

Summary #14

Contractor's Compensation and Annual Rate Setting

Introduction

Recology San Mateo County's (RSMC) compensation is adjusted annually in accordance with the index based adjustment methodology prescribed in Attachment K. The compensation includes three components: annual cost of operations, profit, and contractor pass-through costs. The compensation provisions identified in Article 11, and Attachments K and N of the Franchise Agreement identify the process for determining RSMC's compensation.

Contents

The following sections of the Franchise Agreement, when combined with Attachment K, comprise the annual compensation adjustment and rate setting process. In addition, Attachment N is an example of implementing this process.

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Franchise Fee and Other Fees (Article 10)

Description: RSMC is required to pay Member Agencies' franchise fees and other fees that are then used to cover costs related to administering the Franchise Agreement and providing other services (e.g., recycling, stormwater management and cleanliness of public streets).

Franchise Fee and Other Fees: Member Agencies are entitled to payment of fees included in Attachment M or established by the Agency during the ten year term of the contract. Thus, Member Agencies can include new fees or adjust the amount of existing fees, from time to time, as determined necessary by the Member Agencies. RSMC will pay these fees on or before the 20th day after the end of each month. RSMC will also provide with the payment of fees, a statement showing the calculation of each fee, including the gross revenues billed from customers in each service sector for that month.

Overview (Section 11.01)

Description: This section includes an overview of the three components of RSMC's compensation including annual cost of operations, profit, and contractor pass-through costs.

Overview of RSMC's Compensation: RSMC's compensation includes three components: annual cost of operations, profit, and contractor pass-through costs. Annual operational costs include: labor, equipment, materials and supplies, fuel, insurance, bonds, taxes, overhead and all other costs necessary to perform the services required, with the exception of pass-through costs. RSMC's profit is determined by applying the operating ratio of 90.5% to the annual costs of operation described above. The pass-through costs consist of costs which RSMC is obligated to pay but on which RSMC does not earn a profit and currently consists of interest and regulatory fees. The costs are fixed for the term of the contract and only adjusted annually for specified cost increases (inflation adjustment) or potential decreases (service level adjustment in 2012 for 2013 rates).

Attachment N of the Franchise Agreement includes baseline financial and operational information, which is used in-part to calculate RSMC's compensation. The annual costs of operation, profit, and contractor pass-through costs shown in Attachment N: (i) are based on RSMC's proposal; (ii) are allocated among Member Agencies using the methodology specified in Attachment K, Section 6; and (iii) have been adjusted to reflect refinements in the scope of services and decisions by individual Member Agencies as to specific programs, levels of service or other unique factors affecting only their jurisdiction.

Determination of Contractor's Compensation (Section 11.02)

Description: This section describes how compensation paid to RSMC is determined annually.

Determination of RSMC's Compensation: RSMC's compensation for rate-year 2011 will be determined by adjusting the costs in the company's original proposal submitted in March 2008. The adjustments will follow the index based adjustment methodology prescribed in Attachment K and implemented as an example in Attachment N. The 2008 costs will be adjusted to 2010 dollars based on changes in various indices, applying the wage rates and benefits for employees covered by collective bargaining agreements (CBA), changes to capital equipment costs, and changes in customer account and service levels. Thus, for rate years 2012 through 2020, an annual adjustment to RSMC's compensation will be made following a similar, yet simpler, index based adjustment process (described below). However, there are two exceptions that are applied for rate year 2013. The first is the final change in cost to reflect any changes in service levels, and the second is fixing CBA employees wages and benefits to a CPI (Consumer Price Index) type index, in lieu of following the specific wage and benefit cost increase schedule denoted in the CBA(s).

Application Process for RSMC's Compensation (Section 11.04)

Description: This section describes the application process for determining RSMC's annual compensation.

Application Process for RSMC's Compensation: RSMC must prepare and submit to SBWMA and Member Agencies by July 1 of each year an application for determining compensation for the next rate year. This application will cover all Member Agencies and allocate total costs to each Member Agency using the allocation methodology prescribed in Attachment K and illustrated in Attachment N. (This allocation process is similar to that used for the prior franchise agreements with Allied Waste/Republic Services). RSMC will provide any additional information requested by SBWMA or the Member Agency during SBWMA's review of the application.

