



SHOREWAY OPERATIONS AND CONTRACT MANAGEMENT



A Public Agency

STAFF REPORT

To: SBWMA Board Members
From: Kevin McCarthy, Executive Director
Date: April 23, 2015 Board of Directors Meeting
Subject: Update on SBR Compliance with Terms and Conditions Associated with Board Approval of Consent to Assignment of Majority Interest in South Bay Recycling, LLC to Recology, Inc.

Board Action

This staff report is for discussion purposes only and no formal action is requested of the Board of Directors.

Analysis

This staff report provides the Board an update on South Bay Recycling (SBR), LLC's compliance with the terms and conditions of the consent to Assignment to Recology, Inc. as detailed in the attached (see **Attachment A**) Board adopted Resolution 2014-28.

As stated in Section 12.03(c) of the Operations Agreement pertaining to "Assignment," the contractor at a minimum must meet certain requirements related primary to providing financial documents, and satisfactory proof of operational experience and conducting operations in a safe, legal and environmentally conscientious manner. Recology met all of these requirements per correspondence provided on November 11, 2014.

This transaction closed on March 4, 2015 and staff has been provided the updated, required legal documents to meet terms and conditions items 1-3 in the Resolution.

Attachment B provides a letter from SBR related to terms and conditions items 6-7 which pertain to SBR and Recology analyzing potential synergies with any "back-office" integration and with the truck maintenance functions at the Shoreway facility. The letter concludes by stating:

"Although SBR has not been able to identify savings from back-office or truck maintenance, there are opportunities for service enhancements and facility improvements which are being developed."

Senior management from SBR and Recology will be at the April Board meeting to present and explain the findings summarized in their letter and address other required follow-up items associated with the consent to Assignment.

Background

On December 17, 2014 the Board adopted Resolution No. 2014-28 attached hereto with the specified conditions of approval addressing legal and operational requirements and considerations necessary for consent to Assignment of Majority Interest in South Bay Recycling, LLC to Recology, Inc.

On October 30, 2014, staff became aware of a future potential transaction involving Recology acquiring Community Recycling and Recovery, a majority owner of SBR. SBR is under contract with the SBWMA to operate the Shoreway Environmental Center through 12/31/20. On November 11, 2014 the SBWMA received a letter from SBR requesting that the SBWMA consider and provide its consent, pursuant to Section 12.03 of the Agreement for Operation of the Shoreway Recycling and Disposal Center, to a change in the majority ownership of SBR.

Fiscal Impact

There is no fiscal impact associated with this item.

Attachments:

A - Resolution 2014-28

B – March 30, 2015 Correspondence from Dan Domonoske, Vice President of South Bay Recycling to SBWMA Executive Director



RESOLUTION NO. 2014-28

RESOLUTION OF THE SOUTH BAYSIDE WASTE MANAGEMENT AUTHORITY BOARD OF DIRECTORS CONSENTING TO ASSIGNMENT OF MAJORITY INTEREST IN SOUTH BAY RECYCLING, LLC TO RECOLOGY INC.

WHEREAS, South Bay Recycling, LLC, a California limited liability company (SBR), by letter of November 11, 2014, has requested that the South Bayside Waste Management Authority (SBWMA) consider and provide its consent, pursuant to Section 12.03 of the Agreement for Operation of the Shoreway Recycling and Disposal Center (the Agreement), to a change in the majority ownership of SBR; and

WHEREAS, Community Recycling and Recovery, Inc., a California corporation (Community Recycling) is currently a sixty percent (60%) owner in SBR together with Potential Industries, Inc., a California corporation (Potential Industries) owning forty percent (40%); and

WHEREAS, Recology Inc., a California corporation (Recology) is proposing to acquire Community Recycling's sixty percent (60%) interest in SBR; and

WHEREAS, the acquisition of Community Recycling's interest in SBR by Recology will result in an "Assignment" by SBR of its rights and obligations under the Agreement pursuant to Section 12.03 of the Agreement; and

WHEREAS, in response to a November 21, 2014 letter from the SBWMA to SBR staff has received written assurances as follows: from Recology dated December 1, 2014, and as modified on December 8, 2014; from SBR dated December 1, 2014, and as modified on December 8, 2014; and from Potential Industries dated November 28, 2014. All such assurances are attached hereto as Exhibit A and the SBWMA has relied on these assurances in its review and approval of this Consent to Assignment; and

WHEREAS, the Board of Directors of the SBWMA has reviewed the proposed Assignment pursuant to its authority under Section 12.03 of the Agreement and finds that Recology as the proposed Assignee, can fulfill the terms of the Agreement, subject to the conditions below.

