve Fund were suspended as of October 1, 2010. As of that date, the 1.3% surcharge on billings was re-allocated to the Impound Account for the use of DPW to offset the costs of removing refuse from City streets and properties, and for programs to prevent littering and illegal dumping.

There have only been a limited number of withdrawals from the Special Reserve Fund since its creation. A total of $5,517,390 has been withdrawn from the account since 1988, primarily to pay for improvements at the Altamont landfill required by new environmental regulations. The account balance was $29,529,003 as of April 30, 2013 and is growing at a rate of about $160,000 a year due to accrued interest. The Companies have proposed discontinuing the 1.3% surcharge, consistent with prior Rate Board directions. Staff concurs with this action.

Staff believes that San Francisco is well protected by the reserve and that a $15 million reserve would be sufficient to cover unanticipated costs, especially given previous investments in the Altamont landfill to maintain compliance with environmental regulations. Staff reports that San Francisco is unique in having such a large reserve for unforeseen expenses. According to SFE's survey of ten of the largest cities and counties in the state in 2006, none maintained such a large reserve. The largest reserve was maintained by the City of San Jose, which had a reserve of between $6 and $7 million.

Upon expiration of the Facilitation Agreement, funds will remain in the Special Reserve Fund for up to five years, or until the Rate Board determines whether there is any continuing need for the fund. At that time, the Rate Board is required to allocate the remaining funds for the benefit of the then current and future residential ratepayers and commercial accounts of the Companies.

12. Contingent Schedules

The Companies application includes two contingent schedules, with rate adjustments to go into effect when certain conditions are met.

12.1 Zero Waste Facility Expansion

Staff agrees that to provide the infrastructure necessary for achieving zero waste will require an expansion of the Companies' Tunnel and Beatty site and facilities. This expansion will be needed to allow more advanced, integrated and increased processing of recyclables, compostables and trash. Staff has evaluated alternative siting options for a zero waste facility, including commissioning Zero Waste Facility Siting and Zero Waste Facility Transportation studies in 2011 that concluded expansion of the Tunnel and Beatty site into Brisbane was preferable to other site alternatives in San Francisco. Staff agrees that expansion of the Tunnel and Beatty site is the best option for a future integrated zero waste facility. Staff is supportive of purchasing additional adjacent land in Brisbane to meet the space requirements of a zero waste facility.

Despite staff's support of the Brisbane land acquisition, we do not believe enough is known, or can be known, about the actual terms of the proposed acquisition at this time to justify approval of the contingent rate schedule. To begin with, the Companies don't know exactly how many of the targeted parcels will be acquired, or what the ultimate cost of the acquisition will be (Tr. pp. 164-168). The land appraisal that the Companies submitted (Exh. 27) was for a set of parcels much larger than those being sought by the Companies. But the Companies did not submit any evidence showing whether the portions of the parcels that the Companies are seeking would appraise at the amount stated in the exhibit, or at an amount above or below that per square foot average. Mr. Glaub, Manager of Group Finance and Administration for the Companies, conceded that some of the parcels may sell for an amount greater than the appraisal's stated value (Tr. p. 168).

In addition to the yet-to-be-determined price, the terms of financing for the acquisition are also unknown. The Companies stated that they have not determined how they would fund the property acquisition, either through a bank loan or other form of financing, or through shareholders equity. Furthermore, they testified that they don't know what the terms of the financing (such as down payment, interest rate, return to investors, etc.) would be (Tr. p. 183).

Instead of basing their revenue needs for the proposed acquisition on actual costs, the Companies propose recovering their carrying costs for the property by applying a Weighted Average Cost of Capital (WACC) of 8.25% to the property acquisition price (Exh. 27, p. 1). WACC is calculated through a formula composed of a firm's cost of equity, cost of debt, the market value of the firm's debt and equity, and the percentage of the firm's financing that is debt and the percentage that is equity. The Companies did not present any of these values for RSF, the regulated entity that proposes to purchase the property, or for the corporate entity as a whole. Instead, the Companies calculated their WACC through a convoluted set of averages of and adjustments to the WACC's of three other firms in the refuse industry (Exh. 22, p.104, Tr. p. 558). The Companies also propose that this annual carrying cost be subject to the operating ratio (that is, they would also earn profit on that amount). Under the proposal, the contingent schedule would remain in effect until the Companies complete development of a zero waste facility, but not longer than fifteen years.

It is staff's view that Contingent Rate Schedule 1, and the Companies' proposed approach to recovering the cost of land acquisition in the rates, have too many contingencies and unknowns. The rate setting process is based on an examination of actual or reasonably projected costs in a public process. Too many of the costs and terms of the proposed property acquisition are unknown at this time to allow for the full public review and staff analysis required to justify a rate adjustment. The use of a weighted cost of capital formula will be unnecessary once the property is purchased, because at that time the details of the financing used by the Companies to buy each of the properties will be known, including the details of any bank debt or other loans and the amount of shareholders equity, if any, used to buy each property. (Tr. pp. 185-186).

