



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Kerrie Romanow  
Jennifer A. Maguire

**SUBJECT:** SEE BELOW

**DATE:** May 4, 2012

Approved

Date

5/4/12

**COUNCIL DISTRICT:** Citywide

## REPLACEMENT

**SUBJECT: COMMERCIAL SOLID WASTE FEES AND MAXIMUM CUSTOMER RATES**

### REASON FOR REPLACEMENT

This replacement memorandum includes a revised AB939 Fee of \$3,800,000 and lower maximum customer service rates.

### RECOMMENDATION

It is recommended that Council adopt:

1. An ordinance to amend Chapter 9.10 of Title 9 of the San José Municipal Code to amend sections 9.10.1435 to require the exclusive solid waste franchisee to pay a Source Reduction and Recycling Fee (AB939 Fee).
2. A resolution to amend the Schedule of Fees and Charges (Resolution No. 72737 as amended) to revise the Source Reduction and Recycling Fee (AB939 Fee) for commercial solid waste collected city-wide for two exclusive franchise districts at \$3,800,000 per fiscal year to be paid by the exclusive franchisee.
3. A resolution fixing and determining Maximum Commercial Solid Waste Services Rates in the City of San José pursuant to the Commercial Solid Waste and Recyclable Materials Collection Franchise Agreements between the City of San José and Allied Waste Services of North America, LLC dba Allied Waste Services of Santa Clara County, including the total processing costs for organic processing services.

## **OUTCOME**

Approval of the recommendation will ensure that the City has the necessary authority to collect fees needed to fund the management, oversight, and enforcement of commercial solid waste activities.

## **BACKGROUND**

The City currently issues non-exclusive franchises for the collection of mixed recyclables, organics and garbage from the commercial sector. The commercial sector includes all commercial, industrial and institutional waste generators. An AB939 Fee is assessed on commercial solid waste generators (businesses) and is collected and remitted to the City by the solid waste collector (commercial franchised hauler). This AB939 Fee is based on the volume of garbage collected. Reduced garbage amounts in recent years (due to both the sluggish economy and increased recycling activities) have led to decreased AB939 Fee revenue – from \$2,900,000 in 2007-2008 to an anticipated \$2,100,000 in 2011-2012. Under the current commercial solid waste AB939 Fee structure these declining garbage amounts result in reduced ability to fund required programs. A more stable funding method was incorporated into the final franchise agreements with Allied Waste Services of Santa Clara County (now known as Republic Services, their parent company), approved by the City Council on June 21, 2011. The new fee structure in the agreement includes a flat AB939 Fee to be set by Council resolution and adjusted annually.

The agreement with Republic also includes various maximum customer service rates based on the material collected, container type and size, and frequency of collection. These rates were negotiated with Republic to ensure that they would be able to meet their annual revenue requirement. The annual revenue requirement is the amount needed by Republic to fund their cost of operations, including collection equipment and labor, recyclables processing labor and machinery, and compensation paid to the City's contracted organics processor, Zero Waste Energy Development Company (ZWED), which will process food waste and other organics to produce energy and create beneficial compost. The revenue requirement also includes funding needed to pay for government fees such as Franchise Fees and AB939 Fees (which together represent 27.3% of the total \$54,187,000 annual revenue requirement), and to allow for a profit margin. Because of the time-lag between the submittal of Republic's original proposal and the actual start of service, the agreement includes a formula (based on changes in indices published by the Bureau of Labor statistics) for adjusting both the revenue requirement and the corresponding maximum service rates from 2010 to 2012 dollars.

The redesigned commercial solid waste collection and organics processing services will provide the most comprehensive and innovative commercial solid waste and recycling system in the United States and will further San José's Green Vision goals. Benefits to businesses include: a simple and customizable solid waste collection system; a variety of service options offered to all businesses, including recycling and organics collection (offered to many for the first time); dedicated service representatives providing ongoing recycling assistance; and online billing access and service data. The new system will allow businesses to comply with a new State

mandate (AB 341), which requires all businesses that produce at least 4 cubic yards of waste per week to recycle. This avoids a local mandatory recycling ordinance, which businesses expressed concern about when staff reached out to stakeholders for input on the solid waste system redesign. Specifically, they were concerned about mandates that didn't include City support, so that the burden to recycle would be placed entirely on the businesses. Additionally, because the material is processed locally (leading to a lower carbon footprint) and recycled to its highest and best use (as required in the agreements with Republic and ZWED), the commercial solid waste program can help businesses meet their sustainability objectives, as well as provide credits for environmental certifications for International Standards Organization (ISO) 14001 Environmental Management, Green Building Council Leadership in Energy and Environmental Design (LEED), and Green Business. Additional benefits include a new "green" fleet of approximately 50 compressed natural gas solid waste collection trucks to replace the existing aging fleet, more efficient routing resulting in fewer truck miles driven (with associated greenhouse gas reductions equivalent to taking 180 passenger vehicles off the road), stable franchise fee revenue for the General Fund, increased waste diversion, progress toward renewable energy goals, and the creation of additional green recycling jobs in San José.

