



COUNCIL AGENDA: 12-14-10
ITEM: 7.3

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Lee Price, MMC
City Clerk

SUBJECT: SEE BELOW

DATE: 12-01-10

**SUBJECT: EVERGREEN PROVISIONS IN SOLID WASTE SERVICE
AGREEMENTS**

RECOMMENDATION

As referred by the Transportation and Environment Committee on December 6, 2010 and outlined in the attached memo previously submitted to the Transportation and Environment Committee, discuss and accept the report on the advantages and disadvantages of a perpetual or "evergreen" agreement for Recycle Plus residential solid waste services



Memorandum

TO: TRANSPORTATION AND ENVIRONMENT COMMITTEE

FROM: John Stufflebean

SUBJECT: EVERGREEN PROVISIONS IN SOLID WASTE SERVICE AGREEMENTS

DATE: 11-17-10

Approved

Date

11/19/10

COUNCIL DISTRICT: City-Wide
SNI AREA: N/A

RECOMMENDATION

Discussion and acceptance of the report on the advantages and disadvantages of a perpetual or "evergreen" agreement for Recycle Plus residential solid waste services.

BACKGROUND

On March 30, 2010, the City Council directed the Administration to negotiate new service agreements for the Recycle Plus (RP) residential solid waste services with existing contractors, for an eleven-year term from July 2010 to June 2021. In contract discussions, all of the RP service providers expressed interest in adding an "evergreen" provision to these new agreements. An "evergreen" provision would be a perpetual agreement based on automatic renewals of the term until such time that the City decided to terminate the service. One of the contractor's proposals would require the City to provide notice of termination as long as eight years in advance of the final service date. Two of the four contractors offered additional savings to the City as consideration for an evergreen provision, and one contractor suggested that these savings could be in the form of payments to the General Fund. In response to this aspect of the proposals, the Council directed the Administration to evaluate the advantages and disadvantages of evergreen provisions for the Recycle Plus service agreements. This memorandum clarifies the limitations on the use of RP ratepayer funds and describes potential concerns with including an "evergreen" provision in the Recycle Plus agreements.

ANALYSIS

Limitation on Use of Recycle Plus Ratepayer Funds

Savings from the cost of Recycle Plus residential solid waste services as consideration for an evergreen provision may not be used for General Fund purposes. Proposition 218 requires that property-related fees must not be used to fund general governmental services which are available to the public at large in substantially the same manner as they are to property owners. Moreover,

the fee for services provided may not be used for any other purpose than that for which it is imposed; revenues derived from the fee may not exceed the cost of the service; and the amount of the fee may not exceed the proportional cost of the service to the property.

The limitation on the use of these funds includes any savings realized by the RP haulers on their investments in facilities and vehicles. The initial cost of the investment has been factored into the rates paid by San José residents through their monthly garbage bill. Any savings realized by offering evergreen provisions would need to be returned to residential ratepayers through rate increase mitigations or enhanced RP services.

How Evergreen Contracts Work

“Evergreen” contracts are automatically renewed, typically from year to year, unless one of the contracting parties acts at specified intervals (which may be annually or as long as a decade) to give notice in the manner required to terminate the otherwise perpetual agreement. Evergreen clauses in these contracts vary depending on the circumstances, but typical terms are for eight- to ten-year terms with automatic annual renewal. For example, an eight-year agreement would be renewed at the end of its first year for another eight years. In contrast, to extend the term of fixed-term agreements, both parties must explicitly agree to the new term through an amendment to the original agreement. Currently, all of the Recycle Plus service agreements are fixed-term.

Evergreen Contract Issues

The City of San José’s residential service contracts are valued at \$85 million per year and represent the largest municipal privatized residential solid waste collection system in the country. Consequently, contractors desire to retain this business relationship, and one vehicle would be through a perpetual agreement. An Evergreen contract would provide short-term rate relief by allowing contractors to extend capitalization of their equipment. Extending the contract terms would have a similar impact.