Staff expects that the Companies will need to submit a new rate application within two years to account for costs associated with new contracts for transportation and disposal at a new landfill (when the Altamont contract capacity is reached). Therefore, staff recommends that the Companies include costs for the land acquisition as part of that rate application. At that point, the Companies and the City will have the benefit of more extensive and concrete information regarding the terms of the property acquisition and will be better able to address the Companies' costs while also minimizing the financial burden on rate payers. In the meantime, staff recommends that the Companies engage with the City in investigating the possibility of having the City purchase the land on behalf of the rate payers. Under such a scheme, the Companies would not bear any carrying costs for the land purchase, and the rate payers would not be required to pay property financing or rental costs. It is possible that part of the balance in the Special Reserve Fund under the Facilitation Agreement may be used for this purpose if all parties were able to reach agreement on the arrangement.

12.2 West Wing Project

Staff believes new technologies are needed to process the entire trash stream for maximum recovery of compostable and recyclable material in order for San Francisco to achieve zero waste. Staff also believes that technologies need to be demonstrated at an adequate scale before they can be incorporated into the design and development of a future integrated zero waste facility. Staff agrees with the Companies that their Tunnel and Beatty site is very space-constrained and therefore not currently adequate for testing and developing these technologies. Staff evaluated the Companies' proposed Contingent Schedule 2 - West Wing Project as a near-term facility-expansion opportunity to provide the building space for this technology development.

As part of the review of the draft application, staff expressed concern at the amount of the proposed Contingent Sch. 2 costs, including $10 million in construction costs for a 20,000 square foot building with $500,000 annual depreciation. Staff asked the Companies to provide a detailed construction estimate for the building, as well as a plan on how the proposed equipment and labor would be utilized. In the final Application, the Companies proposed a scaled-down 13,000 square foot West Wing building at a $6.6 million construction cost, with $330,000 annual depreciation, and removed all previously proposed equipment and labor expenses, thus reducing total operating ratio expenses from $2,922,746 to $330,000. The Companies provided conceptual design drawings and construction cost estimates (Exhs. 29 and 30) for the revised West Wing. Staff evaluated the conceptual design and construction cost estimates and concur that the Contingent Schedule 2 costs now are reasonable. Staff supports this project as a critical near-term opportunity to advance the City toward zero waste.

13. Compliance with California Environmental Quality Act

The Environmental Planning Division of the San Francisco Planning Department has evaluated the Companies' rate application under the requirements of the California Environmental Quality Act (CEQA). The Environmental Planning Division has determined that the actions contemplated in the application are statutorily exempt under California Public Resources Code Section 21080(b)(8) and State CEQA Guidelines §15273 (Exh. 73).

Staff proposes the following related findings, required by Public Resources Code Section 21080(b)(8) and State CEQA Guidelines Section 15273, be reflected in the Director's Report and Recommended Order:

(1) Planning has determined that the application is statutorily exempt from environmental review under California Public Resources Code Section 21080(b)(8), which provides that CEQA does not apply to the establishment, modification, structuring, restructuring or approval of certain rates, tolls, fares and charges by public agencies.

(2) The purpose of the Application is to (a) meet operating expenses, including employee wage rates and fringe benefits, (b) purchase or lease supplies, equipment, or materials, (c) meet financial reserve needs and requirements, and, (d) obtain funds for capital projects necessary to maintain service within existing service areas.

(3) The Companies have proposed and the City has approved rates needed for the Companies to "[meet] operating expenses, including employee wage rates and fringe benefits," as provided in the Application and the supporting schedules.

(4) The Companies have proposed and the City has approved rates needed for the Companies to "[purchase] or [lease] supplies, equipment, or materials," to support their refuse collection and disposal activities in the City, as provided in the Application and the supporting schedules.

(5) The Companies have proposed and the City has approved rates needed for the Companies to "meet financial reserve needs and requirements," as provided in the Application and the supporting schedules.

(6) The Companies have proposed and the City has approved rates needed for the Companies to "obtain funds for capital projects necessary to maintain service within existing service areas," as provided in the Application and the supporting schedules.

14. Future Ratemaking Procedures

In 2005, the Director instituted new procedures to improve the rate review process. The rules of procedure for the 2013 Application are consistent with the improvements instituted in 2005, with only modest revisions to provide clarity on the requirements for submission (DPW Order No. 181,252). Among other things, the procedures require the Companies to submit a notice of intent to file a rate application at least 180 days in advance of the application itself. This pre-application period allows for greater review by staff to determine the completeness of the application, and more meaningful participation by the public via workshops.

This year, the Companies are proposing a one-year rate for the rate year beginning July 1, 2013 (RY14), adjusted annually thereafter based on a cost-of-living adjustment formula specified in the application; as noted in Section 9.1 of this report, staff proposes slight modifications to the COLA mechanism. While the proposed rates are anticipated to be in effect for three years (through June 30, 2016 (RY16)), the Companies identified in their application the possible need for a rate adjustment prior to that date to reflect a possible change in the City's landfill agreement. The Companies requested that "a streamlined rate setting procedure be adopted" (Exh. 1, Narrative Summary, p. 15).

