AGENDA

INFORMATIONAL HEARING: OVERSIGHT OF RECYCLING PROGRAMS

ASSEMBLY BUDGET COMMITTEE NO. 3 RESOURCES AND TRANSPORTATION

ASSEMBLYMEMBER RICHARD BLOOM, CHAIR

WEDNESDAY, MARCH 7, 2018

9:30 A.M. – STATE CAPITOL, ROOM 447

ITEMS TO BE HEARD

ITEMS TO BE HEARD

3970 DEPARTMENT OF RESOURCES RECYCLING AND RECOVERY

INFORMATIONAL ISSUE 1: OVERSIGHT OF THE BEVERAGE CONTAINER RECYCLING PROGRAM

The Subcommittee will receive a briefing on the Beverage Container Recycling Program, the fund conditions within the Beverage Container Recycling Fund, and the effects of the recently adopted emergency regulations.

PANELISTS

Panel 1: Background and Overview of the Bottle Bill Program

- Ashley Ames, Senior Fiscal & Policy Analyst, Legislative Analyst's Office

Panel 2: Current State of the Bottle Bill Program, Fund Conditions, and Recently Adopted Emergency Regulations.

- Scott Smithline, Director, Department of Resources Recycling and Recovery

Panel 3: Other Perspectives of the Bottle Bill Program

- Susan Collins, Executive Director, Container Recycling Institute
- Mark Murray, Executive Director, Californians Against Waste

