

Proposed Modifications to Refuse Rate Order for RY 2024 and RY 2025



June 23, 2023

**Recology Sunset Scavenger
Recology Golden Gate
Recology San Francisco**

TABLE OF CONTENTS

INTRODUCTION.....	1
I. RATE PROPOSAL: RECOMMENDED RATE ADJUSTMENTS	2
A. Pension Costs	2
B. Programmatic Reserve Fund.....	4
III. RATE PROPOSAL: OTHER ADJUSTMENTS AND ADMINISTRATIVE PROVISIONS.....	6
A. Reportable Elective Expenses (Cost Control Mechanism in Lieu of “Substituted Costs”).....	6
B. Cost of Living Adjustment.....	7

INTRODUCTION

The Recology Sunset Scavenger (RSS), Recology Golden Gate (RGG), and Recology San Francisco (RSF) (together, the SF Recology Companies) submit to the Refuse Rate Board the following proposed modifications to the Proposed Refuse Rate Order provided by the Refuse Rates Administrator. The SF Recology Companies urge the Refuse Rate Board to adopt a Rate Order that clearly delineates the responsibilities of the SF Recology Companies, the rates that shall be effective October 1, 2023 and October 1, 2024, and the requirements for managing and reporting on the accounts established by this Rate Order.

The following proposed modifications are intended for the Rate Board's consideration as modifications of the corresponding sections in the Proposed Refuse Rate Order provided by the Refuse Rate Administrator. The SF Recology Companies believe that these proposed modifications more clearly specify the obligations of all parties.

I. RATE PROPOSAL: RECOMMENDED RATE ADJUSTMENTS

A. Pension Costs

1. Amount in Rates

Recology Inc. currently contributes \$25 million per year to a defined-benefit pension plan (the Plan), which today mostly serves Local 350 union employees in SF Recology Companies. The SF Recology Companies are allocated a share of that annual contribution based on their respective share of the total service cost as calculated by the actuaries.

Recology's Plan actuary currently projects that the Plan will reach 100% funding in three years (i.e., at the end of RY 2026) with annual contributions of \$17,000,000. The rates shall include projected cash contributions for the SF Recology Companies' allocable share of the Plan's \$17,000,000 in projected contributions for RY 2024 and RY 2025. If new rates do not take effect October 1, 2025 and the Plan is less than 100% funded by that date, the rates shall be adjusted to include the SF Companies' allocable share of the Plan's \$17,000,000 in projected contributions for RY 2026.

A funding level of 100% will be determined by comparing the asset value to the estimated pension obligation in quarterly reports issued by the Plan asset manager. When the asset value is equal to or exceeds the estimated pension obligation, the pension plan will be considered 100% funded. Market volatility, affecting plan assets, and any pension obligation changes could affect these projections, and further contributions may be required in the future based on actual Plan asset returns and changes to service levels or benefits.

Historically, rate applications included a constant pension cost with no projected phase-out of that pension cost. Here, however, 100% funding is projected to be reached at the end of RY 2026. A 100% funding level has not previously been achieved during the life of the Plan. Like all expenses included in the rates, pension costs are projected and actual costs will vary from projections. The SF Recology Companies therefore propose to use the balancing account and the annual rate adjustment to adjust rates for changes to pension contributions during and beyond RY 2026 so that rates fairly reflect necessary contributions to the Plan.

In addition to the Plan costs, the SF Recology Companies also incur costs for Local 3 pension contributions and 401(k) matching for non-union employees. These amounts are projected to be \$1,408,286 in each of RY 2024 and RY 2025. These pension costs are assumed to remain constant regardless of the status of Plan

RECOMMENDED RATE ADJUSTMENTS

contributions. The line item “pension” in the rate application and rate reports includes these amounts in addition to Plan contributions.

2. Pension Component of Annual Rate Adjustment

The rate application recommends adjusting rates annually beginning with RY 2026 by the rate adjustment. The projected change in pension contributions is the difference between the contributions used in rate projections in the current rate year and the projected contributions for the next upcoming rate year. The percentage impact on the rate adjustment for the upcoming rate year would be calculated by dividing the projected change in the pension contributions, grossed up for the operating ratio, by the estimated revenue from ratepayers for the current rate year.