SBWMA Review of Annual RSMC Compensation Application (Section 11.04 and Attachment K)

Description: This section describes the process for review and approval of RSMC's annual compensation.

SBWMA Review of Annual RSMC Compensation Application: The application will be reviewed and analyzed by SBWMA for accuracy and consistency with the procedures for determining RSMC's compensation, as described in Attachment K. SBWMA shall distribute, on or before September 1 of each year, a report in draft form which (i) identifies the amount of RSMC's compensation and pass-through costs allocable to Member Agencies for the following rate year and (ii) provides an overall percentage increase or decrease in Member Agency's collection

rates, which SBWMA calculates will generate customer revenues sufficient to cover RSMC's compensation and pass-through costs.

Member Agencies must submit comments on the SBWMA draft report within 10 days after receiving the report on September 1. A final report will be considered by the SBWMA Board of Directors at their September Board meeting. The SBWMA is obligated to issue the final approved report to all Member Agencies on or before October 1. The determination of RSMC's compensation, the estimation of pass-through costs, and the allocation of costs among Member Agencies contained in the final report approved by the SBWMA Board shall be binding on RSMC and each Member Agency.

Compensation Adjustment Process (Attachment K)

Description: The RSMC compensation application submitted on July 1 of each year includes an adjustment of the company's compensation in accordance with the methodology prescribed in Attachment K and illustrated in Attachment N.

Cost Adjustment Process for 2011: Three types of cost adjustments are used in the 2011 RSMC Compensation Application as required in the Agreements. These cost adjustments include:

1. Adjustments to Original 2008 Operating Costs - This step entails adjusting the original 2008 costs contained in RSMC's March 2008 proposal.
2. Service Level Adjustments - This step requires adjusting the revised 2008 costs to reflect changes in the number of residential accounts serviced and volume of commercial service provided from 2008 to 2010 (i.e., due to changes in the number of residential accounts and commercial lifts and pulls over that time period).
3. Adjustment of 2008 Costs to 2011 - The third and final adjustment to 2008 costs is to apply the changes in several indices and the wages and benefits schedule from the CBAs in order to reflect the costs that will be used for 2011.

Cost Adjustment Process for 2012-2020: The cost adjustment process for rate years 2012-2020 is similar to that used for 2011, yet simpler. These cost adjustments include:

1. Adjustments to Prior Year's Operating Costs - This step entails adjusting the prior year's operating costs based on changes in the indices prescribed in Attachment K.
2. Service Level Adjustments - This step is the same as explained above and is only applied one time (after 2011) in 2012 for rate year 2013.
3. Adjustment of CBA Wages and Benefits - The wages and benefits for CBA employees will be based on the schedule in the current CBAs until expiration of the CBAs. After each CBA expires, the wages and benefits for CBA employees will be adjusted by a CPI type index only.

Member Agency Cost Allocation (Attachment K)

Description: Article 11 and Attachment K prescribe the process to allocate the company's costs equitably across the Member Agencies. The cost allocation methodology described in Attachment K is similar to the process used in prior years with the Allied Waste/Republic Services Franchise Agreements.

Cost Allocation Process: Components of the nine cost categories described in Attachment K will be allocated by four operational statistics specific to each Member Agency. These operational statistics include:

1. Annual route labor hours
2. Annual route hours
3. Number of containers in service
4. Number of customer accounts serviced

The source to derive these statistics for the 2011 RSMC Compensation Application include the estimated route labor hours and route hours in the company's original proposal and data provided from Allied Waste/Republic Services for 2010 (i.e., containers in service and customer accounts).

After determining the total contractor's compensation for a given rate year, this cost allocation process will be used to calculate the costs attributable to each Member Agency.

Annual Revenue Reconciliation Process (Section 11.03)

Description: This section describes the revenue reconciliation process that will take place annually to determine the difference between the actual net revenues billed by RSMC for the preceding rate year and RSMC's compensation approved for that rate year.

