

Attachment 1

Processing Payment Emergency Regulations
Documents Relied Upon
CIWMB Meeting Notes May 20, 2008

Payment Rate Adjustment Options and Recommendations

Context and Considerations

The California Integrated Waste Management Board (CIWMB) is charged by the Electronic Waste Recycling Act of 2003 (ACT) with principal responsibility over the financial provisions of the Act, including the covered electronic waste (CEW) recovery and recycling payments and the associated rates. The CEW recovery and recycling payment rates were established at the beginning of the program through a combination of statute and emergency regulation, and have remained unchanged since January 1, 2005, when eligible recovery and recycling activities began.

The CIWMB has the authority and responsibility to revisit and establish new payment rates, as warranted, every two years. Pursuant to statute, the Board must make adjustments on **July 1, 2008**. The Act dictates that adjustment of the payment rates be guided by the net cost of collectors and average net cost of recyclers providing the services that fulfill the intent of the Act. Specifically, the following sections of the Public Resources Code should guide the Board's consideration:

*"42477. (a) On July 1, 2004, or as specified otherwise in Section 25214.10.1 of the Health and Safety Code, and on July 1 every two years thereafter, the board in collaboration with the department shall establish an electronic waste recovery payment schedule for covered electronic wastes generated in this state **to cover the net cost for an authorized collector to operate a free and convenient system for collecting, consolidating and transporting covered electronic wastes generated in this state....**"*

*"42478. (a) Except as provided in subdivision (b), on July 1, 2004, or as specified otherwise in Section 25214.10.1 of the Health and Safety Code, and on July 1 every two years thereafter, the board, in collaboration with the department, shall establish a covered electronic waste recycling payment schedule for covered electronic wastes generated in this state **to cover the average net cost for an electronic waste recycler to receive, process, and recycle each major category, as determined by the board, of covered electronic waste received from an authorized collector....**"*

It is acknowledged that most every participant in the CEW payment system also handles electronic wastes other than CEW. However the Act does not provide the CIWMB with direction or discretion to consider the costs of managing non-CEW or other waste streams when setting the payment rates for managing covered electronic waste.

In preparing options and recommendations for adjusting payment rates, program has drawn primarily upon cost data derived from Net Cost Reports. These reports, which are required annually from participating collectors and recyclers, provide data for understanding individual participant's costs as well as allow for the examination of aggregate industry data to discern trends and averages. An awareness of circumstances, such as a participant's recent start-up as an explanation of excessive reported net costs, contributed to data refinement and exclusion of outlier data points.

In reviewing and resetting the recovery and recycling payment rates, the Act provides no additional factors for the Board to consider beyond the average net costs of collecting and recycling CEW. Program staff has reviewed the net cost data submitted over the past three years by collectors and recyclers, and has averaged the data in various manners. In doing so, staff has determined that the as-reported 2007 net costs for an expanded sample of the industry as a whole, with subsequent removal of significant outliers, is an appropriate data set to use for establishing payment rates. In addition, the weighted average for these net costs is appropriate for arriving at an initial net cost figure for recovery and recycling. These determinations are based on the following:

- 2007 is the latest available data set in a continually-evolving industry, acknowledging that costs and revenues will inevitably change with future market conditions as evidenced by data trends exhibited in past reports;
- Data from an expanded sample of the industry as a whole takes into account the fullest extent of business models currently participating and constitutes the largest representative sample of the whole that only removes a few significant outliers in the data set;

- The weighted average, as opposed to a simple mean or median, appropriately gives a greater influence to the average net costs of the payment system participants who handle the largest volumes of CEW. The weighted average thus places what staff believes is proper emphasis on the net costs that apply to the management of the largest amount of CEW. Staff therefore believes that the average net cost generated by this calculation is going to be the closest accurate approximation of how much it actually costs to process *most* CEW in California.

In calculating average net costs for the purposes of proposing adjusted payment rates, program staff has factored in not only baseline costs, but the costs of a reasonable rate of return or profit as well. A reasonable “rate of return or profit on investment” is included in the consideration of net costs under 14 CCR Section 18660.10(c)(2)(Q). The inclusion of a reasonable rate of return, in addition to baseline costs, in the net cost determination is based on generally-accepted economic principles and is in keeping with the intent of the Act. Specifically, economists treat “normal profits” as an economic cost of doing business. Normal profits occur when total revenues equal total costs. Normal profits match the rate of return that is the minimum rate required by investors to maintain their present level of investment. In the case of collectors or recyclers, it may be the rate of return required by banks to issue loans to keep such business operating. Economically, “normal profit” is thus treated as a cost of simply staying in business.

The Act states in PRC Section 42476(f)(4)(c) that “[t]he recycling system funded by the fee ensures that economically viable and sustainable markets are developed for recovered materials and components in order to conserve resources and maximize business and employment opportunities within the state.” Collection and recycling are by necessity a for-profit endeavor. In order to ensure the economic viability of the collectors and recyclers that support markets for recovered components and materials, the calculation of average net costs must include the economic cost of “normal profit” or “reasonable rate of return.” The growth of the CEW recovery and recycling infrastructure must be fostered by a return on investment. In addition, a reasonable rate of return from average net cost payments is expected to help to ensure that collection and recycling of CEW continues to be cost-free to the public, as envisioned in the intent of the Act (PRC Section 42461). In the case of the CEW recycling payment system, a portion of the “revenues” necessary to achieve a normal profit – such as a fee for service that would otherwise be charged by the collector or recycler – are absent and must come from the recovery and recycling payments.

