2013 RATE APPLICATION
SUMMARY OF SIGNIFICANT ASSUMPTIONS

Schedule C

Recology Sunset Scavenger
Recology Golden Gate

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The following schedule describes the projected revenues and expenses for Recology Sunset Scavenger and Recology Golden Gate ("the Collection Companies") as well as the assumptions underlying those projections.

I. PROGRAMS

A. <u>Overview</u>

The trash, recycling, and composting collection programs currently operated by the Collection Companies will continue without significant changes in Rate Year 2014 (RY2014). Assumptions associated with these programs, including proposed changes, are described in the following sections. The total tonnage collected by the Collection Companies is assumed to remain consistent with RY2012 levels, with the exception of (1) the trended reduction in recyclables tonnage from reduced generation and (2) the addition of tonnage from abandoned waste collection.

B. <u>Fantastic 3 Trash and Recycling</u>

A total of 132 Fantastic 3 trash and recycling co-collection routes are assumed for the projected rate period. The number of co-collection routes is expected to remain relatively constant, even with continued migration towards diversion services.

C. <u>Fantastic 3 Composting</u>

The continued expansion of the composting program has led to an increase in the number of routes. The last rate setting process assumed 29 Fantastic 3 composting routes in 2011. There are currently 31 Fantastic 3 composting routes. The number of Fantastic 3 composting routes is expected to remain relatively constant, even with continued migration towards diversion services.

D. <u>Commercial Recycling</u>

The Companies currently operate 14 commercial recycling routes per day. As commercial customers adjust to the revised rate structure there may be some migration towards recycling services, but routing efficiencies will allow the Companies to absorb any change in the customer composition or volume of materials. The total number of commercial recycling routes is not projected to change during the rate period.

E. <u>Commercial Composting</u>

The Commercial Composting program is currently operating with 16 routes per day. The program is expected to continue growing as more customers convert refuse service to composting service. 3 additional routes are included in the projection in RY 2014.

F. Bulky Item Collection

The bulky item collection program, which allows for convenient collection of over-sized items, is available to residential ratepayers (two service appointments per customer per year) and to apartment owners and tenants (one service appointment per unit plus one building appointment per year). A significant percentage of materials collected in this program are diverted. The program accepts furniture, metal, carpets, wood, small general clean up items, mattresses, appliances, electronics and textiles. The program currently operates with an average of 7 trucks and 7 drivers per day, although the actual number of drivers and trucks varies with demand for the service and operates with 8 drivers and 8 trucks most days. The program made approximately 32,800 stops during RY 2012 and collected approximately 4,150 tons of material. We currently do active outreach and therefore expect to remain at this level through the upcoming rate period.

G. City Cans

The Collection Companies service all city cans once on a daily basis within regularly assigned collection routes. In addition to that first collection, the Companies collect many of the city cans in the downtown area and the business corridors two or three times per day. The Collection Companies currently operate 7 dedicated city can routes. In addition to the first pass and multi pass routes the Companies utilize a dedicated city can rover in the downtown shopping district during the holiday season and for special events in order to empty city cans which require more than 3 collections per day. All of the drivers and supervisors have been instructed to provide additional service to city cans that come to their attention as needing service. The Collection Companies have offered to provide additional support to the Department of Public Works (DPW) for city can maintenance, including replacement of liners, locks and broken doors. Supplies would be provided by DPW and Recology personnel would provide this service without adding personnel.

H. District Clean-up Events

The rate application includes costs for one annual clean-up in each Supervisorial District. The program has been expanded to includes a compost give-away for residents in each District. In addition, the Collection Companies are periodically asked to provide additional service to support community clean up activities (coastal clean up, Arbor day, etc.).

