



A Public Agency

SHOREWAY OPERATIONS AND CONTRACT MANAGEMENT

STAFF REPORT

To: SBWMA Board Members
From: Joe La Mariana, Executive Director
John Mangini, Senior Finance Manager
Date: November 18, 2021 Board of Directors Meeting
Subject: Hearing on South Bay Recycling's Request for Compensation Adjustment Based on Special Circumstances

Recommendation

It is recommended that the SBWMA Board of Directors approve Resolution No. 2021-40 attached hereto authorizing the following action:

It is recommended that the SBWMA Board of Directors hear and deny SBR's request for a special compensation adjustment, and instead direct staff to include these costs as a line item in SBWMA's 2023 budget. (Attachment 1)

Pursuant to the procedure set forth in the Shoreway Operating Agreement, South Bay Recycling, LLC ("SBR") has requested a compensation adjustment in the amount of \$423,913.03 based on special circumstances to recover eligible costs associated with upgrading 23 of its trucks to comply with the 2009 California Air Resources Board (CARB) Truck and Bus Regulations which require all trucks with a gross truck weight rating above 26,001 lbs. to have a 2010 or newer model year engine by January 1, 2023.

Procedural Background

SBR operates SBWMA's Shoreway facility pursuant to the "Agreement for Operation of the Shoreway Recycling and Disposal Center" ("Agreement"), which has an Effective Date of November 30, 2009. Under the Agreement, SBR's obligation to operate the Center commenced January 1, 2011 and continues until December 31, 2023.

Article 7 of the Agreement sets forth the compensation SBR receives under the Agreement. Although there are a number of adjustments and modifications that can be made, the general method of compensation is as follows.

Under Section 7.08, basic compensation consists of three (3) components:

- 1) Transfer Station Payment (tons delivered and processed x fee);
- 2) Recyclable Materials Processing Payment (tons of recyclables delivered and processed x fee);
- 3) Transportation Payment (tons transported from Center x one-way miles x applicable fee).

Each fee is comprised of four (4) cost components and associated profits. The four (4) components are

- 1) Labor costs;
- 2) Fuel and power costs;
- 3) Depreciation based on a 10 year straight line method;

- 4) Other operating and maintenance costs.

The above-noted fees are subject to an annual adjustment based on a procedure described in Attachment 13-A of the Agreement. (§7.05).

In addition to its annual compensation, SBR may apply for an adjustment to one or more of the three basic compensation fees based on certain specified circumstances per Section 7.11 of the Agreement, entitled "Adjustments for Special Circumstances." Specifically, Section 7.11 provides, in relevant part:

7.11 ADJUSTMENTS FOR SPECIAL CIRCUMSTANCES

- A. The Contractor may apply to the Authority [SBWMA] for an adjustment to one or more of the fees provided for in Section 7.03, and the Authority may initiate such a review, if any of the following events occur, provided that the event will increase or decrease Contractor's component costs of operation by an amount that is two percent (2%) or more of the total fees earned under Section 7.03 during the immediately preceding Rate Year and provided further that the costs will not be otherwise recovered through the per ton and per ton mile fees provided in Section 7.03:
 - (1) [omitted].
 - (2) A change in law occurring after the Effective Date that requires a change in operations.
 - (3) [omitted].
 - (4) [omitted].

The process for reviewing a request for a special compensation adjustment is found in Section 7.11(C) and (D). Those sections provide:

- C. If the Contractor requests, or the Authority initiates, a special review of the Contractor's compensation, the Authority shall have the right to review the financial and operation records of the Contractor and Affiliated Entities that it determines are reasonably necessary to conduct such special review.
- D. Contractor shall bear the burden of justifying to the Authority by substantial evidence its entitlement to continuation of current, as well as any increases in, Contractor's compensation for special circumstances. If the Authority determines that the Contractor has not met its burden, it shall notify Contractor that it is prepared to deny Contractor's request for an increase in compensation, or to proceed with a reduction in compensation. The Contractor may request a hearing to produce additional evidence. Upon such request, the Authority shall provide a hearing before the Authority's Board of Directors. In the event the Authority's Board of Director's denies Contractor's request, Contractor shall have the right to present its claim in a court of competent jurisdiction.

