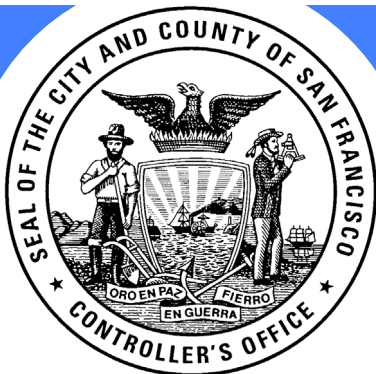


# Public Integrity Review

## Preliminary Assessment:

Refuse Rate-Setting Process Lacks  
Transparency and Timely Safeguards



**CITY & COUNTY OF SAN FRANCISCO**

Controller's Office

April 14, 2021

## Assessment Summary

The Controller's Office (Controller) conducted this assessment in coordination with the City Attorney's Office (City Attorney). It is based on findings from our joint Public Integrity investigation. This assessment identifies areas for further review and makes preliminary recommendations to improve the rate-setting process for refuse (waste, compostable materials, and recyclables) collection in the City and County of San Francisco (City). The assessment focused on:

- The oversight and approval of the refuse collection and disposal rate-setting process, including the role of the director of San Francisco Public Works (Public Works) and the Rate Board in the rate-setting process.
- A review of the 2017 rate application of Recology Sunset Scavenger/Recology Golden Gate, the Public Works director's report, and the rate-setting process.
- Suggested improvements and additional safeguards and updates to the rate-setting process, including other rate-setting process examples, and ways to make the quarterly and annual rate-reporting process more transparent.

More assessments of other internal control processes will be released as our Public Integrity Review progresses. This assessment is the fifth in the series, is offered for public comment and review, and may be revised in the future as our work continues.

## Assessment Summary *(continued)*

### Highlights: Preliminary Findings

Based on a review of the 2017 Rate Application for Recology Sunset Scavenger and Recology Golden Gate, which culminated in orders from the Public Works director that set residential refuse collection rates for rate years ending June 30, 2018, 2019, 2020, and 2021, we identified several areas that need improvement and should be considered for any future rate-setting cycles. These include **mitigating controls to protect refuse ratepayers from errors, omissions, and preventable variances in the rate application and approval process.**

As the City implements a new, two-commission structure for Public Works and the new Department of Sanitation and Streets, **we recommend that the Mayor's Office (Mayor) and Board of Supervisors consider these safeguards and updates to the refuse rate-setting process and reevaluate the 1932 Refuse Collection and Disposal Initiative Ordinance, changes to which would generally require voter approval.**

## Background on the Public Integrity Investigation

The City Attorney is leading the investigation into alleged wrongdoing by city employees outlined in criminal charges brought by the U.S. Attorney's Office against:

- Mohammed Nuru, former director of Public Works
- Nick Bovis, owner of Lefty's Grill and Buffet and other restaurants
- Sandra Zuniga, former director of the Mayor's Office of Neighborhood Services
- Florence Kong, former member of the Immigrant Rights Commission
- Balmore Hernandez, chief executive of engineering firm AzulWorks, Inc., a company with large city contracts
- Wing Lok "Walter" Wong, building permit expediter and owner of several entities that do business with the City
- Alan Varela and William Gilmartin III, officers of ProVen Management, Inc.
- Paul Giusti, former group government and community relations manager for Recology
- Harlan Kelly, Jr., former general manager of the San Francisco Public Utilities Commission

## Background on the Public Integrity Investigation *(continued)*

Mr. Bovis and Mr. Wong have pled guilty to schemes to defraud the City using bribery and kickbacks. Mr. Wong admitted to conspiring with Mr. Nuru and other unnamed city officials since 2004. Both are now cooperating with the ongoing federal investigation. Also, Mr. Hernandez has pled guilty and will cooperate, Ms. Kong has pled guilty to providing bribes to Mr. Nuru, and Ms. Zuniga has pled guilty to conspiring to commit money laundering with Mr. Nuru and will cooperate.

The City Attorney has focused its investigation on misconduct by current and former city employees and any remedies for specific decisions or contracts tainted by conflicts of interest or other legal or policy violations.

Beyond involving those facing criminal charges, the investigation led Tom Hui, then the director of the Department of Building Inspection, to resign in March 2020 because of evidence showing he had accepted improper gifts, violated city law by giving preferential treatment to Mr. Wong and developer Zhang Li, and abused his official position to help his family and friends obtain city jobs.