Staff agrees with the Companies' request. The first reason for a streamlined rate setting procedure is anticipated changes to the City's landfill disposal arrangements. According to testimony by SFE, San Francisco is likely to reach its contracted capacity for refuse disposal at the Altamont landfill by January, 2016 (Exh. 56), or approximately six months before the Companies would otherwise seek a rate adjustment. According to the historical data, the tons of refuse sent to Altamont have been declining steadily since 2000, so it is possible that the contract capacity of 15 million tons would not be reached until later in 2016. Nevertheless, it is clear that the City will need to replace the Altamont disposal contract in the near future. Any new contract, in turn, is likely to result in new tip fees, which potentially would require an adjustment to the collection and disposal rates.

The second reason for adopting a streamlined rate setting process is the proposed acquisition of additional real property by the Companies for refuse processing. Staff is recommending rejection of Contingent Schedule 1, by which the Companies seek to be reimbursed for the purchase of land to facilitate the future development of additional zero waste infrastructure (see Section 12.1 of this report). Staff agrees that acquisition of the subject property may be necessary, and does not oppose inclusion of the reasonable acquisition costs in the rate base when the actual costs are known. Staff believes better information regarding the property acquisition costs will be available in the same time frame as information regarding new landfill disposal and hauling expenses, and that both issues could be covered in a rate application considered under streamlined procedures.

Staff recommends that the Director adopt procedures that streamline the pre-application period, reducing the current requirement of 180 days to 60-90 days, depending on the number of issues and complexity of the Companies' request. Any future application would still be subject to the 150-day review period specified in the 1932 Refuse Collection and Disposal Ordinance.

Staff also recommends that the Director require the Companies to submit an application in substantially the same format as currently required under the rules of procedure, including updated information regarding actual revenues collected under the new rate structure proposed as part of the current application. Given the changes in both the residential and apartment rate structures (including fixed charges per unit and for recycling and composting bins, and incentives for diverting more materials), the Companies acknowledge that their revenue projections may be affected by changes in service levels, and by the removal of caps on apartment customers' bills in RY15 and RY16. Staff recommends additional reporting on the Companies' actual revenues under the new rate structures to allow monitoring of the effect of these changes on the Companies' revenues (see next section). Based on those reports, staff may also request additional information or schedules be submitted as part of the next rate application.

SFE will continue to track the disposal of materials at the Altamont landfill and refine the estimated remaining life under the terms of the existing contract, based on actual tons. The Companies are encouraged to work with City staff to explore options for acquiring additional land for a future zero waste facility, including those discussed in section 12.1 of this report. These steps will help determine the likely timing of a future rate adjustment, and allow sufficient notice for the Director to issue rules for a streamlined rate setting procedure.

15. Additional Reporting Requirements

In accordance with prior Directors' orders, the Companies submit quarterly and annual reports to the City. These reports include information on the amount of materials landfilled and diverted, commercial recycling and composting accounts, toxics collection, revenues and expenses, the various accounts (the Special Reserve Fund, Impound Account, and Diversion Incentive Account), etc. The City uses this information to monitor the Companies' efforts to achieve diversion and other goals established during the rate proceedings.

Given the proposed changes in the residential rate structure (and in particular the apartment rate structure), the Companies acknowledge that their revenue projections are subject to uncertainty. In response to the rate structure changes, the Companies have assumed that both commercial and apartment customers will change their services, resulting in a reduction in revenues due to migration (Exh. 1, RSS/RGG Schds. B.1-3). The Companies have also assumed that apartment customers will change service levels and/or service configuration to offset any additional revenues that would otherwise be generated by the removal of the 25 percent cap in RY15 and the 50 percent cap in RY16 (Exh. 1, RSS/RGG Sch. C, p. 4). The Companies estimate that if apartment customers do not adjust service levels when the caps are removed, the proposed rates would generate an additional $4.6 million in revenue annually (Exh. 54).

In order to more closely monitor the actual revenues collected by the Companies under the new rates, staff recommends that the quarterly reports be submitted within 60 days of the end of each quarter (currently 90 days), and that actual revenues and expenses be included in the quarterly reports (currently required only annually). In addition, the Companies should include information on the number of apartment customers whose monthly bills are subject to the rate caps, and an assessment of the extent to which apartment customers are modifying their service levels to offset rate increases. Staff recognizes that quarterly revenue and expenditure reports will be unaudited, and that only the annual reports will be reconciled to the Companies' audited financial statements.