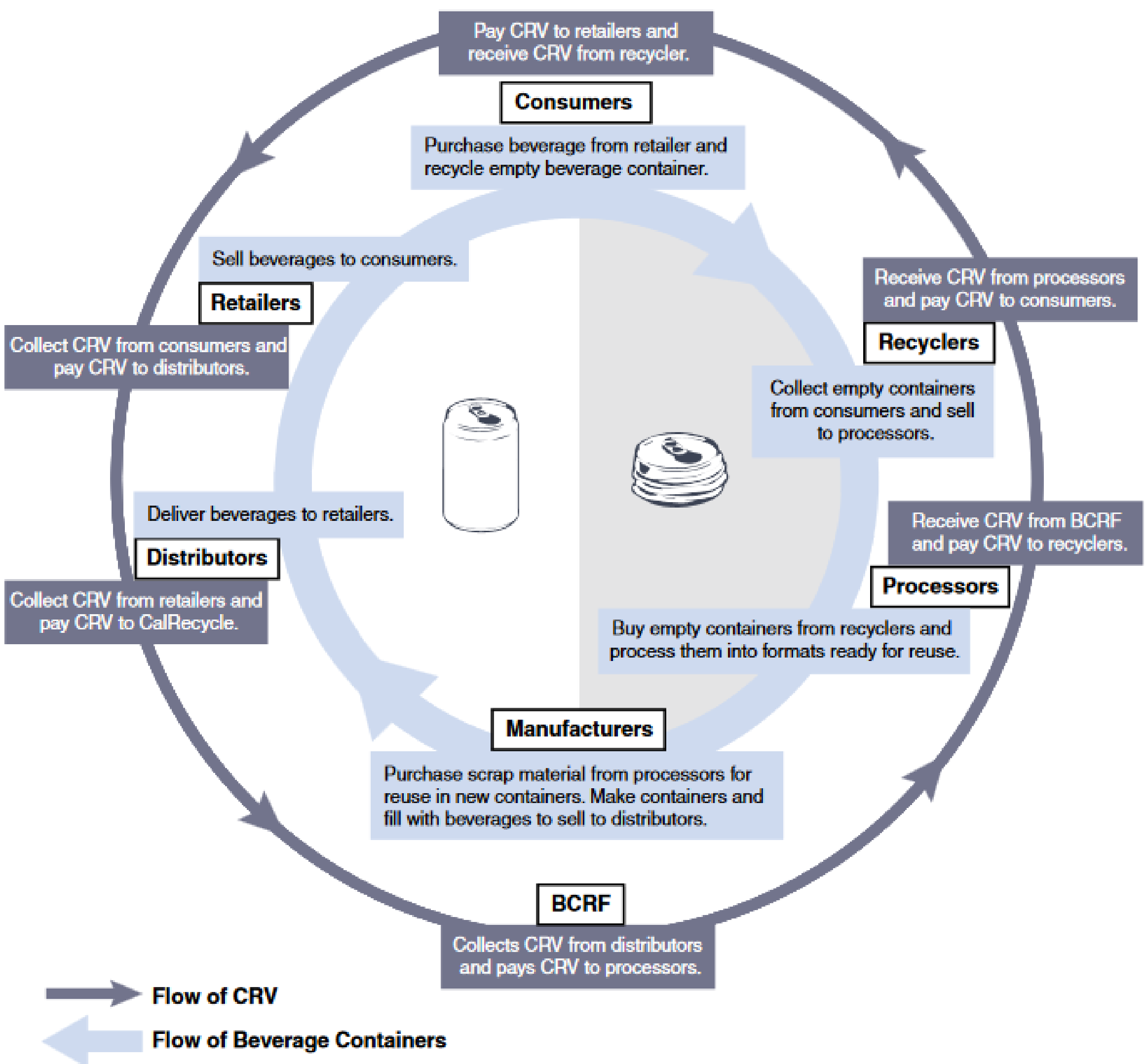
Public Comment

BACKGROUND

The Beverage Container Recycling Program (BCRP) was created almost 30 years ago by AB 2020 (Margolin, Chapter 624, Statutes of 1986). The statute included two goals: (1) to reduce litter and (2) to achieve a recycling rate of 80 percent for eligible containers. The program was meant to be self-funded and accomplishes this by first requiring consumers to pay a deposit for each eligible container purchased. Then the program guarantees consumer repayment of that deposit – the California Redemption Value (CRV) – for each eligible container returned to a certified recycler.

How the Program Works. The CRV program involves the flow of beverage containers and payments between several sets of parties, including consumers, retailers, recyclers, and manufacturers. At each stage, beverage containers and CRV are exchanged between participants.

Figure 3
How the CRV Program Works



BCRF = Beverage Container Recycling Fund and CRV = California Redemption Value.

The recycling of CRV containers begins after consumers have purchased and consumed a beverage. At that point, they may choose to recycle the empty container to a recycling center, curbside collector, or other collection program—which collects the containers and then sells them to a processor. The processors then sort, clean, and process the containers into formats ready for reuse and then sell it to manufacturers for use in new beverage containers or other types of products. Beverage manufacturers then combine the recycled material with virgin material to create new containers and fill them with beverages. The new beverages are sold to distributors, who deliver the beverages to retailers. Retailers then sell the beverages to consumers.

Generally, when beverage containers are exchanged, there is a corresponding CRV exchange. When consumers purchase beverages, they pay CRV to retailers. Retailers pass the CRV to beverage distributors. Beverage distributors pay CRV on all new beverage containers they sell in California, which is deposited into a fund. The fund is then used to pay CRV to processors for the containers they process. Processors pass the CRV on to the recyclers who collected the empty containers. Recyclers, in turn, pay CRV to consumers who redeem their beverage containers at a recycling center. In this way, consumers are able to recoup their CRV from the recycler, and from the consumer’s perspective, the CRV can be viewed as a “deposit.” Similarly, other entities pay and recoup CRV in such a way that their CRV collections and costs net out to zero.

Only Certain Beverage Containers are Eligible. Whether a container is covered by the program depends on the material, size, and content of the container. Section 14504 of the Public Resources Code specifies that the following beverages sold in aluminum, glass, plastic, and bimetal containers are included in the program:

- Beer and other malt beverages
- Wine and distilled spirit coolers
- Vegetable juice 16 ounces or less in volume
- Carbonated and noncarbonated water, soda and mineral water, and similar soft drinks
- Carbonated and noncarbonated fruit drinks that contain any percentage of fruit juice
- Noncarbonated soft drinks and sport drinks
- Coffee and tea drinks
- Carbonated and noncarbonated fruit drinks

The following beverages are excluded from the program:

- Any product sold in a container that is not aluminum, glass, plastic, or bimetal.
- Wine, or wine from which alcohol has been removed, in whole or in part, whether or not sparkling or carbonated.
- Milk
- Medical food
- Infant formula
- Vegetable juice in containers 16 ounces or greater in volume
- 100 percent fruit juice in containers 46 ounces or greater in volume
- Distilled spirits
- Any beverage container product type that is not specifically included by the Act.

