BEFORE THE METRO COUNCIL

FOR THE PURPOSE OF AUTHORIZING THE COMMENCEMENT OF REVIEW OF THE RATES FOR AMBROSE CALCAGNO, JR., DOING BUSINESS AS A.C. TRUCKING COMPANY, FOR THE OPERATION OF THE FOREST GROVE TRANSFER STATION	))))))	RESOLUTION NO 96-2411A Introduced by Executive Officer Mike Burton

WHEREAS, Metro is responsible for the regulation of the disposal of solid waste generated within the region; and

WHEREAS, Metro is responsible for the regulation of the rates charged by solid waste transfer station franchises within its boundaries, including the Forest Grove Transfer Station in Forest Grove, Oregon; and

WHEREAS, the solid waste franchise granted in 1994 to Ambrose Calcagno, Jr., doing business as A.C. Trucking Company, for the operation of the Forest Grove Transfer Station, states that the franchisee shall submit to a rate review; now, therefore,

BE IT RESOLVED:

That the Metro Council hereby authorizes the commencement of a review of the rates for Ambrose Calcagno, Jr., doing business as A.C. Trucking Company, for the operation of the Forest Grove Transfer Station; and

BE IT FURTHER RESOLVED:

That pursuant to Metro Code 5.01.170, the Metro Council directs the Rate Review Committee to undertake a review of the rates and to complete its review by December 10, 1996.

ADOPTED by the Metro Council this 7th day of November 1996.

Jon Kvistad

Jon Kvistad, Presiding Officer

APPROVED AS TO FORM:

DBCooper

Daniel B. Cooper, General Counsel

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STAFF REPORT

IN CONSIDERATION OF RESOLUTION NO. 96-2411 FOR THE PURPOSE OF AUTHORIZING THE COMMENCEMENT OF REVIEW OF THE RATES FOR AMBROSE CALCAGNO, JR., DOING BUSINESS AS A.C. TRUCKING COMPANY, FOR THE OPERATION OF THE FOREST GROVE TRANSFER STATION.

Date: October 18, 1996

Presented by: Roosevelt Carter
David Given
Paul Ehinger

PROPOSED ACTION

Adopt Resolution No. 96-2411

FACTUAL BACKGROUND AND ANALYSIS

The current franchise agreement with A.C. Trucking provides for an annual rate review beginning in 1995. The purpose of a rate review is to determine the reasonableness of direct and indirect expenses associated with providing the services for which A.C. Trucking is franchised and to ensure that the rate recommended does not subsidize a non-franchised portion of this business. A.C. Trucking was formally notified of Metro's intent to conduct a review of their rates on December 21, 1995 and was invited to submit their own proposed rate accompanied by supplemental financial data.

The REM Department staff carefully examined all information submitted by A.C. Trucking along with appropriate tonnage information contained in Metro records. Application of Metro Code provisions and the rate methodology outlined in Executive Order No. 25 (both explained below) results in a combined transfer/transport rate of $16.74/ton which is a reduction of $10.60 from the current rate of $27.34/ton. The Executive Officer recommends a careful review of the staff's analysis by the Rate Review Committee.

The standards applied during the review process are specified in Metro Code provisions §5.01.170 (d) as follows:

> *(d) In determination of rates, the rate review committee, executive officer and council shall give due consideration to the following:*
>
> *(1) Operating and non-operating revenues.*
>
> *(2) Direct and indirect operating and non-operating expenses including franchise fees.*
>
> *(3) Non-franchise profits.*

(4) *Reasonable return on investment exclusive of any capital investment in the franchise or any sum paid for the value of the franchise or any other intangible value.*

(5) *Any other factors deemed relevant by the council.*

The methodology used for calculating the rate is contained in Executive Order No. 25, dated February 20, 1986. The annual revenue requirement is calculated for the entity according to the following formula:

Revenue Requirement	=	*Operating and Administrative Expenses*	+	*Capital Cost Recovery (Depreciation)*	+	*Return On Ratebase*

The revenue requirement is then divided by the anticipated waste flow (tons per year) in order to calculate the rate. This approach has been used previously to set rates for the Forest Grove Transfer Station and is designed to provide a fair and reasonable rate of return on the capital invested in the business. (A brief history of Metro's rate setting relationship with A.C. Trucking is contained in Attachment #1).