## Background on the Public Integrity Investigation *(continued)*

On July 13, 2020, the City Attorney initiated debarment proceedings against Azul Works, Inc., and Balmore Hernandez. By agreement of the parties and a stipulated suspension, the proceedings are stayed until the conclusion of the federal charges against Mr. Hernandez.

On March 1, 2021, the City Attorney issued suspension orders against:

- Nick Bovis and his company, SMTM Technology, LLC
- Alan Varela and William Gilmartin III and their company, ProVen Management Inc.
- Florence Kong and her companies, SFR Recovery Inc. and Kwan Wo Ironworks Inc.
- Wing Lok “Walter” Wong and his companies W. Wong Construction Co., Inc., Green Source Trading, LLC, and Alternate Choice, LLC

On March 4, 2021, the City Attorney announced **a more than \$100 million refuse rate settlement with Recology**. The settlement provides ratepayer refunds based on errors related to omitted Impound Account and Zero Waste Initiative revenues in the rate application for Recology Sunset Scavenger and Recology Golden Gate that was used to set refuse collection rates for July 2017 through June 2021. The settlement also resulted in lower rates effective April 1, 2021.

## The Criminal Complaint Against Mr. Giusti

The FBI affidavit in support of the criminal complaint alleges that over several years Mr. Giusti, former group government and community relations manager for Recology, **bribed Mr. Nuru**, the former director of Public Works, and **concealed the bribes as charitable donations to nonprofit organizations in exchange for Mr. Nuru influencing and approving Recology's requests.**

- Mr. Giusti bribed Mr. Nuru by giving \$20,000 for Public Works' annual holiday party in exchange for Mr. Nuru helping Recology to implement an increase in "tipping" (dumping) fees. Mr. Giusti concealed the \$20,000 as a donation to Lefty O'Doul's Foundation for Kids, a nonprofit organization headed by Mr. Bovis. Mr. Bovis then used the money to pay for expenses associated with Public Works' holiday party and not for his foundation.
- According to the complaint, Recology continually provided benefits to Mr. Nuru, his family, and Public Works in excess of \$1 million either directly or through nonprofit organizations to influence and reward Mr. Nuru's cooperation with and approval of its requests for residential refuse collection rate increases, funding, and other issues related to city contracts and approvals.
- Over six years, these benefits allegedly included annual contributions to the Public Works holiday party and other employee events, a job and an internship for Mr. Nuru's son, and payment for the funeral expenses of a Public Works employee.

## Background on Recology and Mr. Giusti

Recology is a privately held waste management company headquartered in San Francisco that provides refuse services to residential and commercial customers in San Francisco and other municipalities in multiple states. The company operates in the City through three entities: Recology San Francisco, Recology Sunset Scavenger, and Recology Golden Gate.

Mr. Giusti was Recology's group government and community relations manager for all three San Francisco entities from February 2012 until June 2020. In this capacity Mr. Giusti served as Recology's liaison to elected officials, city departments, and community organizations.

According to the FBI affidavit in support of the federal complaint against him, Mr. Giusti was "tasked with keeping [Mr. Nuru] happy." He also played an integral role in Recology's 2017 rate application to increase residential refuse rates and was praised for "minimizing negative press about the rate increase," including "avoiding bad press regarding the rate structure."



## San Francisco's Residential Refuse Collection Services

The City has no formal agreement for the provider of residential refuse collection services in San Francisco that includes service conditions or term limits, nor has it ever engaged in competitive procurement processes for these services, as authorized under the City's Refuse Collection and Disposal Initiative Ordinance (the Refuse Ordinance) approved by San Francisco voters in 1932.

- The Refuse Ordinance is codified in the City's Administrative Code.
- The Refuse Ordinance created a regulatory scheme—and approved 97 permits, which never expire—for residential refuse collection in the City.
- Over time, as the major refuse collection companies merged into Recology, it acquired all 97 permits, causing it to become San Francisco's only residential refuse collector. In this way, Recology gained control of all residential refuse collection in San Francisco. Because the permits are perpetual, Recology is not subject to a competitive bidding process for residential refuse collection.
- The processes other jurisdictions use to select a refuse collection vendor vary, and include competitive bidding, negotiated agreements, or non-exclusive contracts.

## The City's Commercial Refuse Collection Services

In contrast to residential rates, the Refuse Ordinance does not expressly authorize the Rate Board to set non-residential (commercial) refuse rates. Instead, for commercial refuse collection in San Francisco, the rates are subject to an agreement between the City and the permitted and licensed refuse collector(s).