SBR'S Application for Compensation Adjustment

On July 30, 2021, SBR presented the Executive Director with a request for a special compensation adjustment under Section 7.11 contending that it is required to purchase 23 new trucks in order to comply with 2009 California Air Resources Board (CARB) regulations which go into effect on January 1, 2023. SBR contends that the cost of replacing 23 trucks -- 12 trucks that pull working floors trailers, 10 trucks that pull possum belly trailers, and 1 roll off truck -- is \$4,627,657. SBR argues this CARB Truck and Bus Regulation, 13 CCR 2025, enacted in 2009 several weeks after the Effective Date of the Agreement, represents a change in law which will increase their costs by more than 2% of the total fees earned in the previous rate year and SBR is therefore entitled to a special compensation adjustment to cover costs resulting from this purchase.

In Rate Year 2020, the total fees earned under Section 7.03 of the Operating Agreement were \$20,670,514. Two percent (2%) of that equals \$413,410. SBR initially proposed to purchase the required equipment, to amortize the cost of this purchase over either 8 or 10 years, and to pass through the monthly depreciation for a period not to exceed 13 months (November 2022-December 2023). With an 8-year depreciation schedule, the cost was estimated at \$578,457.20. Pursuant to a 10-year depreciation schedule, the cost was reduced to \$486,675.24. Using either calculation, the cost exceeds 2% of SBR's Rate Year 2020 compensation. In its special compensation adjustment request, SBR further proposed that if a new contract is awarded to SBR at the end of the current contract in January 2023 that these trucks would be used to service its operations. If the contract is awarded to a new operator in January 2024, SBR proposed that SBWMA could purchase the trucks from SBR which could then be transferred (sold) and then utilized by the new operator in the course of its operations during the new contract term.

Discussion

Under Section 7.11, SBWMA has the right to review financial and operation records that it determines are reasonably necessary to respond to a request for a special compensation adjustment.

In order to respond to SBR's request, staff made several verbal and written requests for information needed to analyze SBR's proposed special compensation adjustment. On August 9 and August 30, 2021, staff requested in writing all information SBR had reviewed and relied on to support the proposal outlined in their July 30, 2021 letter including:

- a) Relevant CARB regulations enacted in 2009;
- b) An explanation of why SBR did not plan for and initiate a phased in replacement during the last 10 years to meet the January 2023 deadline;
- c) SBR's assessment of its fleet which led to the conclusion that 23 trucks are required to be replaced;
- d) Documentation to support SBR's estimate of costs associated with replacement of 23 trucks;
- e) The proposed depreciation schedule for the 23 trucks;
- f) An explanation of whether SBR could utilize trucks already in its fleet to meet the CARB requirement;
- g) An explanation of whether SBR had considered renting CARB compliant trucks;
- h) An explanation of whether or not SBR had considered retrofitting its current trucks as allowed for in CARB Regulation 2025(9) rather than replacing them.

SBR provided information on August 20, 2021, September 14, 2021, and October 19, 2021. The information provided by SBR answered some, but not all, of the questions posed by staff.

