

## **FINDING OF EMERGENCY**

CALIFORNIA CODE OF REGULATIONS  
TITLE 14. NATURAL RESOURCES  
DIVISION 2. DEPARTMENT OF CONSERVATION  
CHAPTER 5. DIVISION OF RECYCLING

### **FINDING OF EMERGENCY**

The Department of Resources Recycling and Recovery (CalRecycle/Department) is proposing emergency regulations to amend section 2975, Subchapter 12, Chapter 5, Division 2, Title 14, of the California Code of Regulations (CCR) that lays out the reasonable financial return calculation for processing payments paid to recyclers. The term “recycler” for purposes of this rulemaking has the same definition as in Public Resources Code (PRC) section 14519.5., i.e., “recycler” means a recycling center, dropoff or collection program, or curbside program. These entities receive processing payments which reimburse recyclers for the difference between the cost of recycling beverage container material and the value a recycler receives when it sells that material as scrap. For calendar year 2020, the Department is proposing using a reasonable financial return of 10 percent when calculating processing payments instead of the Dun and Bradstreet index as stated in regulations. The reasonable financial return determined from the Dun and Bradstreet index will likely be much lower than 10 percent. This change will help support beverage container recycling in California by establishing a reasonable financial return that provides a balance between the risk associated with operating a beverage container recycling center under current market conditions and a return on investment that retains current operators. This measure is expected to stem ongoing recycling center closures which will preserve convenient redemption opportunities to consumers.

The adoption of these regulations is deemed to be an emergency pursuant to PRC section 14536.1 which provides that “if the department determines that it is necessary to adopt or amend regulations to implement section 14575, the department may adopt or

amend those regulations as emergency regulations. The Office of Administrative Law shall consider those regulations to be necessary for the immediate preservation of the public peace, health and safety, and general welfare for purposes of section 11349.6 of the Government Code. Notwithstanding subdivision (e) of section 11346.1 of the Government Code, the emergency regulations adopted or amended pursuant to this section shall be repealed 180 days after the effective date of the regulations, unless the department complies with Chapter 3.5 (commencing with section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.”

### FINDING OF NECESSITY

The California Beverage Container Recycling Program (BCRP) was established as a California Redemption Value (CRV) deposit and return system to create convenient beverage container recycling opportunities in the state. The Department is tasked with ensuring consumers throughout the state have convenient recycling options to return their CRV beverage containers to and claim their deposit.

When the BCRP was created thirty-two years ago, the law provided for a “reasonable financial return” for recyclers in order to insure the economic recovery of the beverage containers. This “reasonable financial return” was further clarified in the CCR section 2975 which states that “The statewide average reasonable financial return for recycling centers shall be equal to the statewide average allowable costs calculated in section 2960 of this subchapter, multiplied by the average return on costs for the scrap and waste materials industry as determined from data contained in the most recent Dun and Bradstreet Standard Three Year Norm Report (Published by Dun and Bradstreet Credit Services).” Due to adverse market conditions, the 2017 average return on costs for the scrap and waste materials industry reported by Dun and Bradstreet resulted in a negative reasonable financial return for the first time. To address the negative reasonable financial return and declining scrap values, the Department enacted emergency regulations effective December 13, 2018, to raise the reasonable financial return for calendar year 2019 to 11.5 percent for non-rural recyclers and 16.6 percent for rural region recycling centers. The emergency regulations were allowed to expire by

operation of law effective June 13, 2019 since the rates for 2019 were set on December 2018, achieving the objective of the emergency regulations.

The Department had anticipated that a legislative solution setting the reasonable financial return would be enacted in 2018 or 2019, but no such permanent change materialized. Because no legislative solution was enacted, the Department began the process of permanent rulemaking and held a public workshop July 16, 2019 to solicit feedback from interested parties. PRC section 14575(a) requires that the processing fee and processing payment rate be set on or before January 1. With an anticipated completion date of 2020, the permanent rulemaking will not be finished in time to set the desired rates for calendar year 2020. This emergency rulemaking will set the reasonable financial return for calendar year 2020 at 10 percent for all recyclers. The Department intends to make these emergency regulations permanent by completing the permanent rulemaking and filing a certificate of compliance in 2020 which will establish the reasonable financial return rate for calendar year 2021 and for each calendar year thereafter.

The Department proposes to amend or add the following sections to the California Code of Regulations, Title 14, Division 2, Chapter 5, Subchapter 12, Article 2:

Section 2975 will be amended to establish a specified reasonable financial return of 10 percent of the statewide average allowable costs provided in section 2960 of these regulations.

Section 2975 amends the regulations to authorize a reasonable financial return that is equal to ten percent of the statewide average allowable costs in section 2960. Further, in response to feedback from industry that the reasonable financial return needs to be stable from year to year and that the Dun and Bradstreet index is not an accurate reference for the profitability of a recycling center, the Department has selected ten percent in an attempt to provide a financial incentive that balances the risk of operating a recycling center and mirrors the financial incentive policies of other recycling

programs operated by the Department. A more detailed description of how the ten percent was chosen can be found in the Informative Digest below.