Although the City could have administered a competitive solicitation to award its commercial refuse collection contract, it has not consistently done so. Instead:

- In fiscal year 1987-88 the Board of Supervisors approved an exclusive waste disposal agreement with Norcal Waste Systems, Inc., (Norcal Companies), now Recology, to transport waste to a designated transfer station at the Altamont landfill, which was owned and operated by Waste Management, as the exclusive disposal facility for San Francisco for 65 years or until 15 million tons of waste are deposited at the site.
- Despite the City's administration of a competitive solicitation in 2009 for its commercial refuse collection,<sup>\*</sup> upon the expiration of the previous contract in fiscal year 2015-16, the City entered into an exclusive waste disposal agreement with Recology, in effect until nine years elapsed, with the ability to renew, or until 3.4 million tons of waste are deposited at the Hay Road landfill.<sup>\*\*</sup>

<sup>\*</sup> Due to delays, the [previous contract](#) with Recology for a landfill in Yuba County was terminated.

<sup>\*\*</sup> [2015 Landfill Disposal Agreement between the City and Recology San Francisco](#) (2015)

# Popular Vote Required to Change Recology's Exclusive Control of Residential Refuse Collection Services

## Preliminary Finding:

San Francisco voters would have to approve an amendment to the City's Administrative Code to change the process the City uses to obtain residential refuse collection service. The current process allows Recology to hold all of the City's residential refuse permits and not compete to remain as the exclusive permit holder to provide the service.

The City should review its refuse collection structure and consider alternate models for these services, including those set forth in Proposition A of 2012.\* The proposition, for example, would have:

- Required the City to use a competitive solicitation process to award long-term residential refuse collection contracts.
- Split up the residential refuse collection contracting process, allowing the City to contract separately for residential and commercial collection, processing of recycling and compostable materials, transportation to disposal sites, and disposal of the remaining waste.
- Allowed the City to use operating ratios to set commercial rates as it does for residential rates.

\* San Francisco voters defeated [the measure](#) in the June 2012 election.

## Participants in the Refuse Rate-Setting Process

The **director of Public Works** is responsible for ensuring the rate-setting process is fair to ratepayers by holding public workshops and hearings for rate adjustment applications and issuing a report and recommended order to approve or deny a refuse rate adjustment.

The Refuse Ordinance created the City's **Refuse Collection and Disposal Rate Board** (Rate Board),\* which oversees appeals and affirms the director's report. The Rate Board has three members: the City's chief administrative officer (the chair), controller, and manager of utilities.\*\*

The **Department of the Environment** is responsible for reaching the City's zero waste goals and works with Recology to implement city-mandated recycling programs and advance efforts to reduce waste.

\* The Rate Board effectively sets commercial refuse rates, although they are beyond the Refuse Ordinance's scope.

\*\* The chief administrative officer is the city administrator and the manager of utilities is the general manager of the San Francisco Public Utilities Commission. Any member may designate a subordinate employee to act in their place.

## Participants in the Refuse Rate-Setting Process *(continued)*

**Refuse Rate Adjustment Stakeholders:** Multiple stakeholders participate in the rate adjustment application process, including the following.

- **Rate Applicant:** Presents an overview of the application and may respond to questions from its testimony.
- **Public Works:** Staff helps the director review the application.
- **Ratepayer Advocate:** This Public Works appointee provides public outreach about the application and helps the public convey comments during the proceedings. The ratepayer advocate for the 2017 rate application was RDJ Enterprises.
- **Public:** Can comment during proceedings and file formal objections to the proposed rate adjustments.

## Ratepayer Advocate's Role May Be Different Than Intended

### Preliminary Finding:

The ratepayer advocate functions primarily as a public liaison and outreach coordinator rather than as an advocate, which may be inconsistent with the intent of the Budget Analyst's recommendation that led to the position's creation.

In a 2002 report,<sup>\*</sup> the Board of Supervisors' Budget Analyst<sup>\*\*</sup> recommended the Rate Board and the Public Works director retain a public interest attorney or refuse collection expert **to advocate on behalf** of the City's ratepayers in the rate-setting process. In justifying the need for the advocate, the report explains that the rate-setting materials are "technical, cumbersome, and difficult for the general public to review and comprehend," and the public had expressed "frustration with the ability to participate in the City's rate review process."