In the information supplied by SBR on September 14, 2021, it offered the following justifications for its request:

"Fee under section 7.03. CARB impacts section C, Transportation Payment. We suggest it be adjusted by adding the vehicle depreciation cost into the 2023 Annual Compensation Adjustment. The cost would be allocated to the appropriate number of vehicles assigned by disposal site (i.e., OX, Newby, Zanker, BYON) which would be represented in the per ton-mile rate. When the equipment is received (late 2022) and placed in service (November or December 2022) we suggest the same methodology but passed through in the Monthly Invoice. The annual cost of the adjustment is \$578,457, which exceeds the 2% threshold of the total fees paid to SBR in Rate Year 2020 of \$20,670,514 x 2% equals \$413,410. The standard for new truck depreciation is 9 years. The reason we showed an 8-year amortization schedule was we thought we may be able to purchase used equipment and that would make allow for a shorter depreciation, since the useful

life would depend on the model year of the truck and other considerations. However, due to the approaching deadline for company fleets to be CARB compliant, there is no inventory of used equipment available to our operation or that meets the CARB requirements.

Truck compliance options. We considered truck modifications but due to time constraints posed by the CARB deadline, this is not practical. Installation of one CARB compliant engine takes approximately 3-4 months to complete and is cost prohibitive. It's not feasible to replace CARB compliant engines in SBRs fleet in time to meet the requirement. We have looked into renting equipment, however, rental companies will not enter into a rental agreement for one-year and most, if not all, cannot provide the specialized equipment we require.

Affiliated companies. We consulted with affiliate companies but SBRs trailers were custom designed, engineered and manufactured to minimize weight and maximize payload, and Recology's power units will not configure to SBRs equipment."

Because SBR's response did not address several of the questions posed in staff's verbal and written requests, additional verbal requests for information were made to SBR. In response, on October 19, 2021, SBR provided the following additional information:

"Truck modifications were considered but this is cost prohibitive to install CARB compliant engines which take apx 3-4 months to complete- *In speaking with a local vendor, NorCal Kenworth, the cost for an engine replacement is ~\$54K per engine (about \$1.25M for the fleet), please refer to the attached document which itemizes the cost per truck; however, it takes 6-8 weeks to replace a single engine in one truck; SBR utilizes our fleet and can not pull more than one truck out of service at a time for an engine replacement thus it would take more than 3 years to replace all of the engines in our current fleet (23 trucks x 7 weeks = 161 weeks / 52 = 3.1 years)..... This is not a viable solution because the fleet replacement will not meet the CARB deadline of 1/1/2023*

Renting equipment is not possible because rental companies will not enter into a one year agreement and none of them can provide the specialized equipment we require – *Each year there is an annual industry trade show with nearly all vendors making themselves available to discuss business opportunities, SBR spoke and met with several truck manufacturers and none of them will rent a fleet of trucks for a one year period of time; SBR trucks have many unique characteristics that result in them being apx. 2,500 lbs lighter than standard equipment (no driver seat, lightweight materials, engine modifications for oil spinning, aluminum frames, super singles (not normal double axle/wheel assemblies), in addition the tractor frames are apx 24" shorter than normal frames which puts more weight over the front axle thus increasing the payload for each haul*

SBR's trailers were custom designed, engineered, and manufactured..... Recology's power units will not configure to SBR's equipment – *the tractor frames are apx 24" shorter than normal frames which puts more weight over the front axle thus increasing the payload for each haul; SBR is looking for trucks/power units within Recology, Potential, and third party sources but until now trucks have not been found but even if some were available they would have to be modified at a cost of approximately \$10,000 each*

Fleet Leasing Option we are unable to find one-year fleet equipment with "wet kits" – *a "wet kit" is hydraulic power unit mounted to the truck which is used to move walking floors, this functionality is*

needed to power the “walking floor” trailers which self unload at destinations, leased trucks do not come with this functionality and such modifications are not allowed to leased units”

Staff Recommendation

Staff reviewed all information supplied by SBR and the Executive Director determined that a special compensation adjustment was not justified, by substantial evidence, because although the cost of complying with the CARB mandate exceeded the 2% requirement for a special compensation adjustment, these costs could otherwise be recovered through the existing per ton and per mile fees provided in Section 7.03

As discussed earlier in this report, SBR’s Basic Compensation is calculated by multiplying three (3) fees (i.e., transfer station fee, MRF fee, and transportation fee) by the number of tons processed or ton/miles operated. Each of the three (3) above-referenced fees are comprised of four (4) distinct cost components:

- 1) Labor costs;
- 2) Fuel and power costs;
- 3) Depreciation;
- 4) Other operating and maintenance costs.

