


County of Santa Clara

Consumer and Environmental Protection Agency
Recycling and Waste Reduction Division
1555 Berger Drive, Building 2, Suite 300
San Jose, CA 95112
Tel: (408) 282-3180
www.reducewaste.org



DATE: June 3, 2020

TO: Honorable Board of Supervisors
Jeffrey V. Smith, County Executive

FROM: Jo Zientek, Director of Consumer and Environmental Protection Agency 

SUBJECT: **Unincorporated Solid Waste Districts East/West Extraordinary Cost Compensation**

EXECUTIVE SUMMARY

This report explains requests for and our plan to address extraordinary cost compensation from two (of three) contracted solid waste haulers providing services in unincorporated Santa Clara County: Recology South Bay (District East, Supervisorial Districts 1, 2, and 3) and GreenTeam of San Jose (District West, Supervisorial Districts 1, 2, 4, and 5). Moffett Field, Stanford (zip codes 94305, 94309), and Burbank Unincorporated District operate independent solid waste programs and are not served by these agreements.

The County's agreements with the haulers require an adjustment in service rates to compensate the haulers for certain costs related to extraordinary changes in circumstances, subject to approval by the Board of Supervisors (Board). Both haulers have submitted requests for customer service rate increases to recover extraordinary costs associated with recent impacts to recycling commodities markets caused by China's 2017 and 2018 restrictions to recyclables imports, referred to as the "National Sword" policy.

Consumer and Environmental Protection Agency (CEPA) staff, in coordination with County Counsel, and based on reports by a specialized CPA and an integrated waste consultant that CEPA engaged to independently review the haulers' requests, confirmed that they meet the criteria for a rate increase. However, in lieu of covering the entire amount through rate increases, CEPA proposes that the haulers be compensated through direct payment of Administrative Fee savings, a fee collected by the County pursuant to these agreements, in order to minimize rate increases. As a result of these payments:

- Recology South Bay's rate would increase by 4% (or \$1.50 per month for the most common level of service) beginning July 1, 2021; without the payment, the increase would be 9%, on September 1, 2020, and
- GreenTeam's rate would increase by 5.8% (or \$2.50 per month for the most common level of service) on September 1, 2020; without the payment, the increase would be 13% on September 1, 2020.

CEPA will send a notice in advance of the proposed rate increase that explains to ratepayers the extraordinary rate increase.

CEPA staff intends to bring recommendations to address these requests to the Board for consideration at its June 23, 2020 meeting, including Amendments to the Agreements to allow for direct payment of extraordinary costs through County Administrative Fee savings.

BACKGROUND

In 2015, the Board executed Franchise Agreements with three solid waste haulers for garbage, recycling, yard and food waste, and rubbish collection services in the three unincorporated County garbage Service Districts: Recology South Bay (Recology) for Garbage Collection District East, GreenTeam of San Jose (GreenTeam) for Garbage Collection District West, and GreenWaste Recovery, Inc. (GreenWaste) for Garbage Collection District South. The District and Service Map are provided as attachments. These agreements were the result of a competitive bidding process, which generated these three responsive proposals. In December 2020, the Board approved extending GreenWaste and Recology's five-year agreements for additional five-year terms. These agreements, as well as GreenTeam's ten-year agreement, will all expire in 2025. Under the agreements, the haulers possess the exclusive franchise to collect recyclable materials along with other forms of refuse within their respective Service Districts. An overview of the Service Districts is provided in the following table:

Table: Unincorporated Hauler Service Districts

Service Provider	Supervisor District	Agreement Expiration	Commercial Accounts	Residential Accounts
SOUTH - GreenWaste	1, 3	June 2025	300	4,600
EAST - Recology	1, 2, 3	June 2025	50	5,050
WEST - GreenTeam	1, 2, 4, 5	June 2025	250	6,350

Among other things, the agreements require the haulers to provide unlimited curbside/street side collection of recyclable materials, including separated organic waste, as well as optional commercial recycling collection. The haulers must deliver the recyclable materials to a licensed recycling facility—known as a Materials Recovery Facility (MRF)—that will process them into useable and/or marketable materials. The agreements do not allow the haulers to dispose of recyclable materials at a landfill, or to knowingly contract with an MRF that would dispose of these materials, without the prior consent of the County. At the MRF, these materials are sorted to remove the unwanted residual material and segregated by types. These material types become a commodity and are sold to recyclers to be remanufactured.