Yet, according to the DPW Order<sup>\*\*\*</sup> that created the position, the advocate is to act as more of a liaison than an advocate in that it is to:

- Develop and implement public participation to broaden ratepayers' understanding and participation in the rate-setting process.
- Act as a liaison between the City and ratepayers.
- Help ratepayers convey comments and concerns to the City during the rate-setting process.

<sup>\*</sup> [Budget Analyst's 2002 Report of the Refuse Rate Application Process and Review of Audited Financial Statements for NorCal Companies.](#)

<sup>\*\*</sup> [The office is now called the Budget and Legislative Analyst.](#)

<sup>\*\*\*</sup> [DPW Order No: 185078 \(July 11, 2016\): Rules of Procedure Refuse Collection and Disposal Rate Hearings](#)

## Ratepayer Advocate's Role May Be Different Than Intended

*(continued)*

The 2016 Public Works contract with the ratepayer advocate, which is consistent with the City's solicitation document that preceded it, requires the advocate to:

- Define a strategy to notify and engage San Francisco's diverse communities in the rate-setting process.
- Review the 2017 rate adjustment application and translate technical information into layperson's language to explain rate changes.
- Serve as the single point of contact for informational purposes between city representatives, the rate applicant, and ratepayers, and be a resource to ratepayers.
- Represent and advocate the ratepayers' views in an articulate and comprehensive manner at workshops and the Public Works director's hearings and before the Rate Board, including presenting evidence on behalf of the ratepayers.
- Provide reports as required by the contract, which may include a summary of outreach efforts and effectiveness, ratepayer concerns, and issues encountered in the rate adjustment process.

Also, the advocate may file objections with the Rate Board in accordance with the Refuse Ordinance, although it does not appear to have done so regarding the 2017 rate application. As defined by the DPW Order and contract, the advocate's role focuses on being a liaison with the public and presenting public comments in hearings and meetings, rather than devising or executing a strategy to advocate for the public's interest, including lower refuse collection rates.

## The City's Refuse Rate-Setting Process\*

The applicant (Recology) requests residential refuse rate adjustments through the following process:

### San Francisco's Refuse Rate Adjustment Process

1. Applicant submits a 120-day notice of intent to file a rate adjustment application.
2. Applicant submits the final rate adjustment application for rate increase request.
3. Informational Technical Workshop is held.
4. Public Works director and stakeholders evaluate the rate adjustment application.
5. Public Works director holds public hearings on requested rate increases.
6. Public Works director issues a report and recommended order on adjusting rates.
7. If objections to recommended order are filed, Rate Board holds additional hearings. If no objections are filed, Public Works director's recommendation becomes final.
8. Rate Board makes final decision based on Public Works director's recommendation or, if no decision is made within 60 days, Public Works director's recommended order takes effect.

\* Source: [DPW Order No: 185078 \(July 11, 2016\): Rules of Procedure Refuse Collection and Disposal Rate Hearings](#)



## Summary of the 2017 Rate Review Process *(all dates below were in 2017)*

According to Public Works' website, the following occurred in the 2017 rate-setting process:

Date	Rate-Setting Process
February 10 <sup>th</sup>	The deputy city administrator, who chairs the Rate Board, received an application from Recology requesting changes to residential refuse collection and disposal rates. As required by the Refuse Ordinance, the chair referred the application to the director of Public Works for hearings, reports, and recommendations.
February 28 <sup>th</sup>	In response to Recology's application, Public Works held a technical workshop for the public.
March and April	<p>Public Works held nine public hearings to review the application, In each, Recology and city staff offered testimony, and both parties were able to cross-examine. In this hearing process, Recology has the burden of proof to demonstrate through evidence on the record that the rate increase it is requesting is "just and reasonable."</p> <ul style="list-style-type: none"> <li>• At <b>every Public Works director's hearing</b>, the ratepayer advocate offered testimony and conducted cross-examinations, and public comment time was provided.</li> </ul>

## Summary of the 2017 Rate Review Process *(continued)*

Date	Rate-Setting Process
May 12 <sup>th</sup>	The Public Works director issued a report* recommending adjustments to the proposed rates and published two recommended rate orders.
June 16 <sup>th</sup> and 19 <sup>th</sup>	<p>The Rate Board met to hear and consider objections to the director's report and recommended orders, filed by the public. Objections and questions included those regarding:</p> <ul style="list-style-type: none"> <li>• Complaints about the rate increases being too high</li> <li>• The inability of property owners to pass through to tenants' rate increases for two- to five-unit buildings built before 1979.</li> <li>• Inflexible collection rates for unoccupied units.</li> <li>• City costs that may have been included in the rate application.</li> <li>• The waste receptacles not being well-armed.</li> </ul>
June 19 <sup>th</sup>	The Rate Board issued a resolution affirming the director's report and recommended orders.
July 1 <sup>st</sup>	The new refuse rates went into effect.