The current tipping fee at Forest Grove includes disposal costs, Metro fees, excise tax and enhancement fees which are treated as pass through expenses. Following past practices, staff has limited its review of A.C. Trucking's rates to the costs of transfer and transportation operations.

<u>Operating and Administrative Expenses</u>

The first phase of this rate analysis entailed a study of the operating and administrative expenses submitted by A.C. Trucking, one of twelve companies owned wholly or in part by Ambrose Calcagno. Many of the costs identified in the financial statements are for services provided by related companies or for costs shared by these same entities. As a result of this "vertical integration," staff had the additional responsibility to determine that fees charged by related companies represented the fair market value of the services provided and that allocation of shared costs within the Ambrose Calcagno & Sons, Inc. organization were reasonable.

Trending analysis and comparisons of costs with other similar facilities were conducted. Staff noted that these two categories (operating and administrative expenses) increased a substantial 33% between 1992 and 1995. After reviewing each individual expense, staff recommends allowable operating and administrative expenses of $1,067,344 which include reductions of $46,672 in allowable operating costs and $346,327 in allowable administrative costs. (A detailed schedule and explanation are contained in Attachment #2.)

Capital Cost Recovery (Depreciation)

The second phase of this rate analysis involved determining reasonable compensation for capital equipment provided by the owners and compensation for other capital investment (capital cost recovery). This calculation includes recognition of reasonable interest expense (return on debt equity), owners net equity, and an adjustment for income taxes.

A.C. Trucking claimed $208,164 in depreciation for 1995. Staff recommends $90,061 as an appropriate amount. (Attachment #3 contains a listing and explanation of adjustments made to the 1995 depreciation schedule submitted by A.C. Trucking).

Return on Ratebase

Calculation of the rate base requires examination of the fixed assets of the firm and calculation of the required working capital. Staff recommends a total rate base of $584,692 comprised of $240,448 in working capital and an adjusted unrecovered capital investment of $344,244. A 15% rate was selected to apply to this ratebase. A professional utility rate specialists was engaged to review the methodology applied and the assumptions made in this report. He has concurred that the 15% rate and process applied is reasonable. (Attachment #4 provides an itemized listing of adjustments made and calculation of the return on rate base).

Revenue Requirement

Total revenue requirements of $1,245,109 is made up of $ 1,067,344 in allowable operations and administrative expenses, $90,061 in allowable depreciation and $87,704 in return on ratebase.

Rate Calculation

Dividing the total revenue requirements of $1,245,109 by the 74,392 tons processed by A.C. Trucking in 1995 results in a transfer/transport rate of $16.74/ton.

METRO BUDGET IMPACT

The current franchise agreement provides for a $4.83/ton supplemental fee for all tons A.C. Trucking sends to the Riverbend Landfill. The franchise agreement calls for removal of this fee following rate review. Should the Council take no action regarding A.C. Trucking's rates, Metro revenues would decline an estimated $ 424,093 for the twelve month period ending December 1997. Included in this amount is a reduction in Excise Tax revenues of $ 80,882.

EXECUTIVE OFFICER RECOMMENDATION

The Executive Officer recommends that:

- The Council authorize commencement of a review of the rates for the operation of the Forest Grove Transfer Station.
- The Rate Review Committee review a combined transfer/transport rate of $16.74/ton for the Forest Grove Transfer Station.
- The estimated savings of $808,780 per year be passed on to all Metro solid waste rate-payers in the form of a transfer station rate reduction.
- Concurrent with this new rate, consideration be given to establishment of a Rate Equalization Fee under a separate ordinance. The latter fee would bring A.C. Trucking's tipping fee up to a uniform rate charged at other Metro facilities.

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ATTACHMENT #1

Chronology of AC Trucking Rate Reviews

Metro granted Franchise No. 4 to Ambrose Calcagno, Jr. on March 22, 1984 to operate a transfer station in Forest Grove. The transfer station was limited to accepting waste from only his own collection vehicles. The term of the franchise was five years and there was no rate established since the transfer station was only handling wastes from related entities. The actual transfer operations began in 1985.