Each agreement incorporates a Board-approved schedule of monthly residential and commercial customer service rates, consisting of the base garbage collection and disposal service charge, recyclable materials and yard waste charges, a Household Hazardous Waste surcharge, an Administrative Fee covering contract administrative services (based on 5% of gross receipts, with some expenses exempted from fee assessment), and a Franchise Fee (based on 15% of gross receipts). The Administrative Fee, Franchise Fee, and Household Hazardous Waste surcharge

are pass-through costs remitted to the County. The agreements allow for an annual inflation adjustment based on the Consumer Price Index of up to 5% per year, with actuals ranging from 2.5 to 3.6%.

In addition, the agreements contain an Extraordinary Cost provision, which allows the haulers to annually request customer rate adjustments based upon extraordinary changes in circumstances that materially increase the haulers' costs of providing service and that are substantially beyond their control (including, without limitation, changes in laws, ordinances, regulations, or the interpretation or enforcement thereof). This provision, standard in solid waste service agreements, requires the hauler to submit any such requests to the County by May 1 annually with detailed cost substantiation that has been reviewed by a third-party public accounting firm. The agreements allow the haulers to recoup extraordinary costs through changes in service rates, subject to prior approval by the Board.

REASONS FOR RECOMMENDATION

On February 28, 2019 and April 30, 2019, respectively, Recology and GreenTeam submitted initial requests for FY19 and FY20 compensation of extraordinary and unavoidable costs incurred as a result of increased recyclable material processing costs resulting from China's "National Sword" regulations. GreenWaste, which operates the MRF for all three haulers, has not submitted such a request. These requests were then reviewed, revised, and updated based on the combination of staff and consultant analysis and updated actuals over the subsequent year.

"National Sword" refers to progressively more stringent requirements imposed by China in 2017 and 2018 to address the quality of imported recyclables, including a significant reduction in allowable contamination levels for recyclables imported into China accompanied by more stringent inspection of imported recyclable materials. These limitations, which remain in effect, eliminated Chinese markets for many recyclables, as standards for moisture content and residual materials could not be met by current practices, and caused ripple effects throughout international recyclable commodities markets, which have become largely inundated with supply. This has had a devastating effect on the recycling industry in the United States and particularly on the West Coast, as most recyclable material has historically been exported overseas. Access to recycling markets by U.S. haulers has become severely limited, recycling commodities prices have dropped significantly, and the costs of recyclables processing has increased to meet the stringent contamination standards.

As a result of these changes, haulers, including Recology and GreenTeam, have experienced lost revenue, and unforeseen costs in providing the required recycling services, since recycling has moved from a source of revenue to an expense. The attached "China National Sword Impact" provides additional information. Other local jurisdictions have enacted rate increases to address China National Sword, ranging from approximately 2% to 13%. Most recently, in May 2020, Los Gatos, Saratoga, Monte Sereno, and Campbell approved rate increases specifically to cover these costs, ranging from 11.8 to 13.4% (\$3.85/household/month). The City of San Jose noticed a maximum rate increase of 15% for July 2020, with a portion of that increase to cover contractor costs impacted by international recycling markets; this increase includes an offset of

ratepayer fund reserves in the City's budget, and a public hearing for new rates is set for June 2020.

Recology and GreenTeam's requests were evaluated by CEPA staff, an independent CPA firm, and CEPA's consultant HF&H, LLC, a Bay Area firm specializing in solid waste, wastewater and stormwater compliance, support for local governments and the State of California. HF&H, LLC was also able to provide analysis in the context of similar requests evaluated and implemented by other Bay Area jurisdictions. The review included substantiating hauler documentation of the expenses, including material processing invoices, initial cost proposals submitted for County procurement process, MRF contract provisions, and other financial documentation.