\* Source: San Francisco Public Works Director's Report and Recommended Orders on the 2017 Rate Application of Recology San Francisco, Recology Sunset Scavenger, and Recology Golden Gate (May 12, 2017).

## Cost Drivers for the 2017 Proposed Rate Increase at Recology Sunset Scavenger and Recology Golden Gate

On February 10, 2017, Recology Sunset Scavenger and Recology Golden Gate submitted its formal rate application to the Rate Board, requesting a 22.96 percent average increase in residential refuse collection rates.

According to the 2017 director's report, Recology Sunset Scavenger and Recology Golden Gate attributed its proposed rate changes to the following, as submitted in the rate application, not updated for post-filing adjustments:

Type of Change	Amount	%
Business as Usual	\$16,838,070	6.37
Change in Participation in Existing Programs	14,331,386	5.42
Implementation of New Programs	12,231,003	4.63
New Landfill Agreement	12,214,293	4.62
New Composting Costs	3,766,309	1.43
New Capital Investments	1,302,460	0.49
<b>Total</b>	<b>\$60,683,521</b>	<b>22.96%</b>

Recology Sunset Scavenger and Recology Golden Gate also sought to offset rate increases by using balances from the Special Reserve and the Zero Waste Incentives Fund.

## Reserve, Impound, and Zero Waste Incentive\*

Purpose of Fund/Account	
<b>Reserve Fund</b>	This fund is for extraordinary expenses relating to a <a href="#">2015 Landfill Disposal Agreement</a> between the City and Recology San Francisco. Recology Sunset Scavenger and Recology Golden Gate is required to fund this account with \$2 million of annual transfers from the Special Reserve Account, with the last of these transfers to occur at the beginning of Rate Year 2020. At the end of Rate Year 2020, any remaining funds in the Special Reserve Account were to be transferred to the Reserve Fund.
<b>Impound Account</b>	This is a restricted bank account held jointly by Recology San Francisco and the City and used by the City to cover certain waste management and diversion expenses. The company's deposits into the account are not to be reported as assets or liabilities of Recology Sunset Scavenger and Recology Golden Gate.
<b>Zero Waste Incentive Account:</b>	Recology Sunset Scavenger and Recology Golden Gate can generate additional earnings beyond the historically allowed profit by meeting goals for disposal of materials from landfill. The 2013 and 2017 rate orders established new zero waste disposal goals based on the targets disposed of at four tiers. If Recology Sunset Scavenger and Recology Golden Gate do not meet the disposal targets for Tiers 1 and 2 for the rate year, then the incentive funds in the account would be rebated to ratepayers to offset rate increases and COLA adjustments. If Recology Sunset Scavenger and Recology Golden Gate do not meet the disposal targets for Tiers 3 and 4, they can propose to rebate ratepayers or request to use those funds for new programs that reduce disposal.

\* Source: KPMG Combined Financial Statements and Supplementary Information for September 30, 2019, and 2018 for Recology Sunset Scavenger and Recology Golden Gate; [Public Works' Director's Report and Recommended Orders on the 2017 Rate Application](#).

## San Francisco's Refuse Rate-Setting Methodology

Approximately every five years, San Francisco completes a detailed rate review. For Recology, the City uses an "operating ratio" rate-setting formula and accounts for the cost of living during interim years through an indexed adjustment.\*

- The operating ratio formula is intended to provide a regulated refuse company with adequate funds to pay its expenses and receive a profit.\*\*
- The operating ratio compares a company's annual projected expenses to its annual projected revenues for rate-setting purposes.
- According to the 2017 director's report, Recology calculates rates based on a 91 percent operating ratio, with an additional 2 percent operating ratio available for achieving zero waste initiatives. This allows for an annual profit margin of up to 11 percent.