To get a better periodic status of commercial accounts, staff recommends replacing the existing Table 4 in the quarterly reports with the following table:

Table 4
Commercial Accounts

Recology Sunset Scavenger & Recology Golden Gate, Combined	**Number of Accounts**	**Percent of Total**
Total Accounts		100%
Trash Compliant		
Recycling Compliant		
Composting Compliant		

Staff also requests changes to quarterly Table 5 to include additional information that will help the City complete its required reports to the state on toxics collection efforts, as follows:

Table 5a
Toxics Collection and Participation
(Rate Year Cumulative)

Program	*Collection Weight*	*Service Standard*	
	Lbs. Handled	Number	Unit
HHW Facility Drop-off			customers served
HHW Home Collection			addresses served
HHW Home Collection	***not tracked***		equivalent loads
Very Small Quantity Generator			businesses served
Residential Curbside Battery Collection		***not tracked***	
Apartment Building Battery Collection			pick-ups
Retail Collection Partners			pick-ups
Gigantic 3 Collection Events			customers served
Waste Acceptance Control Program		***not tracked***	
Bulky Item Recycling - E-Waste			addresses served
Bulky Item Recycling - Non E-Waste			addresses served
Public Drop-Off - E-Waste		***not tracked***	

Finally, staff requests a new table to allow the City to track the Companies' progress toward meeting the toxics incentive collection targets. This table should also be included in the quarterly report:

Table 5b
Toxics Collection Incentives

Toxics Item	**Target (tons)**	**Actual (tons)**
Latex Paint		
Oil-Based Paint		
Paint Distributed for Direct Reuse		
Total Paint		
Household Batteries - Single Use		
Household Batteries - Rechargeable		
Total Household Batteries		
Fluorescent & Other Mercury-Containing Lamps		

16. Response to Comments

Members of the public offered comments on the Application at the DPW workshops, during public comment at the Director's hearings, and through the Ratepayer Advocate (Exh. 64). Staff considered all of the comments received from the public and the Ratepayer Advocate during the course of reviewing the Application; in a number of instances those comments influenced our recommendations. This section responds to specific issues raised by members of the public; similar comments have been combined by topic.

1. The magnitude of the rate increase seems excessive – especially when inflation is only 3%. Rate application should be cost-driven.
   Response – The Companies' Application indicates that of the 21.5% rate adjustment, 16.1% is due to a revenue shortfall caused by migration to diversion service and the economic downturn. Staff has analyzed both the expenses and revenues of the Companies to assure that the rate adjustment is just and reasonable.

2. The fixed charge for recycling and compost bins should be the same, regardless of volume.
   Response – Larger volume bins have higher service costs. Customers can switch to smaller volume bins to reduce charges.

3. Rates should be on a sliding scale to reflect amount of materials picked up.
   Response – Rates are scaled by volume in fixed increments; the bigger the bin, the higher the charge. The technology is not sufficiently advanced to charge based on a true sliding scale bill for actual material by weight or volume.

4. Success of recycling program could result in more income from recycled products.
   Response – More recycling tons and higher commodity prices result in increased recycling revenue. Recycling revenue offsets expenses to set rates.

5. COLA increases should not simply be passed through to ratepayers.
   Response – Staff agrees that the annual cost-of-living-adjustment should be tied to available indices, and is making recommended changes to that effect. Having an adjustment mechanism saves ratepayers the considerable expense of a full rate review process.

6. City should examine the profit/rate of return the Company is allowed to earn.
   Response – In 2006, the City established that the Companies would be allowed to calculate rates based on an operating ratio of 91%. In addition, the City created a diversion incentive program to encourage the Companies to make investments to increase the amount of materials being diverted from landfill; the Companies could earn up to an additional 2% operating ratio. The total potential operating ratio of 89% translates to a profit of 12.36%. The City recently surveyed other jurisdictions and determined that the existing operating ratio is reasonable. There are several items in the rate base upon which the Companies are not allowed to earn profit (e.g., Altamont disposal cost, Alameda fees, Impound Account items); these items are considered pass-through costs, so the Companies' effective profit margin is lower.

7. Management salaries should be examined.
   Response – The City's financial consultants have examined these salaries and not found them to be unreasonable.

8. San Francisco refuse rates are already extremely high.
   Response – The Companies provided a rate survey that shows San Francisco rates are comparable to other Bay Area jurisdictions when taken as a whole (Exh. 35).

9. Recology has a monopoly, a no-bid contract.
   Response – Refuse collection in San Francisco is governed by the 1932 Initiative Ordinance, which specifies an open permit process for collection of refuse and a rate review process to determine that proposed rates are just and reasonable.

10. Enforce laws against recycling theft. Revenues could offset need for rate increase.
Response – DPW and SFE have asked the police department and district attorney to enforce the anti-poaching laws, particularly against people in vehicles, and recently against the newer development of mobile buybacks. But effective enforcement also depends on the actions of judges and local juries. Poaching losses, by their nature, are extremely difficult to estimate. If strong enforcement were to happen and all poaching could be eliminated, the additional gross revenue would only reduce the rate by about 1%. And the cost of such enforcement, and added collection and processing, would offset a significant portion of this revenue.

