October 13, 2017

Scott Smithline, Director, CalRecycle
James Nachbaur, Ph.D., Deputy Director, Division of Recycling
1001 I Street
Sacramento, CA 95812

Dear Mr. Smithline and Dr. Nachbaur:

The Container Recycling Institute supports the proposed changes to the Reasonable Financial Return (RFR) described during the Workshop on Processing Payment Emergency Rulemaking. Based on our analyses that I will detail below, we believe this a good solution to the current problem. But first, we want to commend you both for taking this unusual and much needed step to address the redemption center crisis in California by enacting emergency regulations. CRI applauds your leadership and initiative on this issue.

Necessity for Emergency Regulations

Since July 2013, redemption centers in California have collectively been underpaid $62 million in processing payment shortfalls. As a result, more than 950 redemption centers have closed in California, leaving only 1,625 redemption centers in the state, and leaving several counties without any redemption centers at all. At least 10 counties in the state have lost more than 50% of their redemption centers since 2012.

This emergency regulation is greatly needed to soften the blow of rapidly declining scrap values and the continually declining “cost of recycling.” Since 2012, scrap values for PET plastic and mixed glass have steadily declined, with the scrap value of mixed glass reaching a negative value. Declining scrap value prices decrease the revenue obtained by redemption centers, who are heavily dependent on these commodity prices. The emergency regulation will help redemption centers offset these falling prices and regain financial profitability.

Another reason why these emergency measures must be enacted is that there is an overall decline in the percentage of aluminum in the beverage container marketplace. Based on the statistics provided by CalRecycle in the annual Fact Sheets, the percentage of aluminum redeemed has decreased from 47.1% of total container redeemed in 2012 to 39.7% in 2016. This decline has eroded redemption center profitability, especially since aluminum has consistently been the most profitable commodity (on a per ton basis) for redemption centers due to its higher scrap value compared to PET plastic and glass. The proposed emergency regulation will help mitigate the effect that this decline has on redemption centers across the state.

Minimum Wage Increase not Reflected in Processing Payment Calculations for 2018

The California minimum wage increased on January 1, 2017 and will continue to increase every year on January 1 until 2023, when it will reach $15 per hour (for small employers). This has increased operating
Scrap values trending down since 2012: all three major container materials

Reasonable Financial Return (RFR)

We agree with CalRecycle that the reasonable financial return that was calculated for 2017 was unfortunate and unfair to recyclers, as the calculation forced them to lose nearly 6% on every ton of glass and plastic that they handled. It is clear that this was a consequence that was never foreseen or intended by the legislature, indeed, the legislation has a purpose “to create and maintain a marketplace where it is profitable to establish sufficient recycling centers and locations to provide consumers with convenient recycling opportunities through the establishment of minimum refund values and processing fees and, through the proper application of these elements, to enhance the profitability of recycling centers, recycling locations, and other beverage container recycling programs.”

All three of CalRecycle’s proposals (base proposal, alternative #1 and alternative #2) are far more reasonable than the default scenario of using the anticipated very low rate of return from Dunn and Bradstreet. In particular, Alternative #1 seems to provide the most benefits to the most recycling centers,
and seems to be the alternative that would be most likely to stabilize the marketplace and potentially ensure that no additional recycling centers close due to financial hardship.

In the longer term, CalRecycle may want to revisit the use of the exact index that is used for the RFR (reasonable financial return), as the business of running a regulated redemption center is fundamentally a different business model than the operation of businesses that fit within SIC code 5093. SIC code 5093 is for “wholesale distribution of scrap materials,” a business type that has much more flexibility in choosing to purchase or not purchase materials and to set the prices for both purchase prices and sales prices; these commodities businesses make money on the small margin (or markup) between the purchase price and sales price of materials. In contrast, California redemption centers have very little flexibility in how they operate, no flexibility in choosing the containers they accept from the public, and are subject to the risk from the volatility of scrap prices for beverage containers.