The franchise was amended in 1985 to grant a variance to the vertical integration prohibitions in the Metro Code. Since the station would accept waste from other haulers, a rate was established for transfer and transportation of the waste. A rate of $14.51 per ton was requested, based on 15% after tax return on equity capital and 17.5% on debt capital. A rate of $13.98 per ton was granted by the Metro Council using a 15% return of equity capital and a 14.5% return on debt capital. This first rate review utilized the methodology outlined in Executive Order No. 25.

A five year renewal of the franchise was granted in 1988, extending the expiration date to September 22, 1993. The franchisee requested a rate of $19.14 per ton. A rate of $19.25 per ton was granted "to simplify accounting procedures." Again, the rate review was conducted utilizing the methodology outlined in Executive Order No. 25. The franchisee requested a rate of return of 14% on equity. No owner's equity existed at this time; the equity portion was made up totally of debt equity. It should be noted that the rates set during the rate review process were maximums and that the franchisee did not normally charge the highest rate allowed by the agreement. The franchisee was granted permission to accept public self haul waste at this time.

In 1991 the franchisee requested and was granted a rate of $22.75 per ton. The rationale for this adjustment was the assertion that an insufficient rate of return existed under the current rate. The methodology used for the review is unclear from the information in our files. There is no record of any review of the reasonableness of operating or administrative costs.

The franchisee requested an increase in rate to $26.22 per ton in May of 1992. The initial request indicated that the increase was needed to recover the $271,000 cost of responding to Metro's request for proposals for a transfer station to serve western Washington County. This was apparently questioned by the rate review committee. A revised request to increase the rate to $25.50 per ton was received in June. The reasons stated for the adjustment was the expected increase in overall expenses, a reduction in payloads due to PUC requirements and a reduction in the hours of operation of the Riverbend Landfill. The rate of $25.50 per ton was authorized.

The franchisee requested a renewal of his franchise on September 15, 1993. The franchisee proposal provided substantial increases in revenues for the franchisee. The franchisee also requested that the rates increase with inflation. Another schedule was provided in November.

Metro conducted a review of the costs and hired a consultant to examine some of the information provided. A decision was made to defer rate review for one year and to allow the franchisee to charge a tip fee not to exceed Metro's tip fee pending rate review. The franchise renewal included a provision that Metro could take responsibility for disposal of the waste from the transfer station and that Metro could direct the operator to install a compactor.

On December 21, 1995 Metro staff initiated the rate review process and requested the submission of a proposed rate accompanied by supplemental financial data. On March 7, 1996 AC Trucking provided Metro staff with part of the financial data requested. An additional information request was issued on April 25, 1996 arising from the financial data provided Metro during the previous month. A.C. Trucking did not provide the additional data citing concerns over confidentiality. After repeated attempts to resolve A.C. Trucking's objection to providing the requested financial data, Metro staff proceeded to calculate a transfer/transport rate with the data previously provided. A.C. Trucking staff was notified of the proposed rate and given an opportunity to respond. Subsequent discussions with A.C. Trucking representatives did not change Metro staff's original recommended transfer/transport rate of $ 16.74/ton.

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ATTACHMENT 2

METRO
A.C. TRUCKING, INC. RATE REVIEW
SCHEDULE OF PROPOSED TRANSPORT & TRANSFER RATE
FISCAL YEAR 1996-97

EXPLANATION OF FOOTNOTES

1. Trucking Management

   An amount of $ 31,698 and $ 17,943 is listed as trucking management expense for 1994 and 1995 respectively. This line item has not appeared in prior applications and seems unreasonable in light of the increasing level of truck expense ($197,479 vs. $195,336) in spite of this apparent management cost. A.C. Trucking asserted that this consulting expense provides driver and safety education training for its hauling staff. While safety education is a reasonable costs, Metro staff questions the amount attributed to this function considering that their transfer operations make use of only three rigs. Metro staff have repeatedly requested the financial records of the other Calcagno entities to verify allocations of this expense. A.C. Trucking staff have declined to provide such access. Staff recommend the exclusion of this expense item.