11. Impound Account funding levels should be guaranteed and included in the Director's order.
Response – Staff agrees and has included a recommendation to that effect in the report.

12. Recology needs the money to pay for billboard advertisements against last year's initiative.
Response –The City's financial consultants reviewed the Companies' financial statements against the rate application to ensure that these items were excluded from allowable expenses in the application.

13. The City should allow e-mail and fax protests, not just written protests, to the proposed rate increase.
Response – All comments, whether by email, fax or through the Ratepayer Advocate, are considered in the rate process. However, for protests under Proposition 218, the City is following the requirements of the State Constitution and the Government Code, which provide for written protests, signed by the person submitting them, and delivered in person or by mail to the hearing officer.

14. Unclear how charges for multiple pickups will be computed.
Response – Weekly service charges are multiplied by the number of collections per week. Monthly fixed charges stay the same regardless of the number of collections per week.

15. How does the transfer of abandoned materials collection and public litter can maintenance benefit the ratepayer? How do Recology's costs compare to the City's costs for these services? What would DPW do with its packer trucks?
Response – Almost all of the abandoned materials on the streets and materials in the public litter containers is generated by ratepayers or tenants or customers of ratepayers. Just as bad debt is included in the rate base, improperly put out refuse is collected using the rate base. The issue of comparative costs was addressed in the hearings where DPW's Manager of Finance, Budget and Performance was cross examined by the Ratepayer Advocate. DPW will repurpose its newer refuse trucks for landscaping and tree maintenance and special projects purposes. Trucks at the end of their useful life will be sold for salvage value.

16. What is the rationale for the fixed charges (per unit, per bin)?
Response – Fixed charges are per dwelling unit or commercial account. Service costs have fixed and variable components.

17. What will the special reserve charge be applied to?
Response – Now that the Special Reserve Fund has reached (and exceeds) its required funding level, the surcharge is being discontinued.

18. The tip fee at transfer station charged by the parent company represents a monopoly rate.
Response – The processing and disposal fee charged by Recology San Francisco for materials brought to the transfer station, including materials delivered by the collection companies (RSS

and RGG), is also subject to review and approval by the Director, and is included in the rate application. All costs are subject to the same level of review by city staff. Staff has recommended a number of adjustments, as described in this report. The processing and disposal amounts charged to the collection companies are considered pass-through costs, so no profit is calculated in determining the residential rates.

19. Contract [rate adjustment] should be for only one year; there is a built-in rate adjustment of 25% in RY14, when residential cap is removed.
    Response – While the Companies are requesting a one-year rate, they have also proposed a mechanism for adjusting rates annually based on a cost-of-living formula. This mechanism has been used successfully in the past. The caps are on apartment, not residential, rates.

20. The Director's report should set a maximum level of funding for DPW programs included in the rate base. DPW activities funded from Impound Account should be enumerated in the Annual Appropriation Ordinance.
    Response – In the 2012 rate proceedings, the Rate Board affirmed the inclusion of DPW solid waste management services in the rate base. The amount included in the current rate application for on-going activities represents approximately 19% of DPW's annual expenditures for refuse-related services (Exhibit 13). While we do not anticipate increasing the amount funded from ratepayers, things could change. Any proposed adjustments would be discussed in public workshops first. DPW's costs are enumerated in the Annual Appropriation Ordinance by program area; funding from the Impound Account is one of several sources for these programs.

21. Revenue derived from fines for trash-related offenses should not go to the City's general fund; DPW should have access to offset enforcement expenses.
    Response – Staff is working on legislation to allow the revenue to be rebated to ratepayers.

22. The Director should hold public hearings on any proposal by the Companies to purchase land for a zero waste or other processing facility.
    Response – The Director will conduct hearings on future rate adjustments that will include any land purchase. There will be other public hearings, such as those required by CEQA, relating to the use of any land purchased.

23. Are there capital costs for improvements at the Companies' composting facilities included in the rate base? If so, what are the details about financing and amortization?
    Response – Other Recology companies are incurring capital costs for improvements at their composting facilities. Financing and amortization details are not needed for analysis as the facilities charge market-based, per ton, tip fees that are included in the rate base.

24. The rate application should include a breakdown of costs by program (e.g., residential recycling). Similarly, revenues should be broken down by source (e.g., composting revenue) and tip fees by stream (e.g., trash).
    Response – Programs are intentionally integrated for efficiencies and typically share collection and processing infrastructure, labor, etc. Overhead and other expense and revenue structures are very complex. It is an extremely time consuming process, involving lots of assumptions and even allocations of allocations, to identify programs and subsectors, then separate and assign costs and revenues, and calculate net costs and tip fees. Specifically, composting revenue offsets composting costs in setting a market-based tip fee. Limited staff and consultant time is better spent evaluating the rate application in other ways to set just and reasonable rates.

25. Companies should advise customers of ways to reduce their trash service (black bin) in order to lower their bills.
    Response – The Companies and SFE frequently advise customers on ways to adjust their service and reduce their bill.