Ways to Redeem CRV Deposit. Participants can redeem their deposit at either a “convenience zone” (CZ) recycling center or a “traditional” recycling center. CZ recycling center are located within a half mile radius of supermarkets. These recycling centers typically serve individuals and collect a lower volume of containers than other types of recycling centers.

Traditional recycling centers are those located outside the radius of supermarkets. These recyclers usually accept large quantities of materials, frequently by truckload from municipal or commercial waste collection services.

Alternatively, a participant may “donate” their containers in their residential curbside recycling collection or take them to other community drop-off programs. Under these options, the participant does not redeem their deposit. Instead, the redemption is made by curbside or the collecting organization.

Unredeemed CRV Deposit. Despite paying the CRV deposit, not all consumers recycle their CRV-eligible containers. In 2015–16, CalRecycle reports that the Beverage Container Recycling Fund (BCRF) received roughly $1.3 billion in deposits, but only about $1.1 billion was spent on redemption payments. The BCRF retains unredeemed deposits, and state law requires that much of the unredeemed CRV be spent on specified recycling–related programs. These supplemental programs are not directly involved in the exchange of CRV, but they are intended to help achieve the programmatic goals of increased recycling and reduced litter. There are currently ten supplemental programs funded from the BCRF (including program administration). Such programs include subsidizing glass and plastic recycling, encouraging supermarket recycling collection sites, and providing grants for market development and other recycling–related activities. CalRecycle estimates that a total of $257.4 million will be spent on supplemental programs in 2016–17.

Structural Deficit in the Program. High recycling rates and spending on the supplemental programs are creating a structural deficit in the BCRF. The structural deficit means that program expenditures exceed program revenues under the current mandated expenditure and revenue structure. The BCRF has operated under an annual structural deficit averaging about $90 million since 2008-09. According to CalRecycle, the BCRP is currently operating with a projected $50 million structural deficit for 2016-17. Based on this structural deficit and current fund balances, the department estimates that there may be insufficient funds to fully support program payments and maintain minimal reserve requirements in 2017-18. The structural deficit can fluctuate as much as tens of millions of dollars from quarter to quarter as a result of economic shifts and other factors (including scrap value rates). Previously, the gap between expenditures and revenues has been temporarily bridged through repayments of loans, particularly to the General Fund, made from the fund when it was operating at a surplus. The final loan repayment, amounting to $82.3 million, was paid in full at the end of 2014-15.

Reforms to Address Deficit. CalRecycle has implemented several program reforms, including reduced daily load limits for redemption at recycling centers, increased monitoring of the importation of out-of-state beverage containers, and elimination of the commingled rate at buyback centers. This last reform allowed for slightly lower perpound refund rate for loads containing a combination of CRV and non-CRV material. However, actions taken thus far have secured only partial success; while the gap is smaller, the amount of money coming into the BCRF is still insufficient to cover the amount being paid out. In order to eliminate the structural deficit and achieve a secure financial future for the fund and the programs it supports, further measures will be necessary. The following table displays the projected operating shortfall for 2016-17:

Beverage Container Recycling Fund Operating Revenues and Expenditures

Revenues and Expenditures	2016-17 Projection (millions)
Revenues from Redemption Fees	$1,280
California Redemption Payments	1,073
Supplemental Program Expenditures	
Processing fee offsets	102.6
Handling fees	47.8
CalRecycle administration	50.7
Curbside supplemental payments	15.0
Payments to local governments	10.5
Plastic Market Development Payments	10.0
Quality Incentive Payments	10.0
Local Conservation Corps grants	6.8
Public Education	2.5
Beverage Container Recycling Competitive Grants	1.5
Subtotal Supplemental Programs	***$257.4***
Total Expenditures	**$1,330.4**
Balance	**($50.4)**

Source: CalRecylce Quarterly Report, November 2016

2014 State Auditor Report and Recommendations. An audit by the Bureau of State Audits (BSA), released in November 2014, confirmed both the positive impact of the first round of reforms and the need for more. The audit confirmed the BCRF structural deficit, then approximately $100 million, and recognized that changes such as reducing or eliminating administrative fees for beverage distributors; enacting changes to mandatory payments, such as those for curbside programs or quality incentives to beverage program participants; or reducing or eliminating processing fee offsets could improve the program's financial condition.