#### AUTHORITY

These regulations are submitted pursuant to the Department's authority under Public Resources Code (PRC) sections 14530.5(b), 14536, and 14536.1.

#### REFERENCE

Title 14 CCR amended section 2975 is intended to implement, interpret and make specific PRC sections 14501(f) and (g), 14518.5, and 14575.

#### INFORMATIVE DIGEST

The California Beverage Container Recycling and Litter Reduction Act, AB 2020/Margolin, Chapter 1290, Statutes of 1986 (Act), created the BCRP and established the Division of Recycling to administer the BCRP. The intent of the Act is to provide increased and convenient beverage container redemption and recycling opportunities for consumers. This is accomplished through the establishment of the CRV for eligible beverage containers and working with industry participants such as recyclers and processors who are certified by the Department.

Section 14501(f) of the Act establishes the purpose of the BCRP, including to create and maintain a marketplace where it is profitable to establish sufficient recycling centers and locations to provide consumers with convenient recycling opportunities. The responsibility to provide convenient, efficient, and economical redemptions opportunities rests jointly with manufacturers, distributors, dealers, recyclers, processors, and the Department (section 14501(g)). Section 14518.5 defines the term "processing payment." section 14575 establishes the processing fee, paid by beverage manufacturers and offset by the Beverage Container Recycling Fund (Fund), and the processing payment, paid to recyclers.

The Department annually establishes the reasonable financial return each January that is applied to the calculation of the processing payment. The source used to determine the reasonable financial return, as specified in regulation, is the most recent average net profit ratio of businesses classified as scrap and waste materials as reported by Dun and Bradstreet. For the first time since the BCRP began using the Dun and Bradstreet index in 2001, the reasonable financial return was a negative value for 2017. The reasonable financial return was calculated to be -5.85 percent of allowable costs, a reflection of the overall losses, rather than profits, of the recycling industry. This resulted in lower processing payments to recyclers than the amount necessary to cover the cost of recycling. At the same time, low prices for scrap material, along with other factors such as difficulty in finding locations willing to host recycling centers, led some recycling centers to close, leaving communities with fewer places for people to redeem CRV containers. To address those circumstances, the Department enacted emergency regulations effective November 16, 2017 and December 13, 2018 that raised the calendar year 2018 and 2019 reasonable financial return to 11.5 percent for non-rural recyclers and 16.6 percent for rural region recycling centers.

The market pressures of 2017 and 2018 have continued into 2019, accompanied by additional recycling center closures, and conditions are not expected to improve in 2020. To provide a more stable and consistent payment structure to recyclers than what would be provided under the current regulations, the Department is proposing a fixed reasonable financial return of 10 percent beginning in 2020. If the Department takes no action on the reasonable financial return, the reasonable financial return will revert to being based on the Dun and Bradstreet index which has averaged only three percent over the last 10 years with severe fluctuations occurring in the last four years, ranging from -5.85 percent to 10.56 percent. These fluctuations have triggered the Department to initiate regulations that implement a more stable rate.

Ten percent is a commonly used as a benchmark for a reasonable rate of return on investment. The average annual return for the S&P 500 since its inception in 1928

through 2017 was approximately 10 percent<sup>1</sup>. Additionally, the Federal government utilizes a 10 percent return on the cost of a contract as a reasonable profit amount for a private entity to make when providing a contractual service for the government<sup>2</sup>. A 10 percent reasonable financial return is also utilized by the Departments' e-waste program to incentivize e-waste collectors and processors to collect and process e-waste material that is otherwise expensive and burdensome to recycle and/or reuse. In establishing the 10 percent reasonable financial return for the e-waste program, the Department considered both industry profitability and a reasonable rate of return needed to attract new entrants into e-waste collection and processing<sup>3</sup>.

While actual returns in investment are highly variable by the size and location of a recycler, the Department believes that a guaranteed reasonable return of 10 percent is considered a reasonable rate because the returns from investing in a recycling business need to be competitive with the returns expected from other available investments. Making the risk and reward climate similar to other investment opportunities will maintain investments in recycling center operations as well as investments in infrastructure needed to deliver clean material required to meet increasingly stringent end-user specifications.

The Department had adopted emergency regulations for calendar years 2018 and 2019 implementing a 11.5 percent reasonable financial return for all recyclers except that a 16.6 percent reasonable financial return was established for recycling centers located in rural areas. The reasonable financial return was determined by starting with a 10 percent base reasonable financial return and then including an increase for expected minimum wage increases and a supplement for rural areas of 5 percent to cover higher costs of business operations.

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<sup>1</sup> "What is the Average Annual Return for the S&P 500"; retrieved from <https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp>

<sup>2</sup> 2019 Federal Acquisition Regulation Section 15.404-4 Contracting by Negotiation: Profit; retrieved from [www.acquisition.gov](http://www.acquisition.gov)

<sup>3</sup> CIWMB meeting May 20, 2008, agenda item 9, attachment 3, retrieved from <https://www2.calrecycle.ca.gov/Docs/CIWMBMeeting/23407>

The 10 percent rate in this proposal does not include a consideration of a minimum wage supplement. A minimum wage supplement is unnecessary because statute addresses year-over-year cost increases by applying an annual cost of living adjustment to the cost of recycling separate from and in addition to the reasonable financial return.