26. What is the nexus between residential ratepayers and the Department of the Environment's zero waste programs?
    Response – SFE receives funding from all ratepayers and allocates its zero waste resources accordingly.

27. Customers will take advantage of the opportunity to reduce their garbage bills by switching to smaller bins, then simply placing refuse on the city streets; what can be done to prevent this?
    Response – Staff believes that the vast majority of ratepayers are good actors and will continue to abide by city regulations and common sense. DPH can cite, place a lien on property for failure to have adequate service. DPW's new Education, Outreach and Compliance program, described elsewhere in this report, will also help ensure everyone has adequate refuse service.

28. Why should I have to pay every week for a black bin I never put out?
    Response – Ratepayers should be commended for generating little trash. Recycling and composting collection and processing, and other programs, have net costs that we are evolving off of trash rates as quickly as possible. Smaller trash bins and minimums are not possible at this time. But we continue to explore options and are testing pay per setout, where you only pay for trash collection when you put your black bin out.

29. Recology is planning to take refuse to a new landfill further from the city (Ostrom Road).
    Response – San Francisco is projected to deplete its contracted capacity at the Altamont landfill around January 2016. The City is securing additional capacity and anticipates another rate process before this capacity is utilized. The City will consider disposal prices in securing the additional capacity.

30. DPW should enumerate how it is spending Impound Account funds.
    Response – DPW's expenditures are detailed in Exhibit 13.

31. Is there an opportunity for residential customers to get black bins of less than 20 gallons?
    Response – Multi-family buildings have a trash minimum of 16-gallons per unit. A 20-gallon bin is the smallest available for single-family. Available collection technology (i.e., trucks and loaders) does not accommodate bins smaller than 20 gallons.

32. Is there a minimum frequency for setting out the black bin under the pay per setout program? This program needs regulations to ensure that customers don't store refuse for extended periods.
    Response – There is no minimum setout frequency if the trash contains no compostables. Compostables must be set out at least weekly.

33. How can San Francisco enforce local hiring commitments made by Recology for the zero waste facility, when it will be located in Brisbane?
    Response – Recology has voluntarily committed to pursue local hiring goals. If the Companies do not make good faith efforts to achieve those goals, the City may follow up as part of future rate proceedings.

34. Have DPW and SFE complied with the provisions of the 2012 Rate Board order to publish certain reports and provide a more robust forum for public engagement?
Response – Yes. DPW has prepared an analysis of the amount of materials collected and diverted by activity (e.g., street sweeping, abandoned materials) and posted the information on DPW's web site. In addition to the Director's hearings, this rate process included two public workshops, which provide a more informal opportunity for members of the public to engage directly with the Companies and City staff.

35. How can the Director of Public Works be an impartial hearing officer for these proceedings, given that funding for his department is included in the rate application?
Response – The Director is required to recommend "just and reasonable" rates under the 1932 Ordinance. The Director follows a carefully constructed public process to reach those recommendations, and that process allows all parties to review and test all evidence presented. The allocation to DPW is less than 2% of the collection rate.

36. Does Recology's assumption of replacing doors and liners on the public litter cans raise a Proposition J concern?
Response – No. The incidental labor that Recology would provide in replacing doors and liners on public litter cans would be done at the initiative of the Companies. The City is not contracting with Recology to perform the work at the City's direction.

37. Recology should track diversion of materials from the public disposal and recycling area and the bulky item collection program and the reuse value of those materials.
Response – Recology does track diversion from the Public Reuse and Recycling Area and Bulky Item Recycling. Reusable materials are provided to nonprofits.

38. Recology's proposed response times for collecting abandoned materials may be too ambitious; some pickups should be scheduled for the next day to improve efficiency.
Response – It is important that abandoned materials be removed from the streets as quickly as possible. Abandoned materials can create a public safety issue and interfere with access to the public right-of-way, especially to disabled or elderly residents. Like graffiti, quick removal of materials reduces the amount of total items placed on the streets.

39. Organization charts for the companies would allow review of supervisory positions, span of control, etc.
Response – Information on staffing levels, including supervisory positions, is provided in the various schedules in Application; organization charts would not add value to the City's review.

40. Would the companies be able to operate more efficiently by combining their two maintenance facilities?
Response – There may be some efficiencies to be gained by combining the two maintenance facilities. There are also some efficiencies from operating vehicles out of two locations. The City will continue to explore overall efficiencies with the Companies.

41. There should have been efficiencies from combining Sunset Scavengers and Golden Gate Disposal customer service representatives; where is this reflected in the application? Why are the companies proposing two new positions?
Response – There have been some efficiencies from combining customer service operations. Staff has requested additional information from the Companies and is recommending one less position.

42. Tonnage from public litter cans appears to be increasing; there should be targeted reduction of public litter cans to reduce the tonnage collected from them.
Response – There is no evidence that public litter can tons are increasing. The Companies conducted an audit recently to estimate tonnage more accurately. The City has reduced the number of public litter cans.