Annual Revenue Reconciliation Process: After completion of each rate year, a revenue reconciliation process will be implemented to determine the difference between the actual net revenues billed by RSMC for the preceding rate year and RSMC's compensation approved for that rate year. RSMC will submit a report to Member Agencies and SBWMA by March 31 of each rate year that includes gross revenue billed, payments to SBWMA, payments to Member Agencies, and revenues attributable to unscheduled services (per the costs specified in Attachment Q – Unscheduled Services). SBWMA will review the report and underlying financial data for accuracy, will confer with Member Agencies to confirm information provided, and will meet with RSMC to resolve any errors or inconsistencies. The results of this review will then be included in the SBWMA report on RSMC compensation application submitted to Member Agencies on or before September 1 of each year.

Special Compensation Review (Section 11.05)

Description: This section includes a description of the special compensation review that allows RSMC or Member Agency to apply for a special review of the compensation paid to RSMC.

RSMC Responsibilities: RSMC may apply to the Member Agency for consideration of a special review of RSMC's compensation, and the Member Agency may initiate such a review, if one or more of the following occur and cause an increase in or decrease to RSMC's compensation by 2% or more for the then-current rate year:

1. Provision of emergency services pursuant to Section 7.08 of the Franchise Agreement.
2. Flood, earthquake, or other similar catastrophic event affecting the Member Agency which is beyond the control of and not the fault of RSMC.
3. Change in law occurring after the effective date.
4. Changes in the rates charged for backyard collection service and/or curbside collection service that alter the price differential between the two, causing customers to migrate from one to the other, with the result of increasing or decreasing RSMC's annual cost of operation by two percent (2%) or more.

A special compensation review must be requested by RSMC, or initiated by the Member Agency, within twelve (12) months after one of the above-described events has occurred.

A special review of RSMC's compensation may not be initiated for any of the following reasons:

1. Increases or decreases in RSMC's cost of operations in excess of the adjustments provided through the annual adjustment mechanism described in Attachment K.
2. Growth or decline in the number of customers or their service levels, with the exception of adjustments made when determining RSMC's compensation for rate year one (2011) and rate year three (2013).
3. Changes in the mix of container sizes or frequency of collection, with the exception of adjustments made when determining RSMC's compensation for rate year one (2011) and rate year three (2013).

In a special compensation review under this section, RSMC shall bear the burden of justifying to the Member Agency by substantial evidence its entitlement to continuation of current, as well as any increases in, RSMC's compensation. If the Member Agency determines that RSMC has not met its burden, it shall notify RSMC that it is

prepared to deny RSMC's request for an increase in compensation, or to proceed with a reduction in compensation. Within ten days after such notice, RSMC may request a hearing before the Member Agency's governing body to produce additional evidence. Upon such request, the Member Agency shall provide a hearing before the Member Agency governing body.

Based on evidence presented to it, including that submitted by RSMC, the Member Agency governing body may grant some, all, or none of the requested increase in, or may reduce, RSMC's compensation. In the event Member Agency denies RSMC's requested increase in whole or in part, RSMC shall have the right to present its claim to a court of competent jurisdiction.

RSMC shall bear all reasonable costs incurred by Member Agency (including assistance provided to it by SBWMA) of a special review which it has requested up to a maximum of \$50,000. Costs of a review requested by RSMC may not be included in RSMC's compensation, charged to Member Agency or customers, nor included in the calculation used as rationale to initiate a special compensation review.

Compensation Adjustments for Changes in Scope of Services or Service Levels (Section 11.06)

Description: This Section describes the process for establishing compensation adjustments in the event of a change in the scope of services or service levels.

Compensation Adjustments for Changes in Scope of Services or Service Levels: In the event a Member Agency directs a change in accordance with Section 15.12 of the Franchise Agreement (Right of Agency to Make Changes in Services and Service Levels), an equitable adjustment in RSMC's compensation will be made, effective with the commencement of the change, to reflect increases or decreases, if any, in RSMC's costs. The adjustment in compensation will also reflect the corresponding change in profit. The change in RSMC's compensation will therefore consist of the sum of (i) the incremental change to costs, and (ii) profit adjustment at the allowed operating ratio of 90.5%.