2. Recycling Expense

   A recycling expense (later reclassified as hauling expense) of $ 28,729 appears excessive for the amount of recyclables involved. It is estimated that 700 tons/year of this material is delivered by self-haul customers resulting in an average $41/ton transport cost. While curb-side collection operations may provide substantially more recyclable tonnage, staff do not consider it appropriate to classify such costs as transfer station expenses. These costs relate to non-regulated operations and would more appropriately be included within the individual hauler's fee. Staff recommends that the recycling expense be disallowed.

3. Data Processing Expense

   Data processing costs were listed as $93,319 for 1995. This equates to an average of $5.50 for every scalehouse transaction or a data processing cost of over $300 per monthly billing for each commercial hauler using the facility. Estimates were received for the installation and maintenance of comparable weighmaster systems as that existing at A.C. Trucking. An average cost of $4,500 was obtained. The $93,319 is inordinately high considering that the related company charging these fees provide data processing services to all the other Calcagno companies, many of which make higher service level demands than A.C. Trucking. Access to intercompany records was requested to verify the allocation of these costs, but A.C. Trucking again declined to provide them. Staff recommend a reduction in allowable costs to the $4,500 average amount.

4. Rent

Rental charges of $140,880 was shown for 1995. The land owner is a related company and portions of the Forest Grove Transfer Station site are utilized by other Calcagno entities. The Washington County assessor lists the fair market value of the land and improvements as $ 1,014,720. Applying the same allocation of rental expense for A.C. Trucking that was used in 1994 equates to an estimated fair market value of $442,418. Based upon appraisal reports and discussions with real estate professionals, a rate of return for this type of property would range from 10-15%. Staff has applied a 12% average return to impute a recommended rental expense rate of $53,090. A.C. Trucking staff replied to this estimate that their published rental charges were based upon fair market value. No documentation was provided to support this assertion. Access to intercompany records was requested to verify the allocation of these rental costs, but A.C. Trucking again declined to provide them. Accordingly, Metro staff recommend that the rental costs should not be greater than the calculated $53,090 amount.

5. Accounting

Accounting fees of $ 40,933 were listed for 1995. During the 1992 renewal process, A.C. Trucking requested only $ 9,905 for accounting fees. This equates to a 313% increase within a three year period. While there have been significant changes in the Calcagno company structure during this time, placing this administrative costs upon the rate payers appears to be unreasonable. Staff has estimated that a reasonable fee to provide reviewed financial statements for an entity similar in size to A.C. Trucking could be accomplished for $13,000 a year. Since this item is a shared expense, access to intercompany records was requested to verify the allocation of these costs. A.C. Trucking again declined to provide them. Staff recommends a reduction in allowable costs to the $13,000 average amount.

6. Utilities

Utility expenses of $ 19,757 were listed 1995. This is in sharp contrast to the 1992 and 1994 records that listed utility expenses as $ 8,806 and $ 9,839. We are not aware of any significant changes in operations or utility rates that would justify a 100% increase. A.C. Trucking staff stated that water usage has increased and that the 1992 allocations may have been in error. Metro staff requested access to intercompany records to verify the allocation of this expense item. A.C. Trucking again declined to provide this data. Staff recommend a reduction in allowable costs to $10,000.

7. Penalties

An amounts of $1,302 was listed as penalties for 1995. There are no benefits to the rate payer's in refunding such costs to the franchisee. Washington County specifically excludes penalties and fines in their solid waste collection guidelines. Accordingly, staff recommend that this cost be disallowed.

8. Public Relations

A Public relation costs of $63,697 was published 1995. While reimbursement for such expenses as Yellow Page advertising and brochures are expected, amounts of this magnitude are excessive for a franchised facility. Metro staff requested access to intercompany records to verify the allocation of this shared expense item. A.C. Trucking again declined to provide this data. Staff recommend a reduction in this allowable costs to $1,500.

9. Contributions

An amount of $ 11,885 was listed as contributions for 1995. While corporate owners are free to distribute the profits to whomever they wish, it is not the obligation of the rate payers to fund this discreet expense. Both the City of Portland and Washington County specifically exclude contributions as non-allowable costs. Accordingly, these amounts are disallowed.