In conjunction with County Counsel, staff excluded part of the request as non-compliant and determined both haulers have met the criteria for an Extraordinary Cost increase under their agreements for the remainder: confirming that the "National Sword" policy constitutes an extraordinary change of circumstances substantially beyond the control of the haulers, which has materially increased their cost of providing services. For instance, reports submitted by a third-party accounting firm for Recology and GreenTeam show price swings of between \$55/ton revenue to \$97/ton processing cost for recyclables materials, as they have gone from a source of revenue for the haulers to a cost that they must pay on an ongoing basis to the recyclables processor for acceptance of their materials. Because China did not formally announce its "National Sword" policy to the World Trade Organization until 2017, these costs increases could not have been anticipated by the haulers when they entered into their agreements, and the Board approved the haulers' schedules of maximum rates in 2015.

Under the agreements, the haulers may be reimbursed for these costs through changes in service rates to the extent and in proportion to their increased cost of providing service, subject to prior approval by the Board. The agreements do not provide for the County to compensate the haulers through direct payment of funds as an alternative to a rate increase. Staff proposes to modify the agreements to allow the County to compensate the haulers directly through repayment of Administrative Fee savings collected under the contracts to minimize increases in customer service rates. For reference, GreenTeam and Recology collect a combined \$5 million in revenue for these agreements annually.

Proposed Board Considerations

CEPA staff plan to bring to the Board for consideration at its June 23, 2020 meeting, proposed recommendations for Board consideration that would amend the current franchise agreements to delineate an annual process to determine the impact of international recycling markets on the haulers and modify rates for extraordinary cost changes related to these fluctuations (including by reducing rates or otherwise refunding customers if international recyclables markets improve); clarify the use of Administrative Fees related to program administration; and allow the use of Administrative Fees to offset rate increases at the County's discretion. Importantly, the amendments would also strictly limit ratepayer exposure to future rate increases due to international recyclables market volatility.

Recommended Actions Summary

GreenTeam (District West)

- 1) Approve extraordinary cost request of \$290,000 per year beginning FY20;
- 2) Compensate by a payment of \$339,000 (\$290,000 for FY20 plus July and August 2020) in FY21 from Administrative Fee revenue in the County's budget; and
- 3) Direct staff to issue a Prop 218 notice to customers for a 5.8% rate increase effective September 1, 2020, plus a 1% maximum annual adjustment in subsequent years, to meet this request.

Recology (District East)

- 1) Approve extraordinary cost request of \$130,000 for FY20 and \$140,000 per year beginning FY21;
- 2) Compensate for FY20 and FY21 by a payment of \$270,000 in FY21 from Administrative Fee revenue in the County's budget; and
- 3) Direct staff to issue a Prop 218 notice to customers for a 4.0% rate increase effective July 1, 2021, plus a 1% maximum annual adjustment, to meet this request.