The report made a series of recommendations, most of which the department has embraced. To ensure that it can demonstrate that its fraud prevention efforts are maximizing financial recoveries for the beverage program, BSA recommended CalRecycle modify and annually update its fraud management plan to include the following:

- Finalize a process to analyze the data the Department of Food and Agriculture provided on out-of-state containers and act on the results to identify and prosecute those committing fraud.

- Develop fraud estimates—by type of fraudulent activity—that quantify the potential financial losses to the beverage program and the methodology CalRecycle used to develop these estimates.

- Identify the amount of actual fraud in the prior year by type of fraudulent activity, such as the financial losses resulting from the redemption of out-of-state beverage containers or the falsification of reports used to substantiate program payments.

- Identify the amount actually recovered for the beverage program in the form of cash for restitution and penalties resulting from fraud.

- Contract with the Board of Equalization (BOE) to determine the feasibility and cost of transferring its revenue collection duties and audit reviews to them.

- Should CalRecycle find that it is feasible and cost-effective, pursue legislative changes that enable the BOE to collect revenues for the beverage program at the point of sale and remit the money to the beverage fund.

Legislative Analyst's Office Review. In 2015, the Legislative Analyst's Office (LAO) conducted a thorough review of the BCRP and determined that not only is the shortfall accurate, certain offsets place additional costs on the program and the effectiveness of some of the supplemental programs are unclear. The LAO review found the following:

- **High Recycling Rates and Spending on Supplemental Programs Create BCRF Shortfall.** The BCRF has operated under an annual structural deficit averaging about $90 million since 2008-09. This deficit is largely due to increased recycling rates in recent years, which have resulted in a greater share of BCRF revenue being paid out for CRV. Moreover, some supplemental programs are paid on a per container basis, and therefore these expenditures increase as the number of containers redeemed increases. The combined effects of higher recycling rates—more spending on CRV payments and certain supplemental program expenditures—make it much more difficult for the BCRF to operate with a structural balance.

For the last several years, the fund balance that accumulated when recycling rates were lower was able to support this expenditure level. However, the balance is being depleted further each year, and programmatic changes will need to be made in the next few years in order to keep the fund solvent and avoid statutorily required automatic funding cuts (referred to as "proportional reductions"). Acting sooner would provide the Legislature a greater number of options to address the deficit and allow for more flexibility when implementing any changes.

- **Offsets Are Major Cost to BCRF and Do Not Clearly Support Goals.** The state subsidizes recycling by making "processing payments" from the BCRF to recyclers and processors. Processing payments are intended to cover the difference between a container's scrap value and the cost of recycling it (including a reasonable rate of return). These payments are funded from two sources: (1) "processing fees" paid by beverage manufacturers and (2) the BCRF supplemental program, referred to as "processing fee offsets," which reduces the amount of processing fees that manufacturers must pay.

  The LAO found that, it is unclear how current processing fee offsets provided to manufacturers incentivize increased recycling. Additionally, providing offsets does not require manufacturers to consider the lifecycle costs of the materials that they use in their products. By reducing the amount of processing fees, the offsets effectively subsidize materials that are relatively more expensive to recycle.

- **Effectiveness of Some Supplemental Programs Unclear.** While supplemental programs might have merit, we find that many of the programs have not been evaluated for their effectiveness at improving recycling. This lack of evaluation makes it difficult to compare the relative cost–effectiveness of supplemental programs and to determine how they help to achieve program goals of increasing recycling and reducing litter. This information is critical in determining the best use of limited program dollars. In addition, the existing structure of "handling fee" payments currently made to certain recyclers does not maximize convenience for many consumers, and may raise convenience–zone recycler costs, resulting in higher handling fee payments from the BCRF. Finally, the department has not evaluated whether administrative fees—funds that beverage container distributors, processors, and recyclers receive to cover their administrative costs to participate in the BCRP—accurately reflect costs for these program participants.