I. Abandoned Waste Collection

The Companies have proposed, at the request of the City, the assumption of the abandoned waste collection program currently operated by DPW. This proposed program includes the collection of wastes identified through the City's 311 reporting system, along with abandoned waste identified by Company personnel. The program is proposed to operate similar to the Bulky Item collection program, with utilization of rearloading packer trucks and MEA (mattress, electronics, appliances) trucks. Each crew would consist of 2 drivers, one in each type of truck. Drivers would be assigned to a specific service area, and would be routed to collect abandoned wastes reported through the 311 system. Each driver would also be expected to collect any abandoned waste present on their routes, even if it is not part of the 311 calls. All stops and collections will be documented. This program structure will enhance recycling and the diversion rate for abandoned waste through utilization of the MEA trucks.

In addition to collection of materials related to 311 calls, the abandoned waste program will provide packer support for special events identified by the City, including selected parades, festivals and holidays. The rate application includes all program costs, including 10 drivers each weekday, 8 on Saturday and 6 on Sunday, supervision and administrative support, vehicle costs and disposal costs corresponding to expected tonnage.

II. REVENUES

A. <u>Residential Rates</u>

As discussed in the Narrative Summary included with this application, the Collection Companies are proposing to change the residential rate structure. The new rate structure for residential customers includes a nominal charge of $2.00 per 32 gallons of capacity for recycling and composting streams. This charge is not expected to impact the level of recycling and composting service provided. Customers are still incentivized to move towards recycling and compositing service (Diversion Services) as the proposed volumetric charge for these Diversion Services is substantially less than the proposed volumetric charge for trash service.

In addition to the variable cost changes described above, the Companies are proposing a fixed charge of $5.00 for each residential unit to be included in the new residential rate. The fixed charge is intended to cover some of the fixed system costs related to the provision of residential services, including capital costs, administrative costs and regulatory costs.

Individual residential customer rate increase percentages will vary depending on their respective volume and composition of service. Customers that in the past have received additional diversion services without a specific charge related to that service may see rate increases greater than the base increase. In order to mitigate the impact of the structural changes, the Companies are proposing to cap the first year rate increase for all residential customers at 23.75%. This cap will be removed after the rate year.

The variable cost for 20-gallon (Mini Can) service is revised to reflect a proportional volumetric charge for that service. The cost for the 20-gallon cart is 62.5% of the cost of a 32 gallon black cart. Other charges, including the $5.00 per dwelling unit charge and volumetric charges for the recycling and composting services, will apply to Mini Can service customers.

B. **Apartment Rates** The Companies are proposing to implement an apartment rate structure patterned after the commercial rate structure adopted in 2006. The new discounted volumetric structure includes a fixed charge and equal volumetric charges for all service volume, irrespective of the type of service. These charges are partially offset by discounts for recycling and composting service. The details of the proposed apartment rate structure are summarized below.

The proposed structure includes a $5.00 per unit fixed charge component. This charge is the same as the fixed charge proposed for residential customers. The fixed charge for each dwelling unit is intended to cover some of the fixed system costs related to the provision of residential services, including capital costs, administrative costs and regulatory costs.

In addition, the proposed structure includes volumetric charges equal to $27.91 per 32 gallons of weekday service, irrespective of type of service. This change applies the current black cart charge to all service volumes. The resulting calculated gross revenue is partially offset by the discounts available for diversion services, as described below.

Discounts of up to 75% are calculated from each customer's diversion percentage as a percentage of total volume, less 10%. . The first 10% of diversion is not eligible for a discount due to the fact that there is a minimum level of diversion service required by the mandatory recycling and composting ordinance. This discount structure rewards customers that have more Diversion services and encourages others to migrate towards more Diversion Service. As customers increase their Diversion Services and their diversion percentage, they will be able to partially offset the rate increase. As an example, if a customer has 3 equal size containers (one for each of the black, blue and green streams) they have 67% diversion. The discount they would receive on their volume is 57% (67% - 10%). If the customer added another recycling cart, the diversion discount would become 65% (75% - 10%).