43. The Diversion Incentive Program should be expanded to include materials diverted to reuse and for the percent of recyclable materials sold for actual reprocessing in Northern California.
Response – The Zero Waste Incentives are focused on San Francisco's overall goal of zero waste to landfill. The City works with the Companies to increase reuse (e.g., St. Vincent de Paul at the Public Reuse and Recycling Area) and local markets for materials (e.g., most plastic end markets are now in Northern California).

44. The city should pay $3 for every mattress brought to the transfer station.
Response – Mattress deposits are a good idea to maximize recovery, but deposit systems are extremely challenging to administer at the local level. Instead, the City is supporting an effective state mattress producer responsibility bill that has a good chance of being chaptered this year.

45. The San Francisco Housing Authority is seeking relief for its low-income residents, and requests eligibility for the lifeline rate.
Response – Staff is examining this issue and plans to discuss it in public hearings in May.

ATTACHMENT A

LIST OF HEARING EXHIBITS

4/12/2013

1.	Final Rate Application	Recology
2.	Post-Filing Changes	Recology
3.	Narrative Summary	Recology
4.	Schedule B-1	Recology
5.	Components of Rate Increase	Recology
6.	Revenues: Projections & Actuals	Recology
7.	Residential Customer: Downsize	Recology
8.	Residential Customer: Downsize Upsize	Recology
9.	Residential Customer (1-5 Units)	Recology
10.	Apartment Customer (once a week service)	Recology
11.	Apartment Customer (reduce frequency of service)	Recology
12.	Impound Account Projects	City
13.	DPW memo	City
14.	2012 Hearing Officer's Report	City
15.	HDR Report	City
16.	Public Workshop: Allocation of Refuse Rate Surcharge	City
17.	Bulky Item Collection Requests	City
18.	Ratepayer Advocate Overview	Advocate
19.	Ratepayer Advocate Comments 4/2/13	Advocate
20.	Summary of March 21st Workshop	Advocate
21.	Follow-Up to March 21st Workshop	Advocate

22.	Summary of Application	Advocate
23.	Initial Comments on Rate Application	Advocate
24.	Follow-Up to January 17th Workshop	Advocate
25.	January 17th Workshop Summary	Advocate
26.	Map re: Contingent Schedule 1	Recology
27.	Methodology for Calculation of Carrying Costs for Plant Held for Future Use	Recology
28.	Letter, dated 4/11/2013, re: Contingent Schedule 1	Recology

<u>4/15/2013</u>

29.	E-mail from J. Glaub to R. Haley, dated 2/4/2013, "West Wing Conceptual Design Package"	Recology
30.	E-mail from J. Glaub to J. Macy, dated 2/7/2013, "West Wing Cost Estimate"	Recology
31.	Brisbane City Council Resolution No. 2011-35	Recology
32.	Brisbane City Council Resolution No. 2012-36	Recology
33.	COLA Mechanism Report (Armanino)	Recology
34.	Fixed vs. Variable Cost Analysis (Armanino)	Recology
35.	Rate Survey – 1/31/2013 (Armanino)	Recology
36.	Schedule G-3: Health Insurance and Postretirement Expenses	Recology
37.	2012-16 Collective Bargaining Agreement between Recology and Sanitary Truck Drivers Drivers and Helpers Union Local 350, IBT	Recology
38.	Letter from Towers Watson to A. Tabak, dated 3/25/2013, "Pension Plan Funding Projection"	Recology
39.	Less Than Weekly Service (to be known as Pay per Setout) Proposal Summary	Recology

40.	Written Protest Against Proposed Rate Change, dated 8/2/2010; Notice of Rate Decision, dated 10/8/2010; Written Objections to Hearing Officer's Report, dated 8/31/2010; Prepared Remarks to Rate Board, dated 9/30/2010; DPW Order No. 178,941; Letter to Hearing Officer, dated 4/23/2012; Letter to City Administrator, dated 5/25/2012; 2012 Rate Board Order; DPW Order No. 180,442	D. Pilpel

<u>4/22/2013</u>

41.	Abandoned Materials Collection	Recology
42.	2011 R3 Report to SF LAFCo re: Selection of Refuse Collection, Hauling and Disposal Providers	City
43.	Organics Infrastructure and Operations	Recology
44.	SF Feedstock	Recology
45.	Food Scraps Capacity in the Bay Area 2013 Benchmark Data	Recology
46.	Recology Allocation and Trends (Workers Compensation)	Recology
47.	E-mail, dated 4/19/2013, from M. Harrington to A. Tabak (Liability Insurance)	Recology
48.	Recology Revenue Trends	Recology
49.	Revenue and Waste Generation vs. Economic Indicators	Recology
50.	Zero Waste Incentives	Recology
51.	Calculation of Small Company Size Adjustment (WACC)	Recology
52.	Apartment and Commercial Migration to Date	Recology
53.	Reconciliation of Rate Application (Revised vs. Original)	Recology