## ANALYSIS

### **AB939 Fee**

To provide the City with the necessary authority to continue to fund commercial solid waste activities, staff recommends amending the Schedule of Fees and Charges to include an AB939 Fee for solid waste collected by the exclusive commercial solid waste franchisee in San José. The AB939 Fee, which would typically be set through the annual Proposed Fees and Charges process, is being brought forward for City Council consideration now because it is a component of the maximum commercial solid waste services rates. Due to the transition to new commercial solid waste services in June, setting maximum rates now enables Republic to notify all 10,000 commercial customers of their rate and service options prior to the July 1 service start date, so that these customers can make informed and timely decisions on the type and level of service needed for their business. The AB939 Fee would not be applied until July 1, 2012, when Republic begins providing service as the exclusive franchisee authorized to perform commercial solid waste and recyclable material collection citywide. Non-exclusive franchises will continue to be issued for the collection of materials such as construction and demolition debris and residential clean-out rubbish through the existing franchise authority. It is anticipated that staff will bring forward approximately 17 new non-exclusive franchise agreements for City Council consideration on May 15, 2012.

The California Public Resources Code authorizes the City to collect an AB939 Fee to be used by the City to cover the cost of administering commercial solid waste programs. The total fee revenue of \$3,800,000 covers 100% of the anticipated City costs for administering the commercial solid waste programs in 2012-2013. This amount is lower than staff's original estimate of \$4,200,000 presented to City Council on April 5, 2011, as part of the recommendation to award the exclusive franchises to Republic. Recognizing the need to minimize rate impacts to businesses, staff has evaluated and reprioritized existing commercial

solid waste programs; identified staffing efficiencies gained with the exclusive Republic franchise; and leveraged partnerships, grant opportunities, and regional resources which allow for cost savings to be realized.

The revised AB939 Fee represents approximately 7.0% of the total rate charged to customers by Republic for solid waste services and will fund oversight, administration, and enforcement for the City's commercial solid waste system (including the Republic Services and ZWED agreements, as well as the 17 non-exclusive agreements mentioned above), ZWED residue disposal, and other auditing and evaluation required in the Republic and ZWED agreement. The fee will also cover the costs of programs targeted at further increasing waste diversion for the commercial sector, including supporting the development of compostable plastics as part of a larger regional effort, management of public litter cans in commercial areas of the City, and the development of infrastructure to provide business opportunities for diverting hard to recycle wastes.

The City can modify the AB939 Fee as costs change with program modifications, new legislative and/or regulatory mandates, and City personnel cost changes. Given the many new and unique aspects to the redesigned commercial solid waste system (customized collection options for individual businesses, innovative recycling processing technology, the complex interface between Republic and ZWED's processing system for handling organic waste, and the enforcement and related outreach needed to ensure compliance with the exclusive and non-exclusive franchises), the cost estimates for administration and addressing unforeseen circumstances during the first year of service reflect staff's best projection at this time. Some of these costs would be limited to the initial roll-out period of the new program. The AB939 Fee will be reassessed in 2012-2013 and modified as needed for 2013-2014, based on an evaluation of actual first-year expenditures for oversight and enforcement of new commercial services.

To facilitate the application of the proposed AB939 Fee to the exclusive franchises, as opposed to the generators (businesses), staff also recommends amending Chapter 9.10 of Title 9 of San José Municipal Code section 9.10.1435. The proposed ordinance would require the exclusive commercial franchisees to pay an AB939 Fee for the commercial waste collected.

#### **Maximum Customer Service Rates**

The Republic franchise agreement includes the formula for establishing maximum customer service rates. In late 2011, Republic submitted calculations for adjusting rates for inflationary increases from 2010 to 2012 dollars. Staff verified that the proposed two-year rate adjustment of 3.846% was consistent with the formula specified in the franchise agreement. This adjustment was based on changes in the Consumer Price Index and an adjustment factor for fuel (compressed natural gas). The proposed maximum service rates may also be adjusted through a rate balancing process detailed in the Republic franchise agreement, whereby adjustments would be made to service levels that see the greatest rate increase, while ensuring that any new rate maximums would reflect an appropriate cost for that specific service level. Staff has solicited the assistance of HF&H Consultants to undertake a rate impact analysis to compare current rates with those in the new system, so that customers likely to be most affected could be identified and rate adjustments allowed for in the Republic agreement could be identified. Concurrently,

through review of customer account information, Republic will identify rate categories most impacted and may propose adjusted rates for those services. Staff plans to bring forward this summer any recommended changes to the maximum customer rates as a result of this analysis.