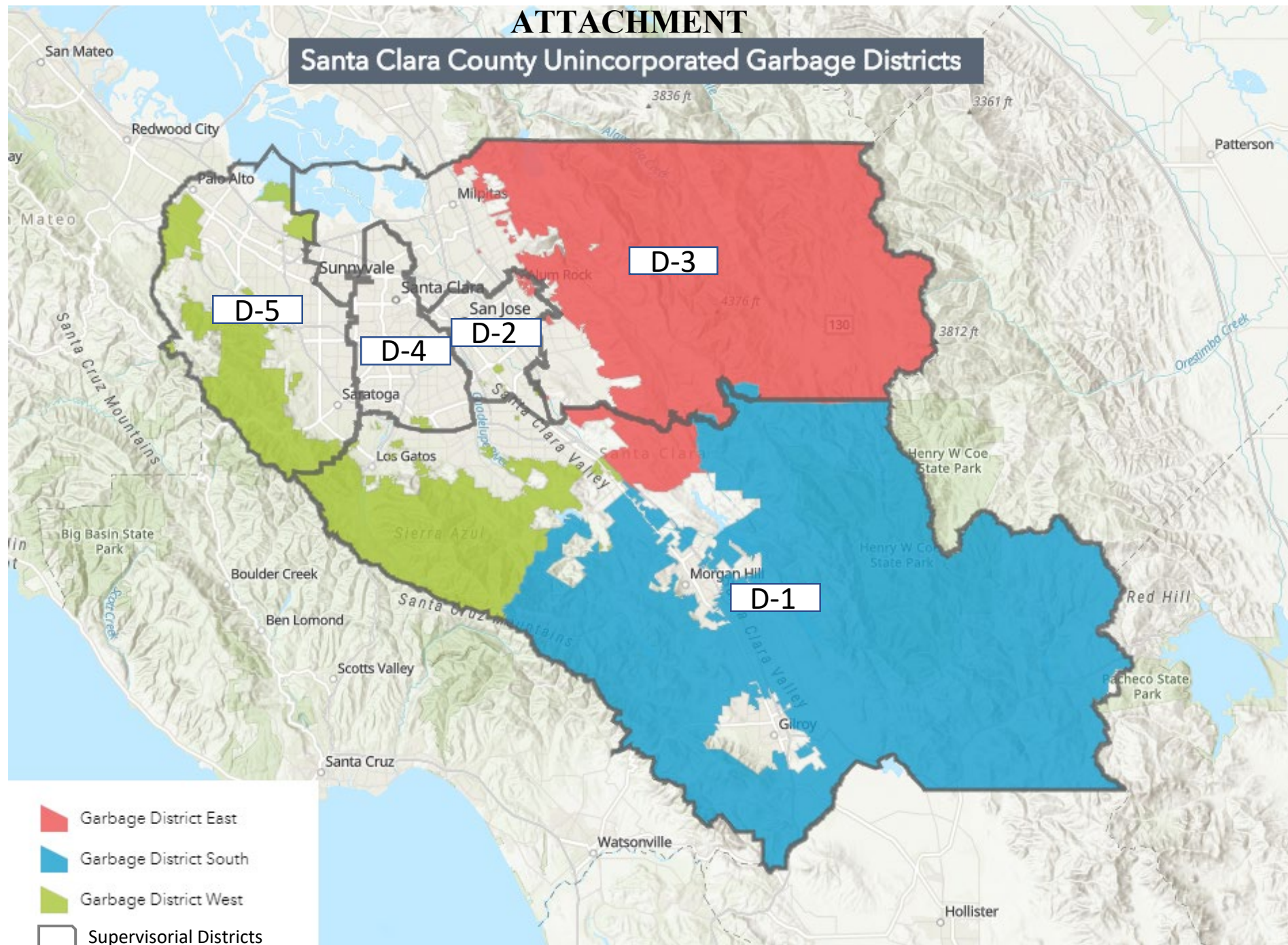
Attachments:

Unincorporated Hauler District Map
China National Sword Impact

cc: Board of Supervisors Chiefs of Staff
Miguel Márquez, Chief Operating Officer
Greg Iturria, Budget Director
James R. Williams, County Counsel
Sylvia Gallegos, Deputy County Executive
Megan Doyle, Clerk of the Board of Supervisors

ATTACHMENT

Santa Clara County Unincorporated Garbage Districts



ATTACHMENT

China National Sword Impact

“China National Sword” (CNS) refers to progressively more stringent requirements imposed by China to address quality of imported recyclables. In July 2017, Chinese leaders formally announced their intentions to ban imports of contaminated recyclables in a notice to the World Trade Organization, in order to reduce import of foreign waste. The overall impact has been that access to recycling markets by US haulers has become severely limited; market prices for recycling commodities have dropped significantly, and the cost of recyclables processing has increased dramatically to remove or exclude banned contaminants, (including household garbage, certain plastic waste, electronic waste, and excessive moisture) to increase the chances for acceptance at foreign ports. The following timeline outlines some of the key milestones for CNS:

- 2017- 55% of exported recyclables from California went to China
- January 2018- China announces a ban on scrap plastics and unsorted paper
- March 2018- China announces more stringent rules for moisture and contamination levels
- June-July 2018- China announces various bans on materials with full recyclable ban by 2020
- September 2018- Plastic imports in Southwest Asia decline as many additional nations enact similar provisions
- October 2018- China shows signs of reinvesting in US recycling
- December 2019- Chinese paper companies and trade associations met to propose import ban on cardboard and nearly all other paper grades by 2021