Proportional Reduction. Under current law, if there are insufficient funds available in the BCRF to make all of the required CRV and supplemental payments, the department is required to reduce most supplemental program payments in equal proportions (commonly referred to as "proportional reductions"), in order to keep the fund in balance. The only payments from the fund that are not subject to the proportional reductions are the return of CRV to consumers, as well as program administration.

Proportional reductions are problematic because they do not allow for discretion in spending based on priorities or other factors. For example, under proportional reductions, the department cannot prioritize programs that are most effective or central to the BCRP's overall mission. Additionally, proportional reductions are very disruptive to program participants. Since all payments are reduced equally and quickly, participants can experience a significant cut in funding without much warning to plan accordingly. In 2009, CalRecycle had to implement proportional reductions to maintain the BCRF's solvency. This included (1) reduced payments to recyclers of about 70 percent, (2) increased processing fees charged to beverage manufacturers totaling around $50 million, and (3) elimination of most grant and market development program funding. Based on current revenue and expenditure projections.

2014 Proposal—Phase 2 Reform. In January 2014, the budget proposed programmatic changes that were expected to result in a net increase to the BCRF annual fund balance of $72.3 million in 2014-15, growing to $127 million when fully implemented in 2016-17. The changes would have both raised revenue and decreased overall program expenditures, while at the same time modestly increasing specific expenditures for fraud prevention, data collection, and expanded grant programs. The Administration projected that these changes would eliminate the program's structural deficit once fully implemented, and avoid the need to implement proportional reductions.

2014 Budget and Trailer Bill Actions. The budget subcommittees did not approve trailer bill language and the budget proposals that would have provided the second phase of the BCRF reform. Instead, the Legislature approved trailer bill language to remove the Local Conservation Corps (LCC) from the statutory provisions of the program funding and diversified the LCC funding similar to that proposed by the Governor under the program reform proposal.

The budget also included several positions to increase audit coverage of beverage manufacturers and distributors to better protect the integrity of the BCRF. The emphasis was on prevention fraud, collecting revenues owed to CalRecycle, and mitigating risk to the fund.

2015 Legislative Oversight and Actions. The Legislature took action in the 2015 budget to make additional changes to the BCRP, specifically to address issues raised by the Legislature and BSA related to audits and compliance. These actions included:

- Targeted Activities to Improve Program Integrity. $357,000 (BCRF) and three positions, and $717,000 (BCRF penalty account) and seven two-year, limited-term positions, to implement targeted activities to enhance program integrity, reduce expenditures, and mitigate potential program funding shortfalls. The budget converted eight existing limited-term positions to permanent for ongoing program certification workload.

- Processor Oversight Activities. $933,000 and 10 two-year limited-term positions to establish a pilot program with dedicated on-site investigation resources at certified processor facilities. These positions were to create a new pilot program to expand current fraud investigation activities on recyclers to processing facilities.

- Rigid Plastic Packaging Container Program. $296,000 (BCRF) and three positions, to conduct annual rigid plastic packaging container compliance certification reviews, pursuant to recently adopted regulations, and provide additional compliance assistance tools.

LAO COMMENTS

The LAO has made several recommendations, some of which are consistent with the Administration's framework, which could help right-size the BCRP. Specifically, the LAO recommendations include:

- **Shifting Processing Costs to Manufacturers.** The LAO recommends shifting processing costs to manufacturers. This would reduce BCRF expenditures significantly, probably eliminating the structural deficit. It would also require producers to cover the recycling costs of their products, which means that these costs are incorporated or "internalized" into the total cost of the product when it is sold. Therefore, the price that consumers pay reflects the entire cost of the product—its production and disposal. Shifting costs to manufacturers could be done in two ways, either by eliminating processing fee offsets or by moving to a market–based system where manufacturers are responsible for the recycling of materials. While either approach could work, the LAO states that the market–based approach would have several potential advantages.