As a result of the change in rate structure, the Collection Companies are anticipating that apartment customers will move from trash service to diversion services and will reduce overall service to manage their cost. The Collection Companies have included a 2.5 percent migration factor in the rate application.

In an effort to allow apartment customers to get acclimated to the new rate structure and to soften the impact of the increase in rates, the Companies are proposing to include acap of 25 percent on the overall increase for all apartment customers. This cap will be phased out over a two year period. The cap will limit the overall increase during the rate period and will allow customers to get acclimated to the new rate structure and determine their optimal service level and configuration before they would be subject to any additional increase. Any additional revenues generated by the removal of the increase caps in the years following the 2014 rate year will be applied as an offset against the COLA adjustment for that year.

3. Disabled and Elderly Program

The rate application continues the disabled and elderly program. This program provides for a waiver of key, distance, and elevation charges for disabled or elderly infirm persons if no able-bodied person resides with such persons.

4. Lifeline Program

The lifeline program will continue, with an adjustment to partially mitigate the impact of the rate increase. The program will charge lifeline customers 75 percent of the current service rates, based on their service configuration. Eligibility documentation for customers and verification procedures for the Companies will remain the same.

C. Commercial Rates

The Companies are implementing some minor changes to the commercial rate structure. The changes are designed to maintain a sustainable revenue stream within the context of movement towards zero waste, along with creating new incentives to drive further diversion amongst the commercial customers. Commercial revenues are expected to increase significantly as a result of the structural changes. The increased commercial revenue is included in the rate model as a reduction of the revenue requirement used to calculate residential and apartment revenue requirements. Commercial rates will be adjusted to allow for an overall increase approximately equal to the residential and apartment revenue increases.

The fixed rate is moving from 5% to 10% of each commercial bill. This change moves the fixed cost component closer to the actual fixed cost as a percentage of total cost.

Discounts of up to 75% of the variable component of the commercial billings are still available based on the proportion of diversion service in excess of 10% and up to 85% of total volume. The first 10% of diversion is no longer eligible for a discount due to the fact that there is a minimum level of diversion service required by the mandatory recycling and composting ordinance. For example, if a commercial customer has one 96-gallon cart for refuse, one for recycling, and one for composting service, then total diversion service volume represents 67 percent. The discount for this customer would be 57% (67% - 10%) If a customer has one 1-cubic yard bin for trash and one 1-cubic yard bin for recycling, then total diversion service volume is 50 percent and the discount would be 40% (50% - 10%).

As a result of the change in rate structure, the Collection Companies are anticipating that commercial customers will move from trash service to diversion services and will reduce overall service to manage their cost. The Collection Companies have included a 2.5 percent migration factor in the rate application.

D. Debris Box Service

Debris box service revenues are assumed to remain flat through the rate period and will be adjusted with the COLA mechanism in future periods.

E. Other Revenues

The Collection Companies offer compactor and related equipment sales and maintenance for the San Francisco region. Customers wishing to acquire specialized refuse equipment, not typically associated with standardized cart and bin collection service, have the option of purchasing, renting or leasing the necessary equipment from the Collection Companies. The Collection Companies also provide maintenance service for refuse equipment at customers' expense. These revenues are shown separately and serve as an offset to the revenue requirement for regular service.

F. Impound Account

Contributions to the Impound Account are based on the payment requirements for funds for the City's Department of the Environment and Department of Public Works. Payments from the Collection Companies will be deposited into the Impound Account on a monthly basis.

G. Operating Ratio

The rate application utilizes a base OR of 91 percent, along with Diversion Incentives (DI) equivalent to up to two percent of allowable expenses if the Companies achieve diversion targets, as described below.

H. Diversion Incentives

As the City pursues zero waste, the Diversion Incentives (DI) should evolve to reflect changing performance requirements and standards. During the 2014 rate year and forward, the tracking parameter and performance measure will be disposal tonnage. Correspondingly, the proposed DIs for Rate Years 2014 and beyond are all based on landfill disposal tonnage. The proposed new DIs are set by the Department of the Environment and will be determined as part of the rate process.