This proposal also does not include a higher rate for rural areas because the Department could not justify that recycling centers in rural areas incur higher costs than those operating in urban areas. Upon further inspection of cost disparities between different recycler business models, the Department determined that recyclers in rural areas are more likely to have higher costs, but this is due to their tendency to be lower volume sites which have higher per-container operating costs than high volume sites rather than their geographical location. The Department is addressing the viability of low volume locations by implementing a separate supplemental payment specifically for low volume sites in effect for FY 2019-20, along with considering options for extending this payment beyond one year and increasing the payment amount.

The Department finds that an emergency exists to amend existing regulations in order to implement statutory mandates of PRC section 14575. The proposed regulations would amend section 2975 of the CCR Title 14. Natural Resources, Division 2. Department of Conservation, Chapter 5. Division of Recycling, Subchapter 12, Article 2. The adoption of these regulations is deemed to be an emergency pursuant to PRC section 14536.1 which provides that "if the department determines that it is necessary to adopt or amend regulations to implement section 14575, the department may adopt or amend those regulations as emergency regulations. The Office of Administrative Law shall consider those regulations to be necessary for the immediate preservation of the public peace, health and safety, and general welfare for purposes of section 11349.6 of the Government Code. Notwithstanding subdivision (e) of section 11346.1 of the Government Code, the emergency regulations adopted or amended pursuant to this section shall be repealed 180 days after the effective date of the regulations, unless the

Department complies with Chapter 3.5 (commencing with section 11340) of Part 1 of Division 3 of Title 2 of the Government Code”.

There are no federal regulations or statutes comparable to these proposed regulations. The proposed regulations are not inconsistent or incompatible with existing state regulations. The BCRP is unique to the state of California, and there is not a similar program within the state. There are no other matters prescribed by statute applicable to this specific state agency or to any specific regulation or class of regulations.

#### SPECIFIC AGENCY STATUTORY REQUIREMENTS

There are no specific agency statutory requirements relevant to this rulemaking.

#### LOCAL MANDATE DETERMINATION

The proposed regulations do not impose a mandate on local agencies or school districts.

#### FISCAL IMPACT ESTIMATE

A 10-year average (2010-2019) reasonable financial return based on the Dun and Bradstreet index of three percent was used as the baseline to determine the fiscal impact of setting the reasonable financial return at 10 percent. The actual Dun and Bradstreet index to be used to determine the 2020 reasonable financial return is not available at the time of this writing and is not expected to be available until late November. Also, as mentioned previously, the Dun and Bradstreet value has been exceptionally unstable during the last four years, making the carry-over of last year's value unreliable to use as a baseline to determine the fiscal impact of this proposal.

Using a three percent baseline reasonable financial return if these emergency regulations are not adopted, a 10 percent reasonable financial return will provide an additional \$11.1 million in processing payments to recyclers funded by \$9.3 million from the Beverage Container Recycling Fund financed by unredeemed CRV deposits and a \$2 million increase in processing fee revenue paid by beverage manufacturers, based



on the method for determining processing fees and payments prescribed in PRC section 14575.

The proposed emergency regulations will not result in either costs or savings to any other State Agency, local agencies or school districts. Approximately four percent of processing payment recipients are local government entities who run recycling programs. The total amount of approximately \$270,000 distributed to these entities over the course of these emergency regulations is not expected to have a significant impact. Further, these proposed emergency regulations will not result in any non-discretionary cost or savings to any local agencies, nor will they result in cost or savings to federal funding to the State.

#### DOCUMENTS RELIED UPON

The Department utilized the following historical sources:

California Integrated Waste Management Board (CIWMB): Meeting Agenda Notes; May 20, 2008, agenda item 9, attachment 3, retrieved from <https://www2.calrecycle.ca.gov/Docs/CIWMBMeeting/23407>

CIWMB: Meeting Agenda Notes; May 20, 2008, agenda item 9, attachment 3, retrieved from <https://www2.calrecycle.ca.gov/Docs/CIWMBMeeting/23407>

Investopedia: What is the Average Annual Return for the S&P 500?; retrieved from <https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp>

2019 Federal Acquisition Regulation Section 15.404-4 Contract by Negotiation: Profit; retrieved from [www.acquisition.gov](http://www.acquisition.gov)

#### NOTICE OF REGULATORY ACTION

The Department has complied with the requirement to provide notice of the proposed emergency rulemaking pursuant to Government Code section 11346.1(a) (2).

Government Code section 11346.1(a) (2) requires that, at least five working days prior to submission of the proposed emergency action to the Office of Administrative Law, the adopting agency provide a notice of the proposed emergency action to every person who has filed a request for notice of regulatory action with the agency. After submission of the proposed emergency to the Office of Administrative Law, the Office of Administrative Law shall allow interested persons five calendar days to submit comments on the proposed emergency regulations as set forth in Government Code section 11349.6.