3. Funding Status Falls Below 98% on an Accounting Basis

If, after reaching 100% funding, the funding status of the Plan, as calculated by the Plan’s then-existing actuary of record on an ASC 715 projected benefit obligation (PBO) basis, falls below 98%, monthly Plan contributions shall increase to one-twelfth of the SF Recology Companies’ allocable share of a \$25 million contribution. These additional monthly contributions shall continue until the funding status of the Plan again reaches 100%. If the funding status of the Plan again falls below 98%, the additional monthly contributions described above shall resume until the funding status of the Plan again reaches 100%.

The Plan’s actuary of record shall calculate the Plan’s funding status on an ASC 715 PBO basis quarterly and shall furnish reports of that funding status to the SF Recology Companies. These reports shall be the sole basis for determining the funding status of the Plan on an ASC 715 PBO basis.

4. Minimum Required Contributions

Should the Plan be subject to a required cash contribution under the Employee Retirement Income Security Act of 1974 (ERISA), either a quarterly or residual Minimum Required Contribution after application of the Funding Balance, in excess of the annual contribution, with or without any additional contributions due to the funding status of the Plan falling below 98%, as outlined above, the SF Recology Companies shall increase monthly contributions to cover the allocable share of such excess contributions.

The Plan’s actuary of record shall calculate the Minimum Required Contributions and quarterly contribution requirements of the Plan annually and shall furnish reports detailing those contribution requirements to the SF Recology Companies. These reports shall be the sole basis for determining the Minimum Required Contributions and quarterly contribution requirements of the Plan.

RECOMMENDED RATE ADJUSTMENTS

5. Balancing Account

If any additional Plan contributions above the contributions included in the rates are made pursuant to the scenarios described above, the amount of such additional contributions shall be subtracted from the notional balance of the balancing account. If any Plan contributions are made after the Plan reaches 100% funding, as calculated by the Plan's then-existing actuary of record on an ASC 715 projected benefit obligation (PBO) basis, the amount of such contributions shall be added to the notional balance of the balancing account.

B. Programmatic Reserve Fund

1. Purpose

The Programmatic Reserve Fund is intended to provide flexibility to the City to make incidental requests for additional service beyond the services provided by the Rate Order. The Programmatic Reserve Fund may fund the following types of requests:

- Services provided by the SF Recology Companies to commercial customers generally in San Francisco;
- Services funded in the Rate Order, in excess of the amounts funded in the Rate Order; and
- Other services mutually agreed by the City and the SF Recology Companies.

The Programmatic Reserve Fund may not be used to fund services normally billed to a customer, including a City department.

2. Funding and Withdrawals

During the term of this Rate Order, the SF Recology Companies shall deposit into the Programmatic Reserve Fund an amount equal to 0.2% of actual Net Revenue Retained of RSS and RGG, as reported in Table 6 of the quarterly and annual rate reports for the rate year. The total annual deposit for RY 2024 is estimated to be \$720,000. Upon receiving a request from a City department for additional services not included in this Rate Order, the SF Recology Companies shall forward the request to the Refuse Rates Administrator with an estimate of the cost of the request plus an amount equal to a 91% operating ratio on the request. Upon the Refuse Rates Administrator's approval of the service request, the SF Recology Companies may draw the total amount approved from the Programmatic Reserve Fund.

3. Limitations

All service requests must be for periods not to exceed one rate year and not to extend beyond the end of RY 2025. In the event that a new rate order is not effective as of the beginning of RY 2026, City departments may renew such requests for service. For a service request to be fulfilled, the balance of the Programmatic

RECOMMENDED RATE ADJUSTMENTS

Reserve Fund must be sufficient to allow the SF Recology Companies to draw the estimated cost for that service request plus a 91% operating ratio. The balance of the Programmatic Reserve Fund may not fall below zero.

4. Reporting

All activity of the Programmatic Reserve Fund in the applicable period shall be reported as a separate appendix in the quarterly and annual reports of the SF Recology Companies. The actual expenses incurred for each service request, offset by the amount received from the Programmatic Reserve Fund for the requested services, shall be included in calculating above- or below-target profit for the purposes of balancing account adjustments.