The Net Cost Reports analyzed by staff in conjunction with Humboldt State University and R.W. Beck did not include a standard reasonable rate of return as a line item in calculating average net costs. Instead, Net Cost Reports allowed collectors and recyclers to report on what they believed was a reasonable rate of return. Reports evaluated for 2005 and 2006 exhibited wide ranges of suggested rates of profit, likely due to the variability in expected return based on risk, investment, scale of enterprise, and means of calculation.

The continuing evolution of the electronic waste management industry in California, the volatility it faces from market fluctuations, and the restrictions it endures with regard to revenue from locked-in State payment rates present uncertainties and risks for the participating enterprises. How much return is then reasonable for undertaking such risks? For guidance, program examined several sources of information, including recycling business plan models, financial ratio benchmarks, and related state regulations. Rates of return varied depending on business models and types. For instance, the model plans for a certain plastic recycling business, found through the web resources of the Small Business Association, cited net profits of 13 percent at start-up and exceeding 20 percent in out years. Such numbers, however, are particular to plastic recycling.

In contrast, the California Department of Conservation’s Division of Recycling (DOR) uses a rate of return in their regulations which was last calculated at 5.43 percent. This number, however, is particular to the bottle and can recycling business which differs from the CEW payment system in many important regards. Staff reviewed data derived from annual statement studies conducted by the Risk Management Association (RMA) that indicate that a sampling of hazardous waste treatment and disposal concerns were averaging a return of up to 10 percent. This rate of return appears appropriate since CEW is a hazardous waste when disposed and such business may face similar risks as those cited in the RMA studies. Additionally, staff had conversations with several of the largest recyclers in California, who confirmed that, based on their operations, 10 percent is a reasonable rate of return. Finally, experts with R.W. Beck, one of the CIWMB’s Net Cost Report analysis consultants, indicated that it is common to use 10 percent as a benchmark reasonable rate of return.

Based on these considerations, and given the inherent risks associated with handling a hazardous waste, and other uncertainties within this rapidly evolving industry, program staff is proposing that a return of approximately ten (10) percent be

added to the weighed average net costs identified in Tables 2 of Attachment 1 when calculating the proposed new payment rates.

The CEW recovery and recycling payment system regulations currently establish one standard rate for recovery and one combined rate for recovery and recycling payments (\$0.20 per pound and \$0.48 per pound, respectively), regardless of the type of device or technology collected and processed. Program is recommending that the recovery and recycling payment system continue with one payment rate for recovery and one combined rate for recovery and recycling for the time being. Furthermore, program is proposing that the payment system structure allowed by the Act, which has the CIWMB making a combined recovery and recycling payment to recyclers and requiring recyclers to make subsequent recovery payments to collectors, be maintained.

In conclusion, using the 2007 industry-wide weighted average net costs, plus a ten (10) percent reasonable return based on the foregoing criteria, and rounding to the nearest whole cent, the new Standard Statewide Recovery Payment Rate is proposed to be **\$0.16 per pound** and the new Standard Statewide Combined Recovery and Recycling Payment Rate is proposed to be **\$0.39 per pound**. This calculation leaves approved recyclers with \$0.23 per pound that they are entitled to keep as a recycling payment.

It is acknowledged that using an average to establish a payment rate, as directed by statute, ensures that a portion of the system participants will view any new payment rates as insufficient. It is further acknowledged that the economic conditions that affect net costs, such as labor, transportation, and commodity markets, will undoubtedly fluctuate in the coming months and years, rendering any payment rate potentially inadequate or excessive when measured against the intent of the Act. This creates the possibility of payment rates at some point becoming out of alignment with the intent of the Act until the rates can be revisited. According to the Act, the next opportunity to do so will be July 1, 2010.

Options

The Board has the option of:

1. Concurring with staff's analysis of net cost data, determination of an average net cost for the recovery and an average net cost for the recycling of CEW, and proposed new Standard Statewide Recovery Payment Rate and Standard Statewide Combined Recovery and Recycling Payment Rate of \$0.16 per pound and \$0.39 per pound respectively.
2. Disapproving any changes to the CEW recovery and recycling payment rates.
3. Directing staff to take into consideration other allowable net cost data or perform an alternate analysis or calculation on allowable net cost data and return with a new proposal for CEW recovery and recycling payment rates.

Recommendations

Staff recommends that the Board approve Option 1 and concur with staff's analysis of net cost data, determination of an average net cost for the recovery and an average net cost for the recycling of CEW, and proposed new Standard Statewide Recovery Payment Rate and Standard Statewide Combined Recovery and Recycling Payment Rate of \$0.16 per pound and \$0.39 per pound respectively, and adopt Resolution 2008-82 and the associated regulatory language to establish the payment rates.