



FULL PRODUCER RESPONSIBILITY DECISION- MAKING MATRIX

OCTOBER 2018



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GLOSSARY OF TERMS

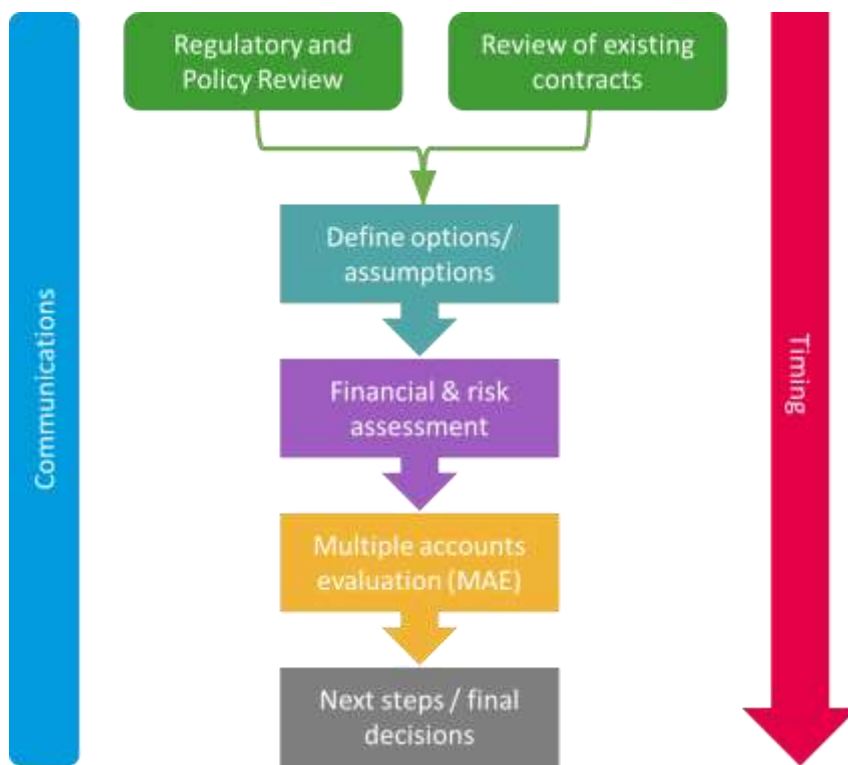
| | |
|--------|--|
| a-BBPP | Amended-Blue Box Program Plan |
| AMO | Association of Municipalities of Ontario |
| EPR | Extended Producer Responsibility |
| FPR | Full Producer Responsibility |
| IC&I | Industrial, Commercial & Institutional |
| MRF | Material Recovery Facilities |
| MOECC | Ministry of Environment and Climate Change |
| MAE | Multiple Account Evaluation |
| PPP | Printed Paper and Packaging |
| RPRA | Resource Productivity and Recovery Authority |
| RRCEA | Resource Recovery and Circular Economy Act |
| SO | Stewardship Ontario |
| WFOA | Waste Free Ontario Act |

INTRODUCTION

Municipalities have played a vital role in achieving a 60% diversion rate of Printed Paper and Packaging (“PPP”) in Ontario by designing, implementing, operating and managing Blue Box recycling services. The delivery of these services have required municipalities to invest millions of dollars in both collection and processing infrastructure. In 2016, the Ministry of Environment and Climate Change (“MOECC”) passed the Waste Free Ontario Act (“WFOA”), which will transition Ontario to Full Producer Responsibility (“FPR”), where producers will be fully responsible for the collection and processing of their materials under the Resource Recovery and Circular Economy Act (“RRCEA”).

This transition will see the role of municipalities change dramatically, where municipalities will have to compete with the private sector for providing certain services, specifically sorting services. Municipalities that own their material recovery facilities (“MRF”) will need to assess a range of options to determine their role while minimizing the financial impact to their taxpayers. The following document is designed to walk municipalities through the various factors they need to consider before determining the role they can or are willing to play once Ontario transitions to FPR, specifically in the area of processing and marketing of Blue Box recyclables. A framework outlining this process is highlighted under Figure 1.