- **Improving the Cost–Effectiveness of BCRP.** The LAO makes several recommendations designed to improve the cost–effectiveness of the BCRP: including (1) evaluating supplemental programs to determine how cost effective they are at achieving recycling and litter reduction goals; (2) giving recyclers more flexibility in where they locate and piloting a new payment structure in order to improve convenience for consumers; and, (3) adjusting the administrative fee to reflect the actual costs of program participation. In combination, the LAO believes these recommendations would improve the program's financial sustainability at current and potentially higher future recycling rates.

STAFF COMMENTS

The Bottle Bill program is over 30 years old and is in need of reform to keep current with the changing landscape of recycling. Comprehensive reform continues to elude the Legislature due to the very diverse group of stakeholders. The Assembly attempted a temporary fix in the 2016-17 budget cycle and again in the 2017-18 budget cycle, however both attempts were ultimately unsuccessful.

Due to the reduced recycling infrastructure and other factors, the fund conditions within the BCRF currently reflect a healthy balance. However, many of the issues that drove the need for comprehensive reform remain. Consumers in many areas continue to have limited or no access to redemption opportunities. Grocers must continue with the inconvenience of taking back the containers or paying a $100/day fee. According to an annual report published by CalRecycle in 2017, the state's empty beverage container recycling rate fell below 80 percent for the first time since 2008, with peak recycling rate at 85 percent in 2013.

3970 DEPARTMENT OF RESOURCES RECYCLING AND RECOVERY

INFORMATIONAL ISSUE 2: OVERSIGHT OF THE MATTRESS RECYCLING PROGRAM

The Subcommittee will receive a briefing on the status of the Mattress Recycling Program.

PANELISTS

Panel 1: Background and Overview of the Mattress Recycling Program

- Ashley Ames, Senior Fiscal & Policy Analyst, Legislative Analyst's Office

Panel 2: CalRecycle's Role in Oversight

- Scott Smithline, Director, Department of Resources Recycling and Recovery

Panel 2: State of Administration of the Mattress Recycling Program

- Mike O'Donnell, Managing Director, Mattress Recycling Council

Panel 4: Other Perspectives of the Mattress Recycling Program

- Heidi Sanborn, Executive Director, California Product Stewardship Council

Public Comment

BACKGROUND

The Used Mattress Recovery and Recycling Act was created by SB 254 (Hancock, Chapter 388, Statutes of 2013) to reduce illegal dumping of mattresses, to increase the recycling of mattresses, and to substantially reduce public agency costs for the end-of-life management of used mattresses. In order to accomplish these goals, the Act requires the mattress industry to develop a statewide mattress recycling program that will strive for the maximum feasible level of recovery and recycling of used mattresses generated in support of the statewide goal that at least 75 percent of all solid waste be recycled by January 1, 2020.

Creation of the Mattress Recycling Council. In 2013, the mattress industry, through its trade association, the International Sleep Products Association, formed the Mattress Recycling Council, a nonprofit organization tasked with designing, implementing, and administering recycling programs in states that have enacted mattress recycling laws. California is one of three states with a mattress recycling law. The Mattress Recycling

Council is the nonprofit organization certified by CalRecycle to administer the mattress recycling program in California.

How the Program Works. The Mattress Recycling Council (MRC) launched the mattress recycling program in California, also known as Bye Bye Mattress, on December 20, 2016 with the principal goals of reducing illegal dumping and cleaning up illegally dumped mattresses. MRC oversees all aspects of the program, including the collection and recycling of discarded mattresses. The program is funded through a $10.50 (decreased from $11 on January 1, 2018) recycling fee collected on all purchases of new, used and renovated mattresses and box springs.

Residents can drop off their old mattress at no-cost at a participating collection site or recycling facility. Residents are also eligible for a $3 reimbursement per mattress if they take the mattress back to a participating recycling facility. This option is limited to five units per person per day. The mattress recycling program also requires retailers to offer consumer’s the option to have their old mattresses picked up when delivering a new mattress, at no additional cost. Further, the program is required to provide financial incentives to fund the collection of illegally dumped mattresses and provide collection services to low-income communities.