\* ["Study to Examine Practices for Selecting Refuse Collection, Hauling and Disposal Providers," R3 Consulting Group, Inc. Prepared for: San Francisco Local Agency Formation Commission \(April 14, 2011\).](#)

\*\* [Budget Analyst's 2002 Report of the Refuse Rate Application Process and Review of Audited Financial Statements for NorCal Companies.](#)

## Other Refuse Rate-Setting Methodologies

Other jurisdictions use a variety of processes to set and adjust refuse collection rates. Below are three rate-setting methods, which are not mutually exclusive.\*

Rate-Setting Methodologies	
<b>Consumer Price Index (CPI)</b>	Measures the average change over time in prices paid by consumers for a group of goods and services. The current service rate is multiplied by the percentage change, or in some cases a percentage change in the CPI over a 12-month period.
<b>Refuse Rate Index (RRI)</b>	A multiple index approach based on various national indices that apply to the refuse collector's direct costs. Each year the collector submits unaudited financial information that separates operating costs into five categories: labor, fuel, vehicle replacement, maintenance, and other. Based on its value as a percentage of total cost, each category is assigned a weight. Each category is associated with a national index, and the change in that index is calculated for the appropriate period. The change is multiplied by the weight factor for the appropriate category, and the sum of the result is the RRI for that period. The current collection rate is then multiplied by the new RRI to establish the collection rate.
<b>Detailed Rate Review</b>	A review of the refuse collector's costs (labor, vehicle, recyclable materials), allocation costs (container and vehicle maintenance, depreciation), profit, and pass-through costs (disposal, processing, city fees).

\* ["Study to Examine Practices for Selecting Refuse Collection, Hauling and Disposal Providers," R3 Consulting Group, Inc. Prepared for: San Francisco Local Agency Formation Commission \(April 14, 2011\).](#)

## Director's Report for the 2017 Proposed Rate Increase

The 2017 director's report includes two key tables related to the proposed rate increase:

1. A schedule of proposed average rate increases for July 2017 through June 2021 for Recology Sunset Scavenger (RSS) and Golden Gate (RGG):

Rate Year	2017-18	2018-19	2019-20	2020-21
Application*	16.40%	4.25%	0.00%	0.78%
Director's Order	14.42%	5.46%	-0.55%	0.79%

\* Reflects post-filing changes to the total rate increase.

2. A list of Cost of Living Adjustments (COLAs) over and above the rate changes, based on two weighted average, composite rates tied to the CPI, Producer Price Index (PPI), or other indices, that appear to be ongoing, absent a new director's order being issued:

COLA Factor	Source/Index	RSS/RGG Weight
Fixed Labor	As per collective bargaining agreements	52.50%
Variable Labor	SF-CPI (U)	6.70%
Health and welfare	Mercer analysis or equivalent	12.10%
Pension	City pension factor or rate from actuarial report	6.80%
Renewable diesel	Weekly California No. 2 Diesel Retail Prices	0.85%
Natural gas fuel	PG&E Series G-NGV1	0.15%
Materials	PPI	14.30%
Capital	No inflation	6.60%
<b>Total</b>		<b>100.00%</b>

## Chronology of the Discovery of 2017 Rate Increase Error at Recology Sunset Scavenger and Recology Golden Gate\*

Year	Event	Results
2017	Recology submits 2017 rate application for Recology Sunset Scavenger and Recology Golden Gate that fails to account for a substantial amount of revenues it was slated to receive from San Francisco ratepayers, and no party involved in the rate adjustment process detects the omitted revenues. This results in a recommended rate increase of more than 14 percent, when the actual revenues only support an increase of about 7 percent.	The public relied on inaccurate information provided by Recology in its 2017 rate application because Recology omitted substantial revenues.
2018	Recology and Public Works exchange a series of draft reports for the first quarter of rate year 2018, in which Recology reports excess revenue. Public Works alerts Recology that it incorrectly reported net revenue instead of all impound account and zero waste incentive revenue. No quarterly or annual reports are posted on Public Works' website after the September 30, 2018, rate report.	Although Recology and Public Works identified the error in Recology's reported revenues in late 2018 and early 2019, no action was taken by either Recology or Public Works to rectify the error on the rate application until 2020.
2019	In January Recology discloses the revenue error to Public Works, but neither organization publicly discloses or corrects it. Recology continues to collect the excessive rates from ratepayers.	
2020	In March Public Works sends Recology an analysis that concludes the rate increase should have been about 7 percent instead of more than 14 percent. In December Recology's counsel reports the rate error to the City Attorney.	

\* From the City Attorney's Office's joint public integrity investigation with the Controller's Office.



## The 2017 Recology Sunset Scavenger and Recology Golden Gate Rate Increase Error

### Preliminary Finding:

The 2017 error in the rate application of Recology Sunset Scavenger and Recology Golden Gate was due to the exclusion of revenues from a zero waste and impound account that greatly impacted the operating ratio formula used to determine the rate increase.