**Costs to Fund**

One of the goals in the CalRecycle presentation was to “Balance impacts and costs to the fund.” The proposed RFR may not actually impact the fund significantly because it is offsetting other decreases in the processing payment calculation for 2018 which has not yet been published, but is widely expected to decrease. Therefore, with the increase in the RFR, the net effect may be positive or negative in terms of cost, but we don’t have enough information to understand the combination of effects, many of which cancel each other out.

**There is no need to increase processing fees in conjunction with these proposed Emergency Regulations**

In 2016/17, CalRecycle began a three-year process of transferring more than $7 million each year to the glass processing fee fund, and more than $3 million per year to the plastic processing fee fund. At the end of three years, more than $22 million will have been shifted into the glass fund, with no accompanying expenditures. The full $22 million will increase the fund balance in that fund, with no need to spend the money. According to the June 2017 Quarterly report, there was a 20% reserve in the Glass fund as of 6/30/17 ($12.9 million versus $63 million in annual expenditures).

Similarly, the three-year process of transferring funds to the plastic account will result in an extra $9.8 million in that account, also with no need to expend those funds. The full $10 million (rounded) will increase the fund balance in that fund. According to the June 2017 Quarterly report, there was a 32% reserve in the Plastic fund as of 6/30/17 ($15.1 million versus $47.5 million in expenditures).

*Therefore, there is no need to increase the processing fees to manufacturers in order to increase the processing payments that are paid to recyclers, because more than sufficient funds are available from the current and pending transfers, regardless of the alternative chosen.*

**Why are Increases in Processing Fee and Processing Fee Offsets Greater than Processing Payment Increases?**

In the base case, the sum of $1.6 million in fees plus $5.9 million in offsets is greater than the $7.0 million in processing payments. The difference is $500,000. Similarly, Alternatives 1 and 2 have more money in processing fee revenue plus offsets than processing payment expenditures – why?
Rural Counties

The rural counties have been hit very hard by the redemption center crisis. Furthermore, of the counties that have lost the highest percentage of redemption centers, half of the top ten are predominantly rural, and they have all lost more than 50% of their infrastructure since 2012. It is very much justified to have a higher RFR for the rural counties because they have higher transportation costs due to having to travel farther to market and generally have lower volumes and therefore lower economies of scale. In addition, offering extra support for rural recycling centers won’t cost the state very much because they only handle 6% of the volume. This fact makes it even more appropriate to give extra support to the people who have the least services and further to drive to reach an operating redemption center.

Differences between the (base) Proposal and Two Alternative Proposals

The three options range from a $7 million increase (compared to current law) to a $12.7 million increase, a difference of $5.7 million, which is less than one half of one percent of the current annual revenues of the beverage container fund. From this perspective, the 3 proposals are fairly similar; however, the increases will be meaningful to the struggling redemption centers, and this is true for all 3 options.

To conclude, over 900 redemption centers in the State of California have closed, and the rural centers have been among the hardest hit. As we show in our attachment, urban areas, especially the San Francisco Bay area, have also lost a large number and percentage of redemption centers.

In the last five months, the redemption centers have continued to close at a rate of 11 redemption centers per month. Furthermore, the redemption centers have collectively been underpaid $62 million since 2013, so a restoration of as big a payment as possible in the coming year will give them the best chance to get back on their feet again and for the situation to stabilize.

CalRecycle’s efforts to prevent additional center closures will hopefully preserve the access to redemption opportunities that California consumers deserve. We urge CalRecycle to continue to monitor the areas with the least access to redemption opportunities, and to draft a strategy for improving access in the “redemption deserts” in the state.

I can be reached by e-mail at scollins@container-recycling.org or at 310-559-7451. Thank you in advance for your consideration.

Respectfully Yours,

Susan V. Collins
President
Container Recycling Institute

Attachments:
California’s Beverage Container Redemption Center Crisis: THE BIGGEST LOSERS
CRRA presentation, “Redeeming Beverage Container Recycling in California,” August 2017