10. Travel

Travel expenses for 1995 were listed as $ 58,644. This figure is twice the amount for the entire Regional Environmental Management Department. A.C. Trucking staff stated that this expense item includes the costs of employee functions which they consider part of employee benefits. Metro staff requested access to intercompany records to verify the allocation of this expense item. A.C. Trucking again declined to provide this data. Staff recommend a reduction in this allowable costs to $2,000.

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Attachment 2

M E T R O

A C TRUCKING INC. RATE REVIEW

SCHEDULE OF PROPOSED TRANSPORT & TRANSFER RATE

FISCAL YEAR 1996 - 97

	Submitted 1995 Financials	Adjustments		Proposed Expense Base
Operating Expenses				
Trucking Management	17,943	(17,943)	1	0
Recycling (Hauling Expense)	28,729	(28,729)	2	0
Other Operating Expenses	685,938	0		685,938
Total Operating Expenses	**$ 732,610**	**$ (46,672)**		**$ 685,938**
Administrative Expenses:				
Data Processing	93,319	(88,819)	3	4,500
Facility Rental Payments	140,880	(87,790)	4	53,090
Accounting	40,933	(27,933)	5	13,000
Utilities	19,757	(9,757)	6	10,000
Penalties	1,302	(1,302)	7	0
Public Relations	63,697	(62,197)	8	1,500
Contributions	11,885	(11,885)	9	0
Travel	58,644	(56,644)	10	2,000
Other Administrative Expenses	297,316	0		297,316
Total Administrative	**$ 727,733**	**$ (346,327)**		**$ 381,406**
Total Allowable Cost	**$ 1,460,343**	**$ (392,999)**		**$ 1,067,344**

Note: Only expenses that are in dispute have been listed. All other expenses have been summarized to preserve confidentiality.

Attachment 3
M E T R O
Calculation of Capital Recovery
Per Depreciation Schedule Provided By AC Trucking [1]
Period Ended December 31, 1995

Group 3: Fixed Assets - Machinery, Equipment & Furnishings			
Amount Submitted:	**$ 95,996**		**Explanation for Adjustment**
Item #17	(195)		Fully Recovered in 1995
Item #19	(169)		Fully Recovered in 1995
Item #24	(1,689)		Fully Recovered in 1995
Item #32	(18)		Fully Recovered in 1995
Item #40	(400)		Stereo System Disallowed
Item #41	(428)		Fully Depreciated prior to end of 1996
Item #42	(3,063)		Fully Depreciated prior to end of 1996
Net Adjusted Capital Recovery - Group 3	**$ 90,034**		
Group 5: No Tax Basis - Assets			
Item #1 - "'No Tax Basis Equipment"	$ 44,775		
Adjustments:	(44,775)		Ineligible per Metro Code
Net Adjusted Capital Recovery - Group 5	**$ 0**		
Group 6: No Tax Basis - Intangibles			
Item #1 - Goodwill	$ 66,667		
Adjustments:	(66,667)		Ineligible per Metro Code
Net Adjusted Capital Recovery - Group 6	**$ 0**		
Group 7: Leashold Improvements	**$ 27**		No Changes
Total Adjusted Capital Recovery	**$ 90,061**		

Note[1] Depreciation listed in the financial statements was $208,164; total depreciation accounted for in their supplemental depreciation schedule was $207,465. Staff have selected the more definitive schedule for rate setting purposes.

ATTACHMENT 4

METRO

A.C. TRUCKING, INC. RATE REVIEW

CALCULATION OF PROPOSED A.C. TRUCKING RATE BASE

FISCAL YEAR 1996-97

EXPLANATION OF FOOTNOTES

1. 1930 Coupe

   An amount of $15,500 is listed as a fixed asset for this item. There is no discernible benefit to the rate payers for this asset. No depreciation is being taken for this item, but the asset value is part of the rate base calculation. Staff recommends that the $15,500 value for the 1930 Coupe be disallowed.