Producers and importers must register with the program in order to sell mattresses in California. Obligations vary depending on what role a company plays in the manufacturing, distribution, sale or renovation of mattresses and box springs. Businesses not complying with the law can be prohibited from selling their products in California and face financial penalties.

The MRC must submit to CalRecycle by July 1 of each year a report that includes an updated list of participating manufacturers, renovators, and retailers and an updated list of brands covered.

The Mattress Recycling Program is one of the first product stewardship programs in California. The mattress recycling program adopts core principals of the extended producer responsibility (EPR) model, which provides that that manufacturer should internalize disposal costs associated with their products. EPR involves: 1) the shifting of responsibility upstream toward the producer and away from the municipalities; and, 2) providing incentives to producers to incorporate environmental considerations in the design of their products. However, the program does include an advanced recovery fee, which is paid by the consumer of a new mattress at the point of sale. The fee revenue funds the proposed program to be managed by the MRC and overseen and enforced by CalRecycle.

CalRecycle's Role in the Program. CalRecycle provides enforcement and oversight of the mattress recycling program. CalRecycle evaluates compliance through various means including, but not limited to, inspections. In performing its compliance function, CalRecycle may ask a retailer, renovator, recycler or manufacturer to provide timely access to records. Relevant records include invoices, functional equivalent billing documents, or other records. CalRecycle also provides approval for the mattress fee at the retail level. This fee is set by the MRC and collected by the retailers and remitted to the MRC on a monthly basis.

Mattress Collection and Recycling Rate. CalRecycle's ability to establish a recycling rate for the MRC is limited due to data gaps. Establishing a recycling rate would require knowledge of total used mattresses available for reuse or recycling. As such, CalRecycle uses the baseline and goal-setting approach, which establishes a goal and then focuses on a year-over-year increase in the number of units collected for recycling and the percentage of material recovered.

In its first year of operation, the MRC collected 955,059 mattresses, or 29,090,484 pounds of material. These units were collected from 122 collection sites, 50 collection events, and 11 recycling facilities. MRC anticipates a 30% increase in units received in 2017.

Mattress Fee Decrease in 2018. By law, the MRC must set the per unit mattress recycling charge that funds its California operations at a level that is sufficient to fund the mattress recycling program's budgeted costs and operate the program over a multi-year period in a prudent and responsible manner. This fee is "per piece" so if a box spring or foundation comes in two pieces, the fee will be charged for each piece. MRC's expenses include collection, transportation and processing, communications, research, CalRecycle oversight, and administrative expenses. The fee is established by the MRC, but requires approval by CalRecycle. As of December 30, 2017, the fee per unit was set at $11 on each mattress, box spring, foundation, and base sold. The $11 charge provided revenue of $42,262,506 in 2016.

In its proposed 2018 California Used Mattress Recovery and Recycling Plan Budget, the MRC proposed to reduce the mattress recycling charge from $11 to $10.50/unit beginning January 1, 2018. The MRC arrived at this figure based on the projected cost to operate the program in 2018, which is $39,973,452, and the anticipated revenue, which is $39,723,452. This proposal was approved by CalRecycle.

Joint Legislative Audit Underway. Assembly member Christina Garcia (D- District 58) filed a request with the Joint Legislative Audit Committee in January 2018 to assess the oversight of the MRC by CalRecycle to ensure they are in compliance with the California Mattress Recycling Law. The Audit Committee approved the request and indicated the audit could be completed in five months.

STAFF COMMENTS

There have been concerns raised over MRC's implementation of the Mattress recycling program. Concerns include the lack of transparency and the meagerness of its recovery rate. Some questionable actions by the MRC include the terminating its recycling contract with the largest mattress recycler in California. The joint legislative audit that is underway would help answer some of the questions relating to the program's progress, efficiency, and efficacy. Any potential proposed changes to the mattress program would be better served until the audit is complete.

Both the mattress recycling program and the bottle bill program seek to reduce litter and increase recycling. Each seeks to accomplish those goals with different means. The mattress recycling program is loosely modeled after the "polluter pays" principal while the bottle bill program is structured after a deposit redemption model. Both have their unique challenges. As the Legislature evaluate potential changes to both programs, it should consider the merits and pitfalls of each model and whether certain elements can be used in conjunction.