Figure 1 – Framework for decision-making



REGULATORY/WASTE POLICY REVIEW

At the time of this document being prepared, May 2018, municipalities and their respective associations have indicated they are not supportive of the amended-Blue Box Program Plan (“a-BBPP”) that was put forward by Stewardship Ontario (“SO”). As a result, municipalities and their associations are still in discussions with SO, the Resource Productivity and Recovery Authority (“RPRA”), and other parties to determine an appropriate path forward towards FPR.

As there is considerable uncertainty in terms of how Ontario will move towards FPR, it will be critical for municipalities to review all relevant documents related to the transition plans to evaluate all possible options to minimize their costs and

risks. To date, municipalities should review the following documents to identify the role they could play during the transition and following the transition. This includes but not limited to:

- Strategy of a Waste Free Ontario: Building the Circular Economy
- WFOA
- SO a-BBPP
- All relevant documents from Association of Municipalities of Ontario (“**AMO**”) related to the a-BBPP (16 documents in total)
 - Three critical documents: Joint Comments on Draft a-BBPP, Joint Comments on SO Proposal, and Letter from SO on a-BBPP Process

During the review of these documents, as well as any newly released documents, municipalities should look to identify the following items:

- Defined role for municipalities for providing Blue Box services (e.g., first right-of-refusal, no specified roles, etc.)
- Inclusions/exclusions of materials to be collected after transition
- Responsibilities for sourcing Blue Box materials (i.e., who controls the flow of the materials; SO, municipalities, etc.)
- Potential changes to service levels (e.g., weekly to bi-weekly collection, bins vs. carts, use of drop-off depots, etc.)
- Costs eligible/ineligible for compensation during and after transition (e.g., transition planning may not be an eligible costs, etc.)
- Fees or penalties for not complying with service provider agreement
- Timing for transition of all municipal programs, and timing and criteria for transitioning individual municipal programs (e.g., based on collection contract expiry, processing contract expiry, etc.)

A review of the relevant regulatory and policy documents, as well as relevant position papers (municipal and other), will provide the framework for municipalities in determining the possible options and roles they can play during the transition. These options will need to be further refined based on a review of existing contracts to determine what options municipalities may have under their current contract.

REVIEW OF EXISTING CONTRACTS

For municipalities that have contracted out recycling services, a review of the existing contract(s) must be completed to determine the opportunities and risks to meet proposed changes put forward within the transition plan. As contract lengths tend to range from 5 to 10 years, and may be bundled with other waste services, municipalities must carefully review the language to understand all available options. The following items must be identified and carefully considered when reviewing existing contracts:

- Ability to modify, change, reassign or terminate existing contract and associated costs/penalties

- Timing for contract expiry or renewal
- Ability to extend contract or exercise options
- Impacts of unbundling Blue Box services from combined waste services contract
- Responsibility for marketing of recyclables, and municipal share of proceeds from the sale of marketed materials

One of the biggest concerns for municipalities around the transition plan is related to timing of when transition will actually occur. This places municipalities in a precarious position as contracts may come up for renewal prior to RPRA or SO providing additional details as to the timing of transition. In these situations, it is recommended that the municipality first attempt to negotiate with their service provider to allow for contract extensions that may not have been included in the initial contract. If unable to reach an agreement with the service provider, it is highly recommended the municipalities include language that enables the new contract to be reassigned over to a new client (e.g., SO) or enable municipalities to terminate with reasonable notice while minimizing costs/penalties.

There is a high likelihood that the Blue Box system transition will include producers keeping the proceeds from the sales of processed materials and being responsible for existing MRF contracts for operation, maintenance and marketing services (O&M contracts). These contracts may need to be restructured so that the municipality retains at least some percentage of materials revenues and it may be easier if all materials revenues are attributed to the municipality. Doing so will result in a clear operate and maintain contractor fee for cost calculations and negotiations without being obscured by pricing that includes offsetting market revenues or priced-in risk associated with market fluctuations that the contractor has agreed to bear.