I. COLA

In the 2001 Rate Application, the Companies and the Rate Board approved a Cost of Living Adjustment (COLA) in rates to enable the Companies to recover cost increases resulting from inflation over the five-year rate period (2001-2006). This COLA carried over to the 2006-2011 rate period, modified to include a fuel index. The present COLA has four components: (1) a labor component based on COLA increases included in the current labor contract changes, (2) a Consumer Price Index (CPI) component for specified cost items, (3) a California Diesel Fuel Index and (4) a Producer Price Index (PPI) component for other specified cost items.

The Companies propose to apply the COLA mechanism to the periods subsequent to the rate period, until such time that a new rate is set by the Rate Board. The COLA will be updated to reflect updated weights applied to the components of the mechanism to reflect the current cost structure. The COLA will include a labor component that is reflective of the current labor agreements, which include an annual COLA adjustment of between 3% and 5%. In addition, the Companies propose to modify the COLA by adding a component for health and welfare costs. As is widely recognized, health and welfare costs have increased greatly over the last several years and are expected to continue to rise. In addition, because of the uncertainty related to recent legislative and regulatory changes, the increase in costs could be quite dramatic The Companies propose to use five (5) year average of historical cost increases as the proxy for future cost increases. Consequently, the health and welfare component of the COLA could be substantially different than the actual change in health and welfare costs. The proposed modified COLA mechanisms designed to ensure that the Companies fairly recover costs that increase during the period subsequent to the rate period until such time that a new rate is established,, thereby protecting both ratepayers and the Companies.

The COLA mechanism will be adjusted to reflect actual changes in the additional revenues generated by the removal of the apartment and residential caps in the two years following the rate period, offset by the loss of revenues due to migration towards greater diversion service and through service reductions.

J. <u>Special Reserve Surcharge</u>

The Special Reserve Fund has reached its minimum target level of $15 million. Therefore, the Companies are proposing to discontinue the 1.3% volumetric surcharge, which is currently being sent to DPW for waste management programs.

III. EXPENSES

A. <u>Wages</u>

Union wages are based on ratified union contracts that run through December 31, 2016. The union wages included in the application contain COLA adjustments of 3% effective as of July 1, 2013 and January 1, 2014. The actual contractual COLA adjustment is between 3% and 5%, and any increase in excess of the 3% minimum will be borne by the Companies. Future increases will be included in the COLA mechanism described above.

B. <u>Payroll Taxes</u>

Payroll taxes are projected based on current city, state, and federal tax rates. Payroll taxes are based on historical rates, which may be subject to change with the current economic issues facing the state and the country.

C. <u>Health and Welfare (including Postretirement)</u>

Health and welfare costs offered through several service providers include medical, prescription drug, dental, and vision coverage, as well as long-term disability and life insurance.

During the last several years the Companies have experienced increases in the cost of health care coverage that average over 10 percent per year. The current cost of coverage is over $1,800 per employee per month.

The Companies have implemented changes to the non-union health benefits in an effort to control costs, including increased co-payments and benefit reductions. Union programs are governed by the contractual obligations and program changes are limited.

The projected cost contained in the rate application for health and welfare benefits is based on the 2013 costs, inflated by 8% for the second half of the year (health insurance rates are set on a calendar year basis and adjusted for rate years). The 8% inflation factor was developed by the Companies' outside actuaries. The inflation estimate will be updated for the final application based on the best then available information.

The health and welfare cost projections include a reinsurance fee expected in 2014 as part of the Affordable Care Act. Early this year in March, Health and Human Services (HHS) finalized its regulations regarding the reinsurance fee. This fee applies to all employer group health plans starting in 2014. It is expected that for 2014, the fee will be in the range of $60-$110 per year, per covered life (not just per employee). The states will also have the option of collecting additional contributions for reinsurance payments (on top of the reinsurance contributions collected by HHS).