Given this provision in the existing contract, SBR costs associated with the truck purchase could be recovered through the 10-year straight line depreciation schedule provided for in the contract and a 10-year straight line amortization of interest. The 10-year straight line depreciation has been the practice for all other equipment depreciation and cost recovery during the term of the current contract. As a result, costs associated with this purchase do not qualify as a “special circumstance” because the costs “will be otherwise recovered through the per ton and per mile fees provided for in Section 7.03.”

When SBR was informed that the special compensation adjustment was being denied by the Executive Director, he advised SBR the denial was based on the fact that these costs could be considered as an eligible pass through in the Agency’s 2023 budget.

While SBR agreed with this approach, its staff indicated that the trucks must be purchased now in order to meet the January 1st, 2023 compliance deadline and SBR was unwilling to move forward with the purchase without Board commitment to view this expense as an eligible 2023 budget line item pass through cost calculated on a 10-year straight line depreciation basis. In order to obtain the Board’s direction on this question, SBR requested that the special compensation adjustment remain on the Board’s agenda, understanding that staff would recommend:

1. Denial of the request for special compensation.
2. Approval of a resolution directing staff to include in the 2023 budget a line item for approval of a pass through cost in an amount not to exceed \$423,913.03 (i.e., the amount SBR would be eligible to recover based on a 10-year straight line depreciation schedule and a 10-year straight line amortization of interest during the remaining term of the Operating Agreement in order to initiate a purchase of 23 CARB compliant trucks).

While this request comes before the timeframe within which the Board will review and approve the 2023 budget, staff recommends approval of the attached resolution (Attachment 1), directing staff to insert an amount not to exceed \$423,913.03 in the 2023 budget so that SBR can now order the trucks required to be manufactured and delivered to be placed in service no later than January 1, 2023.

Fiscal Impact

The fiscal impact in budget/rate year 2023 is \$423,913.03, which represents a .38% rate payer impact.

Conclusion

Given the CARB mandate calling for an upgrade to 23 of SBR's trucks by January 1, 2023 and the need to order the trucks now in order to meet that deadline, staff recommends that the Board approve the attached resolution directing that the 2023 budget include a line item authorizing SBR to pass through costs in an amount not to exceed \$423,913.03 during the remaining term of the Operating Agreement with SBWMA in order to recoup eligible costs associated with an immediate purchase of CARB compliant trucks.

Attachments:

Resolution 2021-40



RESOLUTION NO. 2021-40

RESOLUTION OF THE SOUTH BAYSIDE WASTE MANAGEMENT AUTHORITY BOARD OF DIRECTORS DENYING SOUTH BAY RECYCLING, LLC'S COMPENSATION ADJUSTMENT REQUEST BASED ON CHANGES TO CALIFORNIA AIR RESOURCES BOARD TRUCK AND BUS REGULATION, 13 CCR 2025

WHEREAS, South Bay Recycling, LLC (SBR) operates the Authority's Shoreway Center facility pursuant to the "Agreement for Operation of the Shoreway Recycling and Disposal Center" ("Operating Agreement") dated July 2009, with an Effective Date of November 1, 2009. Under the Operating Agreement, SBR's obligation to operate the Shoreway Recycling and Disposal Center ("Center") commenced January 1, 2011 and continues through December 31, 2023. The Operating Agreement sets forth the terms of SBR's compensation, and provides a mechanism (Section 7.11) for requesting adjustments to its compensation based on certain defined special circumstances; and

WHEREAS, by letter dated July 30, 2021, SBR requested an adjustment to its compensation for special circumstances pursuant to Section 7.11 of the Operating Agreement. Section 7.11 A.2 of the Operating Agreement allows an adjustment based on a change in law occurring after the Effective Date of the Operating Agreement; and