NOW, THEREFORE, BE IT RESOLVED that the SBWMA Board of Directors hereby consents to the proposed Assignment under the following terms and conditions:

1. That pursuant to Section 10.07 of the Agreement, Recology provides its guaranty in the same form as set forth in Attachment 17 to the Agreement on or before its acquisition of Community Recycling's interest in SBR.
2. That pursuant to Section 10.03 of the Agreement, the Faithful Performance Bond of SBR be replaced with a new bond that includes Recology as an obligor on the Bond on or before closing of Recology's acquisition of Community Recycling's interest in SBR.
3. That SBR will provide SBWMA with written confirmation from the insurance brokers placing the insurances required under Section 10.02 of the Agreement that the said insurances will be in effect upon the acquisition of

Community Recycling's interest in SBR by Recology. Said written confirmation shall be provided on or before the closing of Recology's acquisition of Community Recycling's interest in SBR.

4. That Potential Industries will continue to take the technical lead in directing MRF operations and commodity marketing functions associated with the Shoreway Facilities.
5. That SBR will continue to utilize its custom-specification transfer trailers and/or transfer trailers capable of achieving the same payloads to continue to meet or exceed the payloads for shipments of materials per the Agreement.
6. That SBR and Recology will analyze synergies associated with any "back-office" integration with the goal of saving costs and increasing efficiencies and report back to the SBWMA on or before April 1, 2015 regarding identifying such savings.
7. That SBR and Recology will analyze synergies associated with the truck maintenance functions at the Shoreway Facilities with the goal of saving costs and increasing efficiencies and report back to the SBWMA on or before April 1, 2015 regarding identifying such savings. In addition, SBWMA shall not be required to upgrade SBR's temporary outdoor truck maintenance facilities at Shoreway.
8. That SBR will complete its evaluation of alternative MRF sort labor at the Shoreway MRF and report back the results to SBWMA on or before July 1, 2015.
9. That Recology will hire a Senior Financial Manager on or before May 1, 2015 to support both its SBWMA franchise hauling operations and the SBR Shoreway operations. This new position will not be a rate reimbursable expense nor is the approval of such a position the basis for Recology or SBR to otherwise modify their approved personnel per Attachment O of the Member Agency Franchise Agreements or Attachment 9 of the Agreement.
10. That SBR shall pay SBWMA for its reasonable expenses for attorneys' fees incurred in connection with this Consent to Assignment.

PASSED AND ADOPTED by the Board of Directors of the South Bayside Waste Management Authority, County of San Mateo, State of California on the 17th day of December, 2014, by the following vote:

Agency	Yes	No	Abstain	Absent	Agency	Yes	No	Abstain	Absent
Atherton	X				Menlo Park	X			
Belmont	X				Redwood City	X			
Burlingame	X				San Carlos	X			
East Palo Alto				X	San Mateo				X
Foster City	X				County of San Mateo	X			
Hillsborough	X				West Bay San. District				X

I HEREBY CERTIFY that the foregoing Resolution No. 2014-28 was duly and regularly adopted at a regular meeting of the South Bayside Waste Management Authority on December 17, 2014.

ATTEST:


Bill Widmer, Chairperson of SBWMA


Cyndi Urman, Board Secretary

March 30, 2015

VIA EMAIL

South Bayside Waste Management Authority
610 Elm Street, Suite 202
San Carlos, California 94070
Attn: Executive Director

Re: SBR report to SBWMA for items #6 and #7 from Resolution No. 2014-28 regarding SBWMA BOD Consenting to Assignment of Majority Interest in South Bay Recycling, LLC to Recology Inc.

Dear Mr. Kevin McCarthy,

Please find attached SBR's report to SBWMA analyzing synergies related to "back-office" integration and truck maintenance functions at South Bay Recycling.

South Bay Recycling will have members of their management team at the April 2015 SBWMA Board of Directors meeting to address any comments or questions regarding the attached report.