Postretirement costs in the rate application represent the cost of participation in the Teamsters Benefit Trust sponsored Retirement Security Plan (RSP). The RSP provides postretirement medical benefits for union members qualifying for retirement under terms of the collective bargaining agreements. The RSP cost is paid monthly for each eligible employee. The costs have increased approximately 12% per year over the last few years. The current monthly cost of the base program is $441.93 per month and is expected to increase by 11% to $490.54 as of July 1, 2013.

In addition to the base RSP program, the Companies agreed to provide a supplemental RSP benefit, in exchange for elimination of the Recology Rule of 84 postretirement medical benefit(Rule of 84 Benefit). The supplemental RSP benefit reflects program changes designed to make the RSP mirror the Rule of 84 Benefit. This results in an additional premium of 10% of the base cost of the RSP, or approximately $49 per month per employee during the rate period. The total cost of approximately $300,000 is offset by savings of $3.7 million, based on the 2011 cost of the Rule of 84 Benefit program.

D. Pension

Pension costs are based on projected contributions required to meet Employee Retirement Income Security Act ("ERISA") pension plan funding requirements as determined by the Companies' pension plan actuary. During the last few years, the Collection Companies, through their parent Company, Recology Inc., have made increased pension contributions, in an effort to improve the funding status and health of the Recology sponsored pension plan. The Collection Companies' share of the contribution in RY 2012 was $20 million, up from an average of $10.9 million during the last five year rate period. Recology has also frozen the Plan with respect to new non-union personnel, who now participate in a defined contribution plan that is not subject to fluctuating funding requirements.

Contributions are expected to be $14.5 million in RY 2013 and $12.9 million in RY 2014. It is expected, based on actuarial analysis from Recology's third party actuaries that future contributions will be stable at approximately $13 million based on current expectations for discount rates, returns on assets and relatively static employment levels.

E. Workers' Compensation

Workers' compensation expense covers the costs associated with workers injured on the job. These costs arise from temporary and permanent disability, medical care and medical evaluation, claims administration, insurance premiums, legal fees, and ancillary administrative functions. The Companies participate in a risk pool with all other Recology operating companies. Workers compensation rates and allocations are established for the specific historical experience of each Company as prepared by a third-party administrator.

Workers' compensation costs have risen in general over the past several years due to increases in the indemnity payments and the return of double digit medical inflation leading to increases in the cost of medical care. Changes in legislation that led to decreases in some areas in the mid 2000s have been undercut by increases in benefits attributed to recent court decisions, and more liberal rules regarding disputes and appeals. The Collection Companies are continuing to focus on safety training, return to work programs and improvement in work processes. In spite of those efforts, workers compensation costs remain high and are expected to increase during the rate period. The cost of workers compensation is expected to increase approximately 11 percent in 2013 and 10 percent in 2014.

F. Liability Insurance

The Collection Companies participate in a risk pool with all other Recology operating companies to cost effectively manage the Recology insurance program. Liability insurance premium projections are based on information provided by the Companies' insurance brokers, along with projected claims costs associated with fleet operations. Claims costs are allocated to the 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.

G. Disposal Costs

Disposal costs are determined based on the estimated disposal tonnage and the projected tipping fee at Recology San Francisco. The estimated disposal tonnage is based on current tonnage collected, with disposal tonnage adjusted downward for increases in recycling and composting services as well as additional black cart processing. (Please see Schedule C for Recology San Francisco for a more detailed discussion of disposal costs.)

H. Repairs and Maintenance

Projected costs related to repair and maintenance of vehicles are calculated based on the average costs from RY 2010 through RY 2012, inflated by 3% for the rate application period.

I. Fuel

Fuel costs continue to be volatile and have changed (up and down) dramatically over the last several years. Fuel costs for the rate application period are based on the average actual costs from the last 12-month period (Dec-Nov). Fuel costs are based on $3.95 per gallon for Bio-diesel, $3.65 unleaded gasoline, $2.32 per gallon equivalent for CNG, and $1.33 per gallon equivalent for LNG.