Within 45 days of a request by a Member Agency to initiate a change in service, RSMC shall present a proposal to the Member Agency containing a complete description of the following, if and to the extent applicable:

1. Collection methodology to be employed
2. Equipment to be utilized (number of vehicles, types, capacity, age, etc.)
3. Labor requirements (number of employees by classification)
4. Type of containers to be used
5. Description of program publicity/education/marketing materials to be developed
6. Estimated tonnage to be diverted and the methodology for determining that diverted tonnage
7. Anticipated impacts of the change, if any, on performance incentive and disincentive measures included in Attachment I of the Franchise Agreement
8. Description of end uses of collected material
9. Three year projection of the financial impact of the program's operations in a balance sheet and operating statement format including documentation of the key assumptions underlying the projections and the support for those assumptions, giving full effect to the savings or costs to existing services and the rate impact to affected customers
10. Monitoring tools and quantitative measures including: cost per ton; annual diversion; and pre-implementation as well as expected post-implementation route information including cost per route and accounts or lifts per route per day

Rate Setting Process (Section 11.07)

Description: This Section describes the rate setting process for Member Agencies.

Member Agency Rate Setting: Member Agencies are solely responsible for establishing and adjusting rates for collection services. The rates shall be reviewed annually by the Member Agency, commencing with rate year 2011

and continuing through the remaining term including any extension periods. The Member Agency is responsible for adjusting rates as necessary to generate annual gross revenues billed equal to RSMC's compensation approved for the rate year and approved pass-through costs. If the Member Agency elects to set rates that are below those recommended by SBWMA in their annual report, which identifies the amount of RSMC's compensation and pass-through costs allocable to each Member Agency for the following rate year, and the revenue reconciliation process conducted by SBWMA for that rate year demonstrates that net revenues billed were less than RSMC's approved compensation contained in the SBWMA report, interest shall accrue on the difference.

The Member Agency shall have the sole and exclusive right to change the relationship of individual rates in comparison with other rates and to allocate total costs among service sectors and lines of business. However, the Member Agency will not direct RSMC to charge customers a rate less than the cost for RSMC to provide backyard collection service specified in Attachment Q of the Franchise Agreement without considering RSMC's written comments regarding the proposed change. If a change in the rates charged for backyard collection service or curbside collection service causes a customer migration from one to the other which in turn increases or decreases RSMC's annual cost of operation by 2%, or more, either party may initiate a special compensation review as specified in Section 11.05.

Notice of Rate Adjustments (Section 11.08)

Description: This section describes RSMC's responsibilities to Member Agencies regarding the provision of customer addresses and the mailing of notices.

Notice of Rate Adjustments: If requested by a Member Agency, RSMC shall provide the Member Agency with a complete and current list of its customer addresses within 10 days of the request. In addition, if requested by a Member Agency, RSMC shall arrange for notices (prepared by Member Agency) to be mailed.

Potential Rate Constraints (Section 11.09)

Description: This section describes potential rate constraints associated with the application of Articles 13.C and D of the California Constitution to charges imposed by private enterprises for solid waste handling and recycling services when those charges are regulated by a local government.

Potential Rate Constraints: The parties to the Franchise Agreement recognize that, as of the date the Franchise Agreement was entered into, there was no authoritative judicial determination of whether Articles 13.C and D of the California Constitution apply to charges imposed by private enterprises for solid waste handling and recycling services when those charges are regulated by a local government. Until such authoritative judicial guidance is available, the Member Agencies intend to provide notice of proposed rate increases, and an opportunity for public hearing and protest as required by Article 13.D.

If a majority of affected customers protest a rate increase, the increase could be overturned. The Member Agencies will not be in default of the Franchise Agreement if (i) a majority protest prevents a proposed rate increase from being adopted, (ii) a court rules that rates adopted by the Member Agencies are not consistent with Article 13.D, or (iii) an initiative reduces rates from those in effect. After any such event, the parties shall promptly meet and confer in good faith to consider modifications to service levels commensurate with the rates that RSMC may legally charge.