Sincerely,



Dan Domonoske
Vice President, South Bay Recycling

Encl: Report to SBWMA from South Bay Recycling Analyzing Synergies

cc: George P. McGrath, Recology
Dwight Herring, South Bay Recycling
Mario Puccinelli, Recology

Report to SBWMA from South Bay Recycling Analyzing Synergies

Items #6 and #7 from Resolution No. 2014-28 Regarding BOD Consenting to Assignment of Majority Interest in South Bay Recycling, LLC to Recology Inc.

On December 17, 2014 the SBWMA Board Of Directors (BOD) passed Resolution No. 2014-28 which imposed 10 conditions for approving the assignment. This document addresses two of those conditions which relate to SBR and Recology analyzing "back-office" integration and truck maintenance functions.

For many years Recology has been growing their business by expanding geographically in the western US. One of their northern expansions was the Cleanscapes purchase in Seattle. Their most significant southern expansion has been completing the asset purchase agreement of Community Recycling & Resource Recovery (CRRR, aka Community Recycling) and its sister company Crown Disposal. The primary reason for Recology to acquire Community Recycling was the ability for Recology to enter the Los Angeles marketplace in preparation for the release of the LA RFP and immediately obtain a strong presence in collection, processing, and composting operations.

In 2014 Community Recycling and Recology negotiated the terms and conditions of their business arrangement which resulted in Community Recycling leaving the LA marketplace and Recology entering the LA marketplace. During those negotiations the subject of South Bay Recycling came up and the parties agreed to include the share transfer of Community Recycling's 60% ownership share in South Bay Recycling to Recology as part of their LA transaction.

On the evening of March 4, 2015 the transaction between Community Recycling and Recology was concluded. On March 5, 2015 the ownership structure of South Bay Recycling (SBR) became 60% Recology and 40% Potential Industries (unchanged).

There are three areas involving SBR that are helpful to keep in mind when looking for cost savings and increasing efficiencies: the process of selecting SBR to operate the Shoreway facility; the method by which Community Recycling and Potential Industries have managed SBR; and the reason for Recology becoming a member of SBR.

The SBWMA selected SBR using a competitive bidding process which compared pricing and service levels from several qualified and experienced companies that submitted responsive bids. SBR provided prices and commitments to operational performance that were much more favorable to the SBWMA than any of the other competitors, and as a result they were selected to operate the Shoreway facility.

Community Recycling and Potential Industries have managed SBR with a very lean and efficient organizational structure. Both companies are privately owned and have built their businesses

in the highly competitive open market in Southern California. Executives and managers at both companies, such as John Richardson at Community Recycling and Dan Domonoske at Potential Industries, dedicate time and resources to SBR without charging SBR for any of their time or business expenses. This has been the case beginning with the RFP preparation phase and continues through today.

Recology became a member of SBR as part of their expansion into Southern California, and not as a standalone acquisition to harness synergy or fix broken systems. In many cases companies are bought or sold to capture synergy, cut costs, or change operations. However, those traditional justifications for ownership change do not apply in this situation. SBR has been meeting their performance commitments while complying with terms and conditions of the Operating Agreement.

Over the past few months SBR has evaluated the impacts of the share transfer in order to understand where synergies can be achieved, and provides SBMWA our feedback as follows:

Back-office Integration

Given the fixed cost nature of both SBR's and Recology's contracts, both organizations run much leaner than their predecessor. Back office functions such as accounts payable, purchase order processing, payroll, time entry, and weight tag reporting are currently done with minimum staffing levels with specific job duties, as mandated in our Collective Bargaining Agreements with Local 350. Additionally both SBR and Recology have separate CBA's for office and administration workers which stipulate different compensation and benefits from each other. To combine the two units would violate the two CBA's and would almost certainly cause labor unrest.

Information Technology (IT)

Under the CRRR umbrella, SBR ran under a local area platform. This system, while effective, had limitations. Recology is now supporting SBR's IT functions which are now on the Recology company wide network. This network provides SBR with the latest software, applications, data back up, and IT infrastructure and support. This additional cost is borne by Recology.

Human Resources (HR)

HR administration was left to the General Manager (GM) with minimal support from CRRR or Potential. With the evolution of SBR, Recology is now providing HR support and is recruiting for an additional HR generalist to assist SBR. As a result SBR will have enhanced HR support which will allow the GM to dedicate more time to important matters such as increased diversion and support to SBWMA's evolving Long Range Plan. This additional cost for providing HR support to SBR is borne by Recology.