DEFINE OPTIONS/ASSUMPTIONS

In general, municipalities will have four key overarching options in regards to their recycling assets:

- Maintain
- Divest
- Partial Divestiture
- Other (e.g., some sort of public-private partnership)

Under each of these options, there are several sub-options that can provide municipalities with greater control or ensure certain criteria are met to minimize impacts to residents and/or maximize the sale value. For example, a municipality could divest their asset with maintaining certain service delivery conditions. These options and sub-options are provided below.

Table 1 – Options and sub-options that can be considered by municipalities

| Option | Sub-Option |
|----------------|--|
| Maintain asset | 1. Maintain the asset using existing contractor and service delivery options (status quo) |
| | 2. Maintain the asset using existing contractor but change in service delivery option (switch from single to dual-stream or dual to single-stream) |
| | 3. Maintain the asset but replace existing service provider with more competitive service provider |

| Option | Sub-Option |
|----------------------------|---|
| Divest asset | 4. Wholly divest asset with no service delivery requirements |
| | 5. Wholly divest asset with requirement to keep existing contractor and service delivery options |
| Partial divestiture | 6. Partial divestiture of the asset – maintain fibre or container line or a portion of the system |
| | 7. Partial divestiture of the asset – convert to transfer operations |
| | 8. Partial divestiture of the asset – maintain non-residential processing lines |
| Other | 9. Public private partnership |
| | 10. Regionalization of services |

Following the Regulatory and Policy Review, as well as the Review of Existing Contracts, municipalities will be able to identify potential options that they are likely to pursue. It is recommended that municipalities short-list about 4-5 options, as some may not be viable options.

FINANCIAL AND RISK ASSESSMENT

The Financial and Risk Assessment involves developing financial/valuation models for the status quo and options selected above to assess the financial impact of each option relative to the current state. Municipalities that decide to maintain and operate their recycling assets are expected to be competing with the private sector and potentially other municipalities to provide processing services. The valuation of recycling assets from a business perspective are based on the cash flows that the recycling assets can generate.

Here is some practical advice to consider when developing the financial/valuation model for the status quo or options:

- Current Extended Producer Responsibility (“EPR”) funding should be viewed as a source of funding as opposed to revenues attributable to the recycling asset. Treating current EPR funding as a revenue source risks overestimating the value of the recycling asset. Current EPR funding is based on the Blue Box system costs – collection and processing – net of revenues earned from the sale of recycled materials. Municipalities should take this into consideration when attributing current EPR funding to the recycling asset.
- Under the a-BBPP, municipalities and private sector entities will bid for the right to provide processing services. As such, some sort of “cost-plus” model should be employed to model revenues under the baseline scenario and relevant options. A cost-plus model refers to
- Full and partial divestiture options need to reflect and be aligned to the valuation of land, buildings and equipment of the recycling asset. The valuation of the recycling asset’s land, buildings and equipment represents a minimum threshold and reflects the in site value of the assets. It is important that the valuation of land, building and equipment and the business valuation are aligned and share common assumptions.
- Having a strong understanding of the recycling assets cost structure and the interplay between capital and operating costs is essential to assessing each option. Private sector entrants will strive to generate cost efficiencies and their valuation of the recycling asset may reflect this.

The ability of the recycling assets to generate incremental cash flows above and beyond the operating and sustaining capital costs depends greatly on processing sufficient tonnages. Generally speaking, there is a positive relationship between the valuation of recycling assets and tonnages processed. Higher tonnages can also lower the average cost of processing recycled materials and therefore improving competitiveness, which in turn may help secure additional tonnages.

Municipalities that decide to stay in the business need to have a strong understanding of where they can secure tonnages from. For each short listed option, we recommend populating a table like the one below where local tonnages, tonnages from other municipalities, Industrial, Commercial & Institutional (“IC&I”) tonnes and value added services are identified and scored. Scoring should be based on the probability that the municipality may lose tonnages under transition to FPR where municipalities may have to bid and compete to provide processing services. In this example, the risk score ranges from 1 to 5 where 1 is low risk and 5 is high risk of not winning tonnages to process.