However, the City Council should be aware of significant policy concerns with converting a fixed-term agreement to a perpetual agreement.

- a) An evergreen contract is inconsistent with the City’s policy and historical practice in favor of a competitive procurement process to ensure that the City is obtaining a competitive fair market price for the service, and control for the quality of service. Evergreen contracts essentially eliminate competition in the local market;
- b) An evergreen contract is often presented as a cure to the increasing cost of capital assets (vehicles, bins, etc.) and their impact on rates. Yet the City ratepayer has to pay the same costs for such capital assets regardless if the hauler is existing or new. There are easier and less burdensome techniques available to the City for achieving rate stability in agreement terms, such as specifying an average age for collection vehicles rather than

- requiring new vehicles at the commencement of services, or providing an option for the City to acquire the vehicles at the end of the term;
- c) An evergreen contract is particularly challenging in the current dynamic conditions of the solid waste service industry. Local policies, state and federal regulations, and the market place of service providers and facilities are constantly changing. Locking into an evergreen contract could prohibit the necessary flexibility of the City to respond to such changing conditions in a timely manner;
 - d) An evergreen contract could require the City to pay the same service costs despite a significant decrease in level of service due to changing conditions. For example, residents may need far less garbage service over the next five to ten years due to dramatically increased recycling and commensurate decrease in the need for garbage collection service, but the garbage service provider must still be compensated at a consistent level during this period due to the terms of their evergreen agreement;
 - e) Evergreen contracts that carry a long-term advance cancellation notice essentially bind future City Councils, deprive the City of any negotiation advantage, and limit opportunities for the City to negotiate new or enhanced services;
 - f) The contractor's quality of performance may decline if the City surrenders its prerogative to evaluate periodic contract extensions on a short-term basis; and
 - g) Evergreen contracts do not assure stability in the management and ownership of a company, nor guarantee the City secure, stable and high quality service over the long term. The solid waste industry, particularly in the Bay Area, is often engaged in sales, mergers, and acquisitions. An evergreen contract likely increases the value of a company, improving its chances to be sold to other investors. San José has experienced awarding large multi-year solid waste agreements to one contractor only to have the company sold twice during the term of the agreement. This resulted in a new company with a corporate structure, management personnel, and service values entirely different from the company to whom the Council had originally awarded the contract.

In summary, perpetual agreements are contrary to modern government procurement practices because they limit the jurisdiction's ability to obtain a fair market assessment from other potential service providers, thereby locking in the current contractors and eliminating Council's prerogative to select alternative providers. In the event a contractor fails to perform, evergreen contracts could also limit the City's ability to terminate the contract.

Other Jurisdictions with Evergreen Contracts

The Administration identified 39 cities and counties in California that have evergreen solid waste agreements. More than 70% of those municipalities are small communities with median populations of 50,000 residents, and the significant majority of those are located in Southern California. Due to low population densities resulting in a small customer base, these communities needed to offer evergreen provisions in order to attract fair market competition for

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solid waste collection services. By contrast, San José's population of more than one million residents provides a much better market, attracting vigorous competition between contractors. For example, the City's current non-exclusive franchise system in the commercial sector has attracted over twenty haulers, and the City's residential sector supports four large service providers with associated infrastructure.

EVALUATION AND FOLLOW-UP

The Administration will pursue any follow-up necessary from the City Council's discussion of this issue.

PUBLIC OUTREACH/INTEREST

The criteria below do not apply to this report. This document will be posted on the City's website for the December 6, 2010, Transportation and Environment Committee meeting where the public will have the opportunity to comment.

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

COORDINATION

This memorandum was coordinated with the City Attorney's Office and the City Manager's Budget Office.

CEQA

Not a project. File No. PP10-069 – Staff reports that involve no approvals of any City actions do not require environmental clearance.

/s/

JOHN STUFFLEBEAN

Director, Environmental Services

For questions please contact Jo Zientek, Deputy Director, at (408) 535-8557.