III. RATE PROPOSAL: OTHER ADJUSTMENTS AND ADMINISTRATIVE PROVISIONS

A. Reportable Elective Expenses (Cost Control Mechanism in Lieu of “Substituted Costs”)

1. Definition

In response to the Refuse Rate Administrator’s concern that a balancing account adjustment of 100% would disincentivize the SF Recology Companies to control costs, the SF Recology Companies shall report and adjust the balancing account as required based on “reportable elective expenses,” or material expenses that are not included in the Rate Order. This definition attempts to capture significant expenses that were not included as part of the rate application reviewed by the Refuse Rate Administrator and the Refuse Rate Board. The intent of this definition is to exclude small-dollar amounts from those expenses deemed “reportable elective expenses.”

“Reportable elective expenses” means all material, elective expenses incurred by the SF Recology Companies that were not included in the cost base used to set rates in the 2023 Rate Order. For the purposes of this definition, a material expense is an annual variance greater than \$500,000 compared to the projected expense, as listed in Schedule G, submitted to the Refuse Rate Administrator. For the purposes of this definition, an elective expense is an expense incurred by the SF Recology Companies that was not incurred as a result of (a) changes in refuse volumes, including but not limited to, number of employees, employee overtime and weekend hours, employee benefits, fuel, and disposal and processing costs relating to those changes in refuse volumes; (b) fuel or other commodity costs; (c) changes in employee costs due to Collective Bargaining Agreements entered into on or after the date of the 2023 Rate Order; (d) federal, state, local, or other taxes or regulatory requirements; (e) GAAP required changes in accounting rules; (f) requirements of third-party lease amendments or agreements relating to real property leased by any of the SF Recology Companies; and (g) bad debt.

2. Reporting

As part of the annual rate report, the SF Recology Companies will include a schedule reporting all reportable elective expenses incurred by the SF Recology Companies during the rate year covered by the report. The schedule will include a brief description explaining why the reportable elective expenses were incurred during the period and why they were not included in the rate application. Any reportable elective expenses that have been deducted from operating-ratio eligible expenses by

OTHER ADJUSTMENTS

the Refuse Rate Administrator, as described below, shall continue to be reported but it shall be noted that the Refuse Rate Administrator has determined that they should be deducted from operating-ratio eligible expenses.

3. Effect on Notional Balancing Account

Upon reporting of reportable elective expenses, the Refuse Rate Administrator will have the right to review such reportable elective expenses. Within 60 days of receiving the report of reportable elective expenses, the Refuse Rate Administrator may for good cause deduct some or all of the dollar-amount of a reportable elective expense from the operating ratio-eligible expenses used to calculate above- or below-target profits. Within 30 days of a Refuse Rate Administrator decision to deduct an expense from the operating ratio-eligible expenses used to calculate above- or below-target profits, the SF Recology Companies may appeal the decision to the Refuse Rate Board, which shall be the final arbiter of the decision to deduct such expenses. If the Refuse Rate Administrator deducts such reportable elective expenses and, if appealed, the deduction is affirmed by the Refuse Rate Board, the SF Recology Companies shall reflect that deduction in the schedule of adjustments to the notional balance of the balancing account included in subsequent rate reports.

B. Cost of Living Adjustment

1. Past COLA Mechanism

A cost of living adjustment (COLA) allows for annual rate adjustments for changes in the price of the goods and services used by the SF Recology Companies to provide service. A COLA helps keep rates more closely aligned with the SF Recology Companies' actual costs. It does not adjust rates for increases due to changes in service levels or mix of services, nor does it adjust for new costs. For example, if the price of fuel increases by 5%, this increase would be captured by the COLA. But if the use of fuel increased, a COLA would not adjust for this increase in operating costs.

A COLA has several benefits, including avoiding the time and expense of rate change proceedings each year and helping to reduce the likelihood of large jumps in rates when a new rate order is issued. A COLA mechanism has been used for San Francisco rates since the 2001 rate adjustment cycle, with some methodological modifications over the years.

The COLA mechanism adopted as part of the last rate order is comprised of various expense categories or "factors," such as fixed labor or fuel. By using a combination of factors to assemble a COLA – rather than using a single "inflation" number, such as the Consumer Price Index – a more granular calculation can be performed that accounts for different relative rates of inflation for different expense categories. The rate of inflation from the time of the immediately preceding rate change for each factor is calculated using data from an appropriate source, such as an index of diesel

OTHER ADJUSTMENTS

prices for the renewable diesel factor. The inflation percentages for each factor are then adjusted for their relative weight to calculate an overall COLA for RSF and, separately, for the Collection Companies. The factors, sources for inflation percentages, and weights adopted in the 2017 rate order are as follows:

COLA Factor	Source/Index	RSF Weight	RSS/RGG Weight
Fixed labor	As per Collective Bargaining Agreements	40.8%	52.5%
Variable labor	SF-CPI (U)	13.3%	6.7%
Health and welfare	Mercer Analysis or equivalent	10.4%	12.1%
Pension	City pension factor or rate from actuarial report	4.8%	6.8%
Renewable diesel	Weekly California No. 2 Diesel Retail Prices	1.4%	0.85%
Natural gas fuel	PG&E Series G-NGV1	0.9%	0.15%
Materials	PPI	23.6%	14.3%
Capital	No inflation	4.8%	6.6%
Total		100%	100%

Historically, the COLA adjustment for RSS/RGG was further modified by adjusting for any new rebate for unearned Zero Waste Incentive (ZWI) funds and for rebates included in the prior year's rate adjustment.

2. Application of COLA

The SF Recology Companies share the Refuse Rate Administrator's expectation that there will be a subsequent rate process in 2025, with a new rate order in place for RY 2026 rates. If, however, no rate order is approved to adjust RY 2026 rates, a COLA would be applied to the rates beginning in RY 2026 and each rate year thereafter up to and including RY 2028, until new rates are set in a subsequent rate order. The COLA mechanism to be applied in this instance follows that described above but with several modifications.

3. Weighting

The COLA methodology described above shall be modified by adjusting the relative weights of the COLA factors each year. Whereas in the past the weights were fixed at the time of the rate application, beginning in RY 2026 (if a COLA is applied), the weights in each rate year shall be based on the actual costs reported in the annual rate report of prior rate year. For example, the cumulative costs for the period October 1, 2023 – September 30, 2024 would be used to determine the relative weighting of the cost components of the COLA factors used in the calculation of the COLA to be used for setting new rates for RY 2026 (effective October 1, 2025). Making this change allows a more accurate weighting of these cost categories and

OTHER ADJUSTMENTS

allows the relative weights to adjust year to year as the SF Recology Companies' actual costs and mix of costs change.

4. Period of Index Data

For the COLA factors based on an index, the SF Recology Companies shall use the most recent available index data at the time of the COLA submission for each index listed above. These index values shall be compared to the index value at the same point 12 months previously to calculate the change over the 12-month period (e.g., the change between June 2025 and June 2024). For the fixed labor factor, the change shall be calculated by taking the fixed labor cost increases from the relevant collective bargaining agreements over the relevant time period. Because the SF Recology Companies' collective bargaining agreements provide for wage increases on January 1, that is, three months after the beginning of a rate year, the fixed labor factor shall be calculated by multiplying the percent of the fixed labor increase by 0.75. For example, the wage increase that would be effective January 1, 2026 would be used in the COLA calculation for the rate change to occur on October 1, 2025.

5. Treatment of Pension

The pension factor shall be removed from the list of COLA factors. Any variance between the pension costs included in the rates and the actual pension costs shall be added or subtracted, as applicable, to the notional balance of the balancing account at 100% of the variance.

6. Notional Balancing Account

Any use of the notional balance of the balancing account shall be applied at the same time as regularly scheduled rate changes and shall be calculated by dividing the amount to be applied by the revenue estimated to be collected from ratepayers for the upcoming rate year. Any amounts used in the prior year shall be added back and shall be calculated by dividing the amount by the revenue estimated to be collected from ratepayers for the upcoming rate year.

7. Refuse Rate Administrator Review

The SF Recology Companies must follow the COLA methodology approved as part of this Rate Order in any submission of a COLA to the Refuse Rate Administrator. The Refuse Rate Administrator shall timely review the submission to ensure that it follows this methodology and accurately reflects the sources or indices required for each COLA factor. If the submission does follow this methodology and accurately reflects the required sources or indices, the Refuse Rate Administrator shall approve the COLA.

To allow the Refuse Rate Administrator sufficient time to review a proposed COLA and to allow the SF Recology Companies sufficient time to implement a rate

OTHER ADJUSTMENTS

adjustment, the SF Recology Companies must submit a proposed COLA by August 1 of the rate year preceding the rate year for which rates will be adjusted (e.g., August 1, 2025 for a RY 2026 COLA). The Refuse Rate Administrator shall notify the SF Recology Companies by September 1 whether the COLA may be applied to the rates beginning on October 1.