- The main driver of the 2017 rate increase error was that revenue paid by ratepayers for the zero waste incentive and impound accounts were excluded from the rate application when they should not have been. The error resulted in a recommended rate increase of more than 14 percent, when the actual revenues, including zero waste incentive and impound revenue, only supported an increase of about 7 percent.
- The error was missed by the financial reviewers of the 2017 rate application, including Public Works staff, a retired Public Works employee acting as a consultant, and R3 Consulting Group, Inc (R3). R3 was to examine and analyze the rate adjustment application to determine if Recology's calculated costs, revenues, and assumptions were reasonable, appropriate, and accurate.
- The City should improve its rate review process to prevent such errors and assess whether the operating ratio methodology should continue to be used in the rate-setting process.

## Consideration of Codifying Safeguards

### Preliminary Finding:

The Refuse Ordinance has few safeguards for the refuse rate-setting process other than hearings that offer the public an opportunity to comment. In contrast, the **San Francisco Charter, Section 8b.125, has several safeguards for the City's water and sewer rate-setting process to protect those ratepayers that should be considered in the refuse rate-setting process.** These safeguards require the San Francisco Public Utilities Commission to:

- Retain an independent rate consultant to conduct rate and cost-of-service studies for each utility at least every five years.
- Set retail rates, fees, and charges based on the cost of service.
- Study rate-based conservation incentives and/or lifeline rates to assist low-income users and consider the studies' results when establishing rates, fees, and charges, in accordance with applicable state and federal laws.
- Adopt annually a rolling five-year forecast of rates, fees, and other charges.
- Establish a Rate Fairness Board consisting of seven members,\* four of whom represent residential and commercial customers. The Board makes a report and recommendations for the Public Utilities Commission, which then makes the final determination on the rate proposal.

\* The members include the city administrator or a designee, the controller or a designee, the director of the Mayor's Office of Public Finance or a designee, two residential retail customers (one appointed by the mayor and one by the Board of Supervisors), and two retail business customers (a large business customer appointed by the mayor and a small business customer appointed by the Board of Supervisors).

## The Role of the Director in the Rate-Setting Process Should Be Revised and Codified

### Preliminary Finding:

Although his actions were subject to multiple stakeholders' review at public hearings and comments, Mr. Nuru had significant influence over the City's refuse collection rate-setting process.

- Although the rate adjustment process is codified via the Refuse Ordinance, the procedure is dictated by an order issued by Public Works.
- Because the Public Works director is the only participant in the rate adjustment process whose determination could be final in the absence of a Rate Board decision, the weight of the director's determination is substantial.

Proposition B, passed in November 2020, transferred some of the Department of Public Works' responsibilities to a new Department of Sanitation and Streets, which will be overseen by a five-member Sanitation and Streets Commission. The law may transfer the Public Works director's rate-setting responsibilities to the new department's head. Although the Rate Board still oversees the rate-setting process, the City would benefit from a revision to, and then codification of, the role of the director and, if applicable, the department's commission in the rate-setting process. The revisions should include the addition of further internal controls.

## Recommendations

Given the findings of our preliminary assessment, we offer the following preliminary recommendations, which we may refine as the investigation and review continue and we consider the feedback we receive in the review process.

1. **The Mayor and Board of Supervisors should consider whether the 1932 Refuse Collection and Disposal Initiative Ordinance and the City's arrangement with Recology continue to provide optimal benefits to ratepayers or whether another business model should be employed. Any change to the Refuse Ordinance will require voter approval.**
2. **The Mayor and Board of Supervisors should codify the extent and limitations of the roles, including oversight roles, in the refuse rate-setting process of the commission, director, and staff of the new Department of Sanitation and Streets and any related contractors, including the ratepayer advocate, rate consultants, and auditors.**
3. **The Mayor and Board of Supervisors should consider whether additional changes to the refuse rate-setting process are warranted, such as assigning operational and financial oversight to a department that is further removed from the refuse collector.**

## Recommendations *(continued)*

4. To ensure that the public interest is adequately represented in the rate-setting process, the City should review the role of the ratepayer advocate and, if deemed necessary, direct that the role be changed in future competitive solicitation documents and contracts for this service so that the role emphasizes advocacy, as its name implies.
5. Regarding the refuse rate adjustment process, the City should assess whether the operating ratio or another methodology should be used and should require that:
  - a. The refuse company submits documents supporting its rate application, such as: audited financial statements; quarterly and annual rate reports that include all sources (including reserves and special accounts) and costs by ratepayer class, operating ratios, and balancing accounts; and a reconciliation between the audited financial statements and annual rate reports.