WHEREAS, the Operating Agreement defines "Change in Law" for purposes of Section 7.11(A)(2), as "the enactment, adoption, promulgation, issuance, modification, or written change in administrative or judicial interpretation, on or after the Effective Date, of any Applicable Law" which has a material and adverse effect on the performance by the Parties or their respective obligations under the Operating Agreement, and defines "Applicable Law" as "all federal, State, and local laws, regulations, rules, orders, judgments, decrees, permits, approvals, or other requirements of any governmental agency having jurisdiction over the processing, transportation, and Disposal of Solid Waste, Recyclable Materials, Organic Materials and other materials covered by this Operating Agreement that are in force on the Effective Date and as they may be enacted, issued or amended during the Term; and

WHEREAS, the California Air Resources Board adopted Regulation 2025 in late 2009, with an effective date of January 8, 2010, to require all in-use heavy duty trucks, medium heavy duty trucks and busses powered by diesel engines to progressively add the best available emission control technology for fine particulate matter and oxides of nitrogen to their engines over a period of phased-in implementation culminating January 1 2023, by which date all such vehicles must have a model year 2010 or newer engine in order to operate in California (13 CCR 2025); and

WHEREAS, SBR contends that compliance with 13 CCR 2025 requires replacement of 23 of its trucks and the cost associated with that replacement exceeds 2% of the compensation earned in Rate Year 2020; and

WHEREAS, the Executive Director has determined that the eligible cost associated with purchase of CARB compliant trucks exceeds 2% of SBR's compensation for 2020, the Executive Director has also determined that a special compensation adjustment is not justified because those costs can be otherwise recovered pursuant to Section 7.03 of the Operating Agreement; and

WHEREAS, SBR understands the Executive Director's determination and has requested that the Board hear its special compensation adjustment request and, if denied, approve a resolution directing staff to instead include these costs as an eligible pass through item in the 2023 budget; and

WHEREAS, staff has recommended that the Board direct staff to include these costs in the 2023 budget in order to give SBR time to obtain CARB compliant trucks by January 1, 2023 and prepared a resolution for Board action approving this approach; and

WHEREAS, the Board considered SBR's request, the staff report, and evidence presented at a duly noticed hearing held on November 18, 2021, and determined that SBR has not demonstrated that it is entitled to a special compensation adjustment because the identified costs can otherwise be recovered pursuant to the Operating Agreement; and

WHEREAS, the Board further determined that there is an immediate need to consider SBR's request for reimbursement of these costs in order for SBR to move forward with the purchase of CARB compliant trucks to meet the State mandated January 1, 2023 deadline and therefore determined that the costs be included in the 2023 budget.

NOW, THEREFORE BE IT RESOLVED that the South Bayside Waste Management Authority hereby denies SBR's special circumstance request for a compensation adjustment and directs staff to include in the 2023 budget a line item authorizing SBR to pass through costs in an amount not to exceed \$423,913.03 representing the total eligible costs of depreciation and interest associated with purchase of 23 CARB compliant vehicles.

PASSED AND ADOPTED by the Board of Directors of the South Bayside Waste Management Authority, County of San Mateo, State of California on the **18th** day of **November, 2021**, by the following vote:

Agency	Yes	No	Abstain	Absent	Agency	Yes	No	Abstain	Absent
Belmont					Redwood City				
Burlingame					San Carlos				
East Palo Alto					San Mateo				
Foster City					County of San Mateo				
Hillsborough					West Bay Sanitary Dist				
Menlo Park									

I HEREBY CERTIFY that the foregoing Resolution No. 2021-40 was duly and regularly adopted at a meeting of the South Bayside Waste Management Authority on November 18, 2021.

Alicia Aguirre, Chairperson of SBWMA

ATTEST:

Cyndi Urman, Board Secretary

