August 26, 2015

Container Recycling Institute
4361 Keystone Avenue
Culver City, California 90232

Attention: Susan V. Collins
President

I first want to thank you for CRI’s comprehensive and very complimentary report on the BC deposit return system. Our team is very proud of the numerous ways in which the system contributes to better the environment, our streetscapes and open spaces, and the quality of life in BC.

I also want to thank you for the recommendations in the report. Interestingly, we have a project currently underway to study how compaction or densification can be further incorporated into our system and will take into consideration your comments regarding presentation of financial results.

Several of the comments and recommendations, however, might benefit from more background or context. While I recognize that the report has been finalized, I hope that as CRI distributes, presents or discusses the report you can incorporate the following thoughts and comments into the dialogue.

Transportation and Processing Costs

Encorp issues open and competitive requests for proposal for major processing and transportation contracts (for example, there is an open RFP currently for glass processing in the Capital Region District that includes the city of Victoria). Our transportation rates to contractors also reference current rate standards for transportation in the province. As a result, we are confident that our costs reflect competitive market rates for transportation and processing.

You offer a comparison with our neighbouring province, but there are four factors which make a direct, per unit comparison of costs between the Alberta and British Columbia systems quite misleading:

1. **Mandated Return to Retail**: The B.C. regulation mandates return to retail. Encorp must pick up and transport from major retailers. We serve 173 depots, almost 200 government liquor stores and over 200 grocer locations, and it is inherently more costly to service the
small volume retail locations. There is no return to retail in Alberta, ABCRC services only the approximately 220 depots in that province.

2. **Geography**: Transportation costs in BC are inherently higher than in Alberta. We have many small communities separated by multiple mountain ranges, lakes and rivers. A significant portion of our population lives on one large and numerous smaller coastal islands from which it is very expensive to move materials.

3. **Product mix**: Glass is expensive to handle and to process relative to other commodities. Glass is only 9.4% of ABCRC volume, while in BC it is over 20% of Encorp’s volume.

4. **Economies of scale**: ABCRC handles twice the number of containers as Encorp. There are inherent efficiencies with higher volumes.

**Reserves**

Oversight and management of our reserves is an important audit and governance activity at Encorp. As opposed to being “arbitrary”, CRFs are set annually as a key part of our budgeting process that requires the review and approval of our Board of Directors.

While the report highlights the steady increase in reserves over the past few years, it does not provide the historical or operating context for those increases.

As the chart on page 55 of Encorp’s 2014 Annual Report shows, as packaged beverage sales began to decline in late 2008 and 2009 (when the recession took hold) our reserves were rapidly depleted and, in fact, were briefly negative. Since that time we have been through a period of rebuilding reserves to an appropriate level.

As Table 14 of your report shows, we began reducing CRFs in 2012 as our reserves entered our target range (around $17 million in 2013). The table also shows that many more CRF reductions have been made in the past three years.

Our principle of no cross-subsidization between container types requires not just that CRFs cover the net cost of recycling a given container type, but also that we maintain reserves by individual container types. Key inputs to managing CRFs and individual reserves are forecasts of industry sales, commodity prices and exchange rates among others. We use both internal and external forecasts to support our budgeting, but like many other businesses and organizations we could not anticipate some of the large swings that have occurred in these factors in recent years.

We had budgeted that CRF reductions would result in reserve reductions in 2013 and 2014. In fact, a number of factors offset the impact of the CRF reductions, including unusually high commodity prices, a turnaround in industry beverage sales, and a significant change in the mix of container types being sold, all of which were cash flow positive.
We can only change CRFs in one-cent increments and only change them once per year. Therefore, we cannot hold our reserves at a specific level, but manage them within a range around our target. We have budgeted reserve reductions for both the current 2015 and the 2016 fiscal years to move closer to our target reserve levels.

**CRF on Glass Over 1 Litre and Cost Allocation**

The non-alcohol glass over 1 litre category is a tiny portion of our recovered containers, 151,000 units out of 968 million collected last year, or about 0.015% of containers. This glass is sold largely by small producers of non-alcoholic ciders and fruit beverages. It is a long-declining sales category.

In your recommendation you make reference both to ‘allocating costs by weight’ and to likely cross-subsidization of the CRF by other glass collected. Regarding the first point, the most significant cost of collecting and recycling beverage containers is the handling fees paid on that particular container type. Handling fees are based on a time and motion study by an independent consultant on the activity required to accept the container from the customer, count, sort and place it for shipment. Based on this study, there is a higher handling fee paid for glass containers than, for example, aluminum cans.

Further, transportation of the containers is based on an industry pallet position. There are more small glass containers in a pallet position than large glass containers; therefore on a unit basis the transportation cost for large glass containers is significantly higher.

Regarding the second point, ironically, it is not cross-subsidization, but our strict policy of no cross-subsidization that also contributes to the higher CRF.

Our principle of non-subsidization requires that each container type (which are defined in the regulation, not by Encorp) has its own appropriate reserve. In this particular case, because of the steady decline in sales of this container type and very high recovery rates (so no unredeemed deposits remain with Encorp) the container’s CRF simply was not covering its actual costs, hence a high CRF.

More generally, the disparity between CRFs in the various glass categories relates to the relative positions of their reserves. The CRF, over the long run, represents the actual cost of recovering and recycling a container type. However, at any time, the reserves for the various container types will be higher or lower than their individual targets, which means that as we balance reserves over time, at any given time CRFs for similar container types will not match.

**Transfers from Reserves**

Finally, Table 13 on page 50 of your report shows transfers from Encorp’s Restricted Reserves over a five year period. As presented, a reader who is not referencing the notes to our financial statements may misunderstand the purpose or use of those transfers. As the notes to our
financial statements describe, these restricted reserves allow us to defer applying CRFs in the future for container types not requiring a CRF today. These reserves are reviewed annually by the board and when sufficient funds are in a reserve some portion may be released for initiatives specifically to improve recovery rates for the specific container type from whose reserve fund the monies are released.

To close, I want to reiterate that notwithstanding the lengthy and somewhat technical comments above, the report raises a number of discussion-worthy points and reinforces some initiatives already underway.

We want to thank CRI for highlighting the very positive outcomes we are able to achieve in B.C. As always, please contact me if you need additional clarification regarding any of the above points.

Best regards,

ENCORP PACIFIC (CANADA)

Scott Fraser
President

cc: BC Ministry of Environment – Meegan Armstrong (Meegan.Armstrong@gov.bc.ca)
cc: BC Ministry of Environment – Louise LeBoutillier (Louise.LeBoutillier@gov.bc.ca)