Similarly, ZWED submitted their adjusted compensation rates (paid to them by Republic) and staff confirmed that the proposed adjustments to the organics processing rates were correct. The organics processing agreement contemplates that proposed organic processing costs would be considered by the City Council. These costs are a component of the maximum commercial collection rates. The proposed maximum service rates (with an effective date of July 1, 2012) are based on the City Administration's review of Republic's proposal and application of the formula set forth in the franchise agreement, approved by City Council on June 21, 2011. Any proposed changes to these rates would require a review of the franchise agreement terms, or requirements under the Municipal Code that contribute to costs to determine if certain costs can be modified. Such a review would delay the proposed service under the franchise agreement, and there is no certainty that the rates would be modified. The proposed maximum rates are detailed in the resolution accompanying this report.

In negotiations, the City and Republic developed a customer rate structure that allows Republic to meet their total revenue requirement while encouraging customers to choose cost-effective services that help achieve waste diversion and operational goals. Unlike the current non-exclusive system, the rates are consistently applied to all services for San José businesses. The proposed maximum service rates are cost competitive with rates charged elsewhere in the Bay Area. The table below compares San José proposed maximum rates with average rates from 16 nearby jurisdictions that were surveyed with comparable rate structures for two common service levels. Additional details can be found in the Attachment, Rate Comparison by Jurisdiction.

	<b>3 Cubic Yard Container Collected Once Per Week (monthly rate)</b>	<b>40 Cubic Yard Container (per collection rate)</b>
Proposed San José Maximum	\$150	\$623
Regional Survey Average	\$279	\$791

Businesses will experience a wide range of rate impacts due to the large disparity in rates charged under the current non-exclusive franchise system. The current rate disparity is due to a number of factors, including: businesses negotiating their own rates (with larger businesses often able to negotiate lower rates); City franchise and AB939 fees only charged to waste material classified as "garbage"; and differing hauler billing practices. After comparing current rates with proposed rates and anticipated service levels under the new solid waste system, Republic estimates that those businesses experiencing a rate decrease and those receiving an increase will likely be evenly divided. In the coming months, Republic will work closely with

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businesses to find the most efficient service options, while at the same time, helping to minimize rate increases.

The Republic agreement includes methodologies for adjusting customer rates annually (either up or down) with specific controls limiting both the cost drivers that can be considered and the total adjustment amount allowed in any given year. The adjustment methodologies are designed to protect both the customers and the franchisee by ensuring that Republic is compensated appropriately as operating expenses rise and fall from year to year. The Republic agreement also includes a cap in the total annual increase to maximum service rates in any given year not to exceed six percent (6%).

### **EVALUATION AND FOLLOW-UP**

As part of the rate setting process, it is anticipated that staff will return to Council on an annual basis for the adoption of maximum customer service rates. Staff may also request that Council consider modifications to the maximum rates this summer after completion of the rate balancing analysis of the new commercial services currently underway.

### **PUBLIC OUTREACH/INTEREST**

- Criteria 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criteria 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)**
- Criteria 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)**

This recommendation does not meet any of the above criteria; however, it will be posted on the City's website for the May 15, 2012 City Council agenda. In March 2012, Republic implemented an extensive outreach campaign to San José businesses, which includes informing customers of new service rates.

### **COORDINATION**

This memorandum was coordinated with the City Attorney's Office and the Office of Economic Development.

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### **COST SUMMARY/IMPLICATIONS**

The anticipated revenue of \$3,800,000 is included as part of the Integrated Waste Management Fund in the 2012-2013 Proposed Operating Budget that was released on May 1, 2012.

Approximately \$500,000 of this revenue will be retained by Republic for the disposal of processing residue. The remaining \$3,300,000 is part of the \$4,200,000 of the Proposed 2012-2013 AB939 Revenues displayed in the Integrated Waste Management Fund Source and Use statement in the 2012-2013 Proposed Operating Budget. The remaining \$900,000 in AB939 revenue is expected to be generated from Landfill AB939 Fees.