2. Truck Stereo System

   An amount of $2,600 ($3,000 net of depreciation taken of $400) is listed as a stereo system for Truck #712. While some type of radio/tape system is reasonable, the amount provided here is excessive. It is recommended that costs be limited to the depreciation already taken.

3. No Tax Basis Assets

   An item described as "no tax basis assets" of $246,262 ($313,424 net of depreciation already taken of $67,162) was listed in the 1995 depreciation schedule. A.C. Trucking representatives have revealed that this item is an adjustment to the value of assets exchanged during the reorganization of the parent company. The impact of this accounting treatment is to allow an additional depreciation expense for assets whose original cost has already been recovered. Staff recommends that this item be disallowed and removed from the rate base calculation.

4. Unsecured Loan

   A note receivable from an individual in the amount of $12,000 ($10,800 long term portion plus a current portion of $1,200) was listed in the 1995 balance sheet. It was further described as an unsecured loan at 1% interest with monthly payments of $100 plus interest. A financial statement footnote declared that payment on this note is delinquent. In light of the terms and conditions of this note, this item appears to be a personal rather than a business transaction. Accordingly, staff recommends that this item not be included in the rate base.

5. Goodwill

An amount of $900,120 ($1,000,000 net of $ 99,880 amortization already taken) was listed on the 1995 balance sheet. Goodwill did not appear in the financial statements of A.C. Trucking until the Calcagno companies were restructured in 1994. Goodwill is generally calculated as the premium for the existence of a going concern. Philosophically, the granting of a franchise to this company has furnished this benefit; the rate payers should not have to reimburse the owner for a privilege they themselves granted. Metro code §5.01.170 (d) (4) specifically excludes intangibles from the rate base calculations. Accordingly, this item is excluded from these calculations.

6. Current Amount of Disallowed Loan

The $1,200 current portion of the note receivable is not included in the rate base. See explanation in note #4 above.

7. Deferred Tax Benefit

An amounts of $483 is listed as a deferred tax benefit. A footnote disclosure describes this as a current asset arising from timing differences in reporting amortization of goodwill for income tax reporting purposes. As mentioned in Note #5 above, goodwill is excluded from the rate base calculation. Accordingly, this amount is excluded also.

8. Adjustment for Income Tax

1995 reviewed financial statements provided by A.C. Trucking's CPA contained the note that the consolidated entity had no income tax liability for that year. While an income tax expense was listed in A.C. Trucking's financial statements for 1995, a fair allocation of this tax expense cannot be verified without an examination of the parent company's financial records. Staff requested access to inter-company records but A.C. Trucking declined to provide them. Staff recommend that there be no tax adjustment made to the rate base calculation.

Attachment 4

M E T R O

Calculation of AC Trucking Rate Base

Per ACT Financials of 12/31/95

Fixed Assets		
Total Fixed Assets	$ 1,399,916	
Accumulated Depreciation	(791,310)	
Net Fixed Assets	$ 608,606	
Adjustments (Net of Accumulated Depreciation):		
Delete: 1930 Coupe	$ (15,500)	1
Delete: Truck Stereo System	(2,600)	2
Delete: "No Tax Basis Assets"	(246,262)	3
Subtotal Adjusted Fixed Assets	$ 344,244	
Other Assets	$ 910,920	
Adjustments:		
Delete: Unsecured loan to an individual	$ (10,800)	4
Delete: Goodwill	(900,120)	5
Adjusted Other Assets	$ 0	
Total Adjusted Unrecovered Capital Investment	**$ 344,244.00**	
Working Capital Calculation		
Current Assets	$ 500,876	
Delete: Current amount of disallowed loan	(1,200)	6
Delete: Income Tax Intangible	(483)	7
Adjusted Current Assets	$ 499,193	
Current Liabilities	$ (258,745)	
Working Capital	**$ 240,448**	
Return on Rate Base Calculation		
Working Capital	$ 240,448	
Total Adjusted Unrecovered Capital Investment	$ 344,244	
Rate Base	**$ 584,692**	
Return Calculation	**X 0.15**	
Return on Rate Base	**$ 87,704**	
Adjustment for Income taxes (None)	**X 1.00**	8
Return on Rate Base	**$87,704**	