Table 2 – Evaluation of each scenario

| Scenario | Local Municipal Tonnes | Other Municipal Tonnes | IC&I Tonnes | Value Added Services | TOTAL |
|----------------------------|--|--|---|---|--|
| Baseline Scenario 1 | Tonnes = 30,000 Revenues = \$\$\$ Risk score = 1 | Tonnes = 15,000 from ABC Revenues from ABC = \$\$\$ Risk score = 2 Tonnes = 10,000 from XYZ Revenues from ABC = \$\$\$ Risk score = 4 | Tonnes = 5,000 Revenues = \$\$\$ Risk score = 1 | Tonnes = N/A Revenues = \$\$\$ Risk score = 2 | Tonnes = 70,000 Revenues = \$\$\$ Risk score = 1.25 (weighted average) |
| Scenario 2 | | | | | |
| Scenario 3 | | | | | |
| Scenario 4 | | | | | |

The following factors should be considered in assessing a risk score:

- Cost competitiveness of recycling asset relative to other municipalities and programs – RPRA Datacall can be used to provide an indication of the relative cost competitiveness of the recycling asset;
- Number and proximity of competitors (e.g., other service providers that would compete for the right to provide processing services);
- Historical success or lack thereof in winning tonnages from other municipalities/regions;
- Proximity to more populated cities/regions;

- Understanding of competitor plans and strategies (e.g., a private company may pursue a regionalization strategy and underbid to secure tonnages to achieve economies of scale).

MULTIPLE ACCOUNT EVALUATION


Financial and risk considerations are important, but are not the only factors that municipalities need to consider in selecting a go-forward option. Municipalities have a broader public policy mandate and a Multiple Account Evaluation (“MAE”) is one tool that can be used to more formally consider a wider set of factors. As outlined in the table below, financial, risk, local economic impact, control/service quality, timing for implementation and other factors were considered. However, each municipality can add other factors if they wish (e.g., environmental/sustainability considerations)

Each account is levied a relative score or ranking based on predefined criteria and then averaged using weights that reflect each municipalities prioritization of accounts. For example, in the table below the financial account has the highest weight by a large degree, which reflects a municipality’s prioritization of financial considerations in making a decision about the future direction of the recycling asset.

Table 3 – MAE evaluation grid

| Parameter | Weight | Criteria | Status quo | Option 1 | Option 2 | Etc. |
|----------------------------------|--------|---|------------|----------|----------|------|
| Financial | 60% | Based on above | | | | |
| Risk | 15% | Based on above | | | | |
| Local Economic Impacts | 15% | Based on the number of local jobs supported by each option | | | | |
| Control/service quality | 5% | Based on the level of control and service quality municipality can maintain | | | | |
| Timing for Implementation | 5% | How soon can the option be implemented? | | | | |
| Other | N/A | | | | | |
| MAE Score | | Weighted average based on weights | | | | |

How are MAE scores developed for each factor? Is it important to document the rationale for establish MAE factor scores. Outlined below is how we recommend doing so:

- 
- Factors that should be considered to establish a financial and risk score, are described above.
 - Local economic impact scores can be established based on the number of jobs and purchases from local suppliers supported by the recycling asset.
 - Control/service quality scores can be estimated based on the extent of control each municipality has to ensure a certain level of service quality.
 - Timing can be an important consideration for municipalities looking to continue to host recycling activities – the speed at which each option can be implemented is how this account can be scored. This may require reviewing termination provisions of existing contracts.

The option with the best MAE score should be pursued as the preferred option.

COMMUNICATION

Engaging key stakeholders throughout the decision-making process is essential to the successful operationalization of an MAE framework. We recommend that key stakeholders, such as municipal financial and public works staff, senior administration and possibly municipal committees/council and other potential stakeholders are consulted in the regards to the following:

- Selection of options to consider for evaluation;
- Identification and definition of factors/accounts to consider as part of the MAE framework; and
- Determination of the basis to establish relative scoring for each account.

Municipal staff can complete the MAE framework on their own, but engaging a third party to do so could be important to some municipalities. This provides an independent third party review, which in our experience often helps expedite the decision-making process.

We recommend reporting results of the analysis in a clear and concise report that documents the methodology, data and assumptions. This facilitates transparency and allows users of the report to assess the voracity of the analysis. The resulting report could be used as an appendix to a staff report.

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