Insurance

Prior to the share transfer SBR obtained insurance with volume discounts as part of a package deal with Community Recycling's affiliated entities. Although the assets from Community Recycling and Crown Disposal have been sold to Recology, other affiliated entities were not included in the transaction and as such the volume discounts no longer provide the savings which SBR has enjoyed. Recology has various types of hybrid insurance packages which are not applicable for SBR, and as such SBR has obtained new insurance policies as a standalone entity. This has resulted increased insurance costs which are borne by SBR.

Senior Financial Manager

During discussions about the SBR share transfer Potential Industries and Recology were asked to add a Senior Financial Manager to help support both the SBWMA franchise hauling operations and the SBR Shoreway operations. Potential Industries and Recology agreed to create this new position, fill it before May 1, 2015, and not be re-imbursed for this additional expense in either the Franchise Collection Agreements or the Facility Operations Agreement. This is another example of how costs related to office functions have increased as a result of the SBR share transfer.

Truck - Maintenance Functions

Collective Bargaining Agreement (CBA)

SBRs maintenance personnel are part of the Facility Operations Unit, which stipulate compensation and benefits that are different from that of Recology's CBA for the similar job descriptions. Attempting to combine the two units would 1) violate the two CBA's and would almost certainly cause labor unrest; and 2) would require SBR to hire one or more additional mechanics to replace a mechanic "off on scheduled" or "nonscheduled time off" in the bargaining unit.

During recent CBA negotiations the SBR Truck Mechanics/Welders CBA was dissolved and these two positions were folded into the Facility Operations Unit to provide SBR with greater operating flexibility.

Mechanics

SBR has two (2) Truck Mechanics/Welders who primarily perform repairs and maintenance on semi-tractors and trailers, and three (3) Mechanics and two (2) Preventative Maintenance Technicians who primarily perform repairs and maintenance on MRF stationary equipment, as well as wheel loaders, forklifts, and other rolling stock.

All SBR mechanics are trained or in the process of being trained to perform repairs and maintenance on the MRF stationary equipment, which is highly specialized. Recology's mechanics and technicians are specialized in collection vehicles, and as such the skills and tools required are substantially different.

Material Recovery Facility (MRF) support

MRF maintenance projects often require excessive manpower since projects must be conducted during non-processing hours. Each quarter, BHS along with SBR Mechanics and Tech's conduct a detailed equipment inspection and perform preventative maintenance and equipment repairs. This work is performed over a weekend and consists of five 10-12 hour shifts, and requires every mechanic and tech to assist in this process. SBR has not been able to find synergy or savings related to Recology's collection truck mechanics providing service to the MRF support functions.

Custom Trailers

SBR uses custom trailers that were designed and built by Maintenance Services Inc. (MSI, formerly known as Tuxford Maintenance Services). When the trailers require work that can only be done by the Original Equipment Manufacturer (OEM) then MSI does the work. When MSI was part of the Community Recycling group of companies that included SBR the cost of such work was based on out of pocket cost without markup or profit. Now that SBR is no longer affiliated with MSI the cost of such work is based on prevailing industry practices, such as 10% markup on the price of parts. This does not mean that SBR is now paying for work at rates above industry standard, but it does mean that SBR will be incurring higher costs for services than what they enjoyed in the past.

Conclusion

Although SBR has not been able to identify savings from back-office or truck maintenance, there are opportunities for service enhancements and facility improvements which are being developed. SBR and Recology are currently exploring opportunities for site improvements to simplify certain maintenance functions, such as storing used oil from truck oil changes in one location that will enhance site functionality. SBR has agreed to modify the outdoor truck maintenance area so that a SBWMA planned capital expenditure is no longer needed. After Recology hires a General Manager and SBR hires Site Manager then plans for proposed modifications to the outdoor truck maintenance area will be presented to SBWMA for approval. These improvements are the direct result of the share transfer and should bring lasting benefits to the SBWMA.

With the addition of a Senior Financial Manager, both Recology and SBR foresee a review of our current operating and financial reporting structure, which may result in a better method to retrieve and report the required information, while improving accuracy of delivered reports. Having this person on board in early 2015 will also help the SBWMA as they find and train a Finance Manager to fill the vacancy being created when the current Finance Manager retires.

SBR believes that the new partnership between Potential Industries and Recology will create opportunities for SBWMA to finalize and implement their Long Range Plan to achieve higher levels of sustainable diversion. By aligning the interests of collections with processing there will be options for enhanced beneficial diversion and traditional recycling that can be created which will benefit all Member Agencies.