J. Licenses and Permits

Licenses and permits include costs for Department of Motor Vehicle registrations, Department of Public Health license fees, and Department of Public Works debris box permits.

K. Recycling and Composting Processing

The processing fees for recyclables are projected based on the tipping fee and the estimated tonnage processed at Recycle Central. The processing fees for compostables are based on the tipping fees charged by Recology Grover and Jepson Prairie Organics. The fees per ton are based on competitive market prices. (Please see Schedule C for Recology San Francisco for a more detailed discussion of processing costs.)

L. Professional and Contract Services

Professional services costs for legal and general services are based on the average costs from RY 2011 and RY 2012, inflated by 3%. Accounting and engineering fees are based on RY 2012 actual + 3% inflation for RY 2013 and RY 2014. In addition, costs associated with the rate application are included in the rate application period. While this rate covers a one-year period, the Collection Companies are proposing to amortize these costs over three years. Contract services costs are based on RY 2012 costs, reduced by lower temporarily replacement, and inflated by 3% per year.

M. Corporate Services

Human Resources (HR) provides benefits, employment law and employee management support services. The cost projections are based on the estimated costs associated with Recology's HR Department. These estimated costs are allocated to the Collection Companies based on the percentage of their employees proportional to the total Recology employee count.

Corporate Management provides general operations and corporate support services. Corporate Management cost projections are based on the estimated costs of management services provided by the Corporate Office. These estimated costs are allocated to the Collection Companies based on their percentage of Recology's total revenue.

Environmental Compliance provides planning, permitting and compliance support services. Environmental Compliance costs are based on costs of Recology's Environmental Compliance Department. These estimated costs are allocated to the Collection Companies based on their percentage of Recology's total revenue.

Information Technology (IT) provides systems development and support for all technologies, including computers, phones, etc. IT costs are based on the costs of Recology's Information Technology Department. These estimated costs are allocated to the Collection Companies based on series of measures that approximate computer usage — the percentage of Recology's checks written and customer counts that are attributable to the Collection Companies.

Corporate Accounting provides audit, internal audit, treasury and other financial services. Accounting costs are based on the costs of Recology's Finance Department. These estimated costs are allocated to the Collection Companies based on their percentage of Recology's total revenue.

Sustainability provides support for sustainability issues, including emerging technologies, green energy and water initiatives and regulatory support related to sustainability and air, water and land use issues. Sustainability costs are allocated to the Collection Companies based on their percentage of Recology's total revenue.

N. Office, Telephone, and Supplies Expense

Costs related to telephone and office expenses are based on the RY 2012 cost, adjusted for inflation at 3% annually. Supplies expense is based on an average from the last three rate years RY 2010 – RY 2012, inflated 3% for the rate application period and additional supplies for the Abandoned Waste Program and Less-Than-Weekly-Service project.

O. Property Rental

Property rental costs are included for leasing off-site office space for customer service and administrative operations.

P. Other Expenses

Other expenses include community outreach, medical expenses, shoes and uniforms, bank service charges, and other miscellaneous items. Community outreach costs include cost of working with community groups to implement changes to the rate structure.

Q. Capital Expense

Capital requirements for trucks, equipment and leasehold improvements are projected based on the replacement schedule and anticipated facility and program needs. Costs are added as equipment is acquired and leased over specified lease years. Generally, lease terms are assigned as follows:

Trucks and Rolling Equipment	7 years
Stationary Equipment	10 years
Facility Improvements	20 years

The lease rates are calculated based on the asset lives shown above utilizing an implicit interest rate of 3.71%. The interest rate is reset on a monthly basis, based on the cost of capital for Recology. The Collection Companies believe adequate financing will be available for all capital expenditures from Recology's line of credit, lease lines with third party lessors, and/or California Pollution Control Financing Authority financing.