4/24/2013

54.	Apartment Revenue Analysis: Impacts of Apartment Cap	Recology
55.	Commission on the Environment Guidelines for the Use of Impound Account Funds	City
56.	Tons Sent to Altamont	City
57.	Recology Organics Group Customers, Material Types and Rates	Recology
58.	City of Berkeley/Recology Grover Environmental Products Contract (2010)	City
59.	City of Berkeley/Recology Grover Environmental Products Amendment (2012)	City
60.	SBWMA/Recology Grover Environmental Products Contract (2011)	City
61.	Recology The Compost Store	City
62.	"That's WACC!" entries for Waste Management, Republic Services, and Waste Connections	City
63.	"Monetizing the Trash" $3 per mattress	R. Davis
64.	Public Comment Received by The Ratepayer Advocate	Advocate

ATTACHMENT B

TABLE OF PROPOSED STAFF CHANGES TO 2013 REFUSE RATE APPLICATION

RECOLOGY SAN FRANCISCO

Schedule	Proposed Change
E	Reduce "City Can Allocation" tonnage by 1,643
G.1	Reduce Recycle Central Regular Payroll - FTE Union -Sorter/Material Handler from 67.5 to 65.5
G.2	Reduce RSF Local 3 pension expense from $10.35 to $10.11
G.3	Reduce reinsurance fees from $110 to $63
H.2	Increase lease term for stationary equipment from 7 to 10 years
J.1	Reduce compostables processing rate from $48.64/ton to $45/ton
L.2	Remove incorrect license and permit expense of $12,000 in RY12
L.2	Disallow operating ratio on Brisbane license fee
M.2	Reduce inflation factor on corporate services expenses from 3.4% to 3.2%
M.2	Exclude certain corporate expenses from allocation to SF companies

RECOLOGY SUNSET SCAVENGER/RECOLOGY GOLDEN GATE

Schedule	Proposed Change
B.3	Reduce apartment migration to 1.4%
D, F.1	Reduce pay per setout -- amortize rollout costs (except lease) over 7 instead of 3 years; remove 1 route
F.1	Increase Apartment Revenue for 2,847 new units
G.1	Reduce G&A Regular Payroll - FTE Union - Clerical from 24 to 23
G.1	Reduce T&G Regular Payroll - FTE Union - Shop from 51.3 to 50.3
G.3	Reduce reinsurance fees from $110 to $63
H.3	Eliminate RGG (smaller of 2) Facility Upgrade-Maintaining/Servicing CNG
J	Increase Fantastic 3 tonnage by 1,643
L.3	Reduce CNG fuel expense
M.2	Reduce inflation factor on corporate services expenses from 3.4% to 3.2%
M.2	Exclude certain corporate expenses from allocation to SF companies

Recology Sunset Scavenger/Recology Golden Gate **DPW Revisions**
Rate Application, Schedule **B.1**
Rate Calculations - Total Revenues

	RY 2014
Operating Ratio Expenses	$ 151,080,367
Calculated Operating Ratio Expenses	**151,080,367**
Allowed Operating Ratio	91.00%
Operating Expense with Operating Ratio	**166,022,381**
Non-Operating Ratio Expense	
Disposal Cost	38,856,213
Processing Cost	51,350,555
Impound Account	14,614,399
Revenue	
Non Rate Revenue	(18,548,561)
Apartment - Migration	738,846
Commercial - Migration	2,142,421
Paperless Bill Credit	180,400
Compactor Rate Adjustment	1,629,025
Residential - Change in 20-gal Volumetric Charge	1,257,219
Diversion Incentive (2% OR)	3,730,840
Net Revenue Requirement	**261,973,738**
Revenue @ Current Rates	219,883,300
Difference	**42,090,439**
Overall Revenue Increase	**19.14%**
Operating Expenses with 89% OR	169,753,221
Variance to 91% OR	3,730,840
Net Revenue Requirement @ 89% OR	**261,973,738**

Recology San Francisco DPW Revisions

Rate Application, Schedule **B**

Rate Calculations - Processing and Disposal

		RY 2014
Operating Ratio Expenses	$	97,299,613
Calculated Operating Ratio Expenses		**97,299,613**
Allowed Operating Ratio		*91.00%*
Operating Expense with Operating Ratio	**$**	**106,922,652**
Existing Capital Charge		**-**
Non-Operating Ratio Expense		
Impound Account	$	5,332,765
Altamont Disposal		4,362,273
Revenue		
Other Commercial Revenues		(988,704)
Recycling Revenues		(20,836,599)
Diversion Incentive		2,402,756
Net Revenue Requirement	**$**	**97,195,144**
Percent Increase		***4.60%***
Current Tipping Fee per Ton	$	140.76
Proposed Tipping Fee per Ton	$	147.23
Total Revenue Tons		660,164
Operating Expenses with 89% OR	$	109,325,408
Variance to 91% OR		2,402,756
Net Revenue Requirement @ 89% OR	**$**	**97,195,144**