This Commercial Solid Waste AB939 Fee will also be presented in the 2012-2013 Proposed Fees and Charges Report scheduled for release on May 4, 2012. The total fee revenue of \$3,800,000 covers the costs for City administration of the commercial program, allowing the program to operate at 100% cost recovery in 2012-2013. This fee represents approximately 7.0% of the total rate charged to customers by Republic for solid waste services and will fund oversight, administration, and enforcement of the City's commercial solid waste system (including the Republic Services and ZWED agreements, as well as the estimated 17 non-exclusive agreements for construction and demolition material and residential clean-out debris), ZWED residue disposal, and cover the cost of programs targeted at waste diversion for the commercial sector (including technical assistance for recycling and outreach, planning, and recycling facility infrastructure development). This fee level also includes the cost of 2.0 Environmental Inspectors brought forward for City Council consideration as part of the 2012-2013 Proposed Operating Budget. The Inspectors will ensure that Republic complies with contractual performance standards, and enforce requirements that no providers are to conduct commercial solid waste and recyclable material collection in San José without a franchise from the City. This enforcement function will also help ensure that the cost of the new system will be distributed appropriately among all customers required to participate, mitigating risk of rate increases resulting from Republic not meeting their annual minimum revenue requirement defined in the agreement. It is estimated that related 2012-2013 IWM Fund expenditures will increase by approximately \$245,000 to fund the two proposed Environmental Inspectors. The AB939 Fee will be reassessed in 2012-2013 and modified as needed for 2013-2014, based on an evaluation of first-year expenditures.

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The chart below summarizes the estimated 2012-2013 costs that are covered by this fee and associated staffing represented as full-time equivalents (FTEs).

Description	\$	FTE
<b>ESD Personal Services</b>		
Provides for Contract Administration, Commercial Solid Waste program administration, and the portion of management and support staffs' time (ie, personnel, fiscal, budget) allocated to the Commercial Solid Waste program	1,740,000	13.6
<b>ESD Non-Personal/Equipment</b>		
Commercial and ZWED franchise and agreement support and oversight of franchise enforcement program including customer and hauler outreach; process and performance audits required in the agreement.	440,000	
Public Litter Can replacement, maintenance and warehousing	170,000	
Programs targeting additional diversion for waste outside the franchise system (ie., programs promoting reuse and hard to recycle wastes, development of compostable plastics)	55,000	
<b>Support Departments – Personal Services and Non-Personal/Equipment</b>		
Includes Finance, IT, HR, PBCE, DOT, OED, Attorney, and DPW Personal Services and/or Non-Personal Equipment funding related to activities these departments perform to support the Commercial Solid Waste Program	240,000	1.9
<b>Other Commercial Solid Waste Program Costs</b>		
ZWED Processing Residue Disposal (retained by Republic)	500,000	
General Fund Overhead (Commercial Solid Waste share)	325,000	
City Hall Debt Service (Commercial Solid Waste share)	280,000	
Workers' Compensation Claims	50,000	
<b>Total Costs</b>	<b>3,800,000</b>	<b>15.5</b>

### FISCAL POLICY ALIGNMENT

This recommendation meets the following Budget Balancing Strategy Guidelines from the 2012-2013 March Budget Message: establish a fee structure to assure that operating costs are fully covered by fee revenue and balance ongoing expenditure needs with ongoing revenues to ensure no negative impact on future budgets and to maintain the City's high standards of fiscal integrity and financial management.

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CEQA

Not a Project, File No. PP10-067 (a), Increase or Adjustment to Fees, Rates & Fares

/s/

KERRIE ROMANOW

Acting Director, Environmental Services



JENNIFER A. MAGUIRE

Budget Director

Attachment: Rate Comparison by Jurisdiction

For questions, please contact Jo Zientek, Deputy Director, Environmental Services Department,  
at 408-535-8557.

**Commercial Solid Waste Fees and Maximum Customer Rates**

**Attachment  
Rate Comparison by Jurisdiction**

<b>City</b>	<b>3 yards, 1x a week</b>	<b>City</b>	<b>40 yards, per pickup</b>
Palo Alto	\$480	Palo Alto	\$1,191
Oakland	\$341	Mountain View	\$1,068
Los Altos	\$331	Cupertino	\$776
Sunnyvale	\$325	Saratoga	\$730
Mountain View	\$309	Gilroy	\$728
Saratoga	\$300	Campbell	\$726
Morgan Hill	\$272	Los Gatos	\$724
Gilroy	\$259	Fremont	\$702
Foster City	\$256	Morgan Hill	\$627
Los Gatos	\$243	<b>San Jose</b>	<b>\$623</b>
Campbell	\$218	Los Altos	\$615
Cupertino	\$202		
Santa Clara	\$187		
Fremont	\$181		
<b>San Jose</b>	<b>\$150</b>		