## Recommendations *(continued)*

- b. Any quarterly or annual rate report submitted shows the date it was issued and includes a summary of any revisions made if later versions are published. All such reports should be posted to website of Public Works or the Department of Sanitation and Streets (when it begins operations) and filed with the Rate Board in a timely manner.
- c. Cost of Living Adjustment factors are analyzed based on actual results over the preceding four years.
- d. Public Works report to the refuse company and file a report with the Rate Board when an error in documentation that had been submitted is identified.
- e. The refuse company ensures an independent rate analysis is performed that includes a study of comparable jurisdictions' refuse collection rates to support the accuracy and reasonableness of the proposed rate adjustment. This analysis should be considered by the Public Works director, Rate Board, and/or Sanitation and Streets Director and Commission as part of each rate-setting process.

## Completed and Upcoming Public Integrity Reporting

The Controller's Public Integrity Review, performed in consultation with the City Attorney, will continue to assess selected city policies and procedures to evaluate their adequacy in preventing abuse and fraud. Completed, current, and future assessments and reports address the following topics:

- [San Francisco Public Works Contracting](#) (report issued on June 29, 2020)
- [Gifts to Departments Through Non-City Organizations Lack Transparency and Create "Pay-to-Play" Risk](#) (report issued on September 24, 2020)
- [San Francisco's Debarment Process](#) (report issued on November 5, 2020)
- [Ethical Standards for Contract Award Processes of the Airport Commission and Other Commissions and Boards](#) (report issued on January 11, 2021)
- Citywide ethics reporting requirements
- The Department of Building Inspection's permitting and inspection processes
- The San Francisco Public Utilities Commission contracting process
- A final report on the topics covered in these preliminary assessments

Additional reviews and assessments will be determined and performed as the City Attorney's investigation proceeds.

# Any questions or comments?

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## Appendix

Further details of what the City should require for any future rate application and for the subsequent monitoring and administration of refuse rate orders are as follows:

1. All rate applications should:
  - a. Be dated and include all sources and uses of funds, by ratepayer class, including residential single-family, residential multifamily, apartment, commercial, commercial compactor for collection, disposal and/or diversion related to waste, and recycling and composting services, and should include a summary of key assumptions.
  - b. Include audited financial statements that reflect all sources and uses in the same categories noted in 1a above, to ensure ratepayers can see the cost of service by ratepayer class.
  - c. Include a balancing account for each ratepayer type subject to the City's process, to ensure that excess profitability, due to either mis-estimation, errors, revenue omissions, or otherwise do not go unidentified and are timely credited back to the ratepayer with interest.

## Appendix *(continued)*

2. An independent rate analysis should be performed with results reported to both the Public Works director and the new commission, and the scope of work should include a check of and confirmation that updated projections between the time of initial application and the Director's Order issuance has occurred, along with a check of and confirmation that all sources and uses by ratepayer type, revenue, and expenditure components have been confirmed and reconciled against the most recently published audited financial statements and rate orders.
3. An independent audit of the refuse company's financial statements should be clearly presented by ratepayer type, including all associated revenues and expenditures allocable to each ratepayer type, as well as covered service, such as refuse collection and disposal, diversion, and recycling and composting. Each audit report should be completed and published in a timely manner.
4. Cost of Living Adjustment factors should be analyzed based on actual results over the past four years and, if continued, subject to an independent annual audit. If applicable, any surplus or shortfall should accrue to the balancing account for the ratepayer type that paid the rate resulting in the surplus or shortfall.

## Appendix *(continued)*

5. All quarterly and annual rate reports should be required to be dated when issued and, if subsequent revisions or versions are published, include a summary of revisions made. All reports should be required to be promptly published to the City's website and filed with the new Sanitation and Streets Commission.
6. For ease of comparison by the public, policymakers, and city staff, tables and content required in the quarterly and annual rate reports should be updated to clearly show all sources and uses by ratepayer type, revenue and expenditure components by ratepayer type, and include the same from the most recently published audited financial statements.
7. The City should consider requiring an independent study of the refuse rates of various metropolitan jurisdictions. These rates should be compared to those of the City and considered by the Public Works or Sanitation and Streets director and commission during each annual rate-setting review.