

$$PP_{\$/t} = (NHFR_{\$/t} + RR) - SV_{\$/t}$$



Department of Resources Recycling and Recovery

$$HF_{\$/c} = HFR_{\$/c} - NHFR_{\$/c}$$

Processing Fee/Handling Fee Cost Survey

	NHFR	HFR
$\$/t$	4	N/A
$\$/c$		

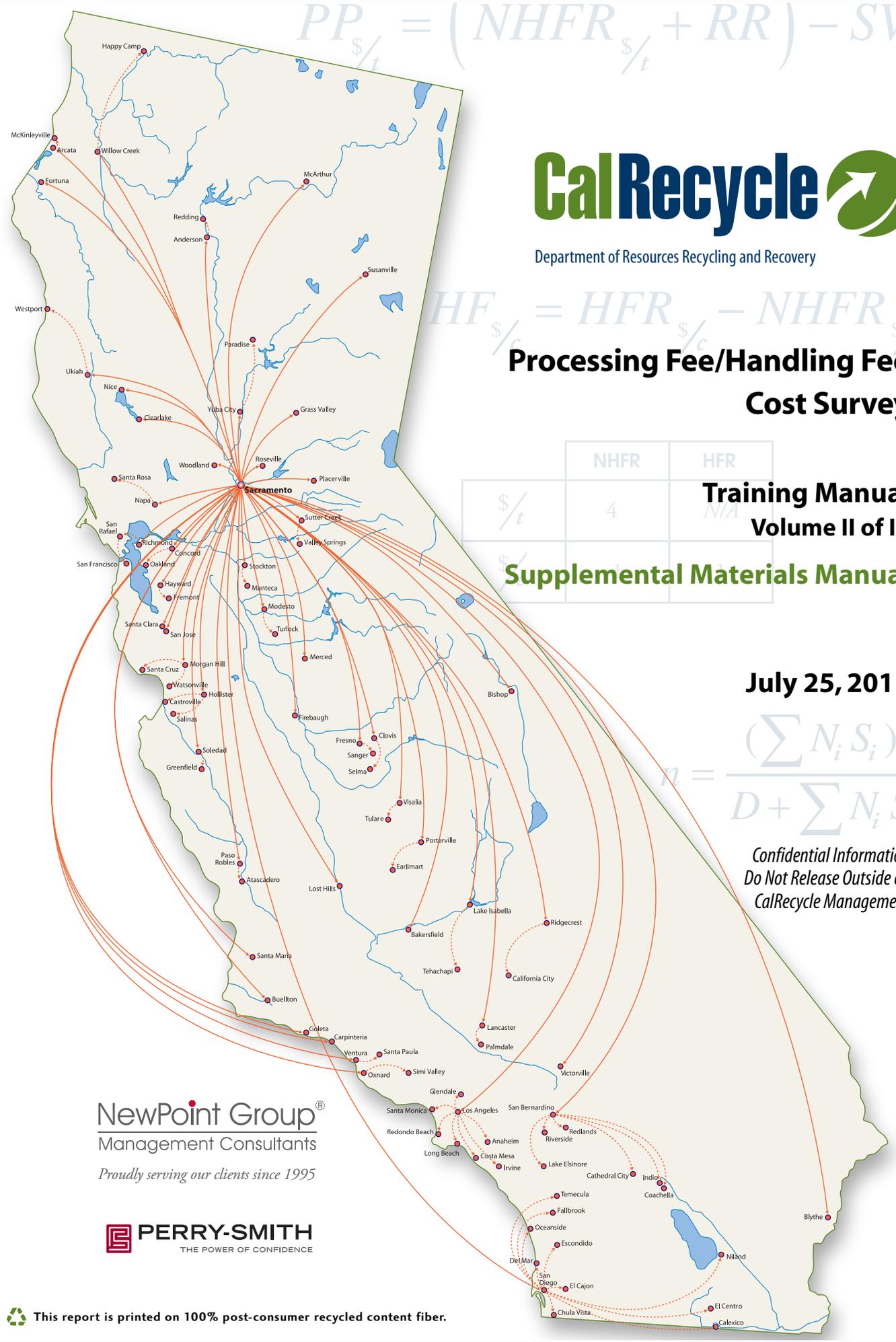
Training Manual
Volume II of III

Supplemental Materials Manual

July 25, 2011

$$n = \frac{(\sum N_i S_i)^2}{D + \sum N_i S_i^2}$$

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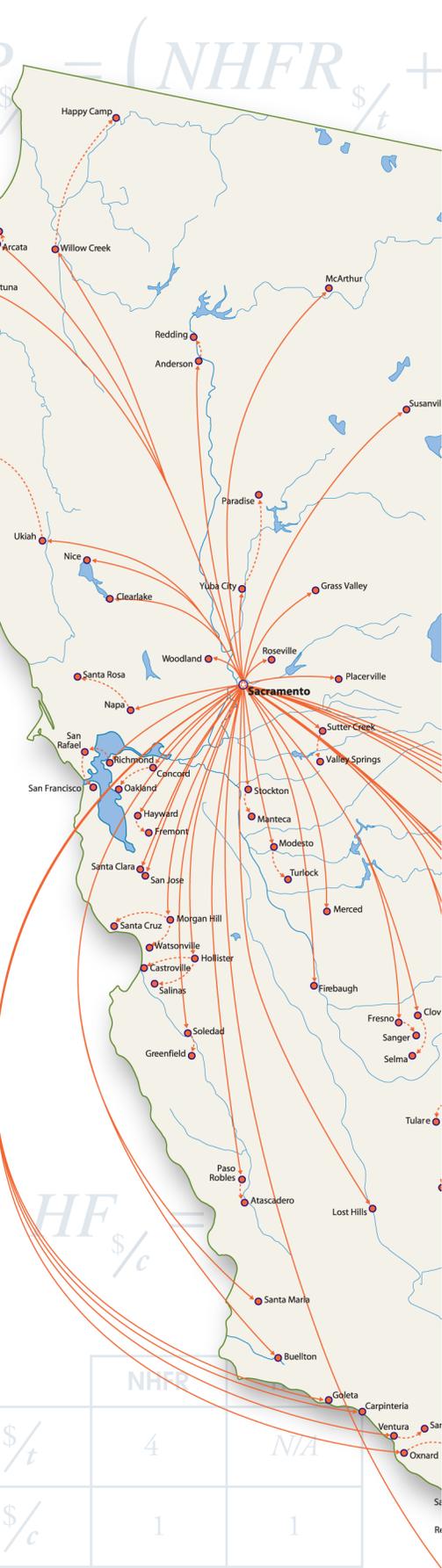
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Handout 1
Program Background



Program Background

This document provides background for the beverage container recycling program and key project challenges. This section is organized as follows:

- A. Program Background
- B. Key Project Challenges

A. Program Background

This subsection describes the Beverage Container Recycling Program (commonly referred to as AB 2020) and its evolution over the last twenty-four years. The background is important to understanding the public policy intent of processing fees and handling fees, the two components of this project. This subsection is organized as follows:

1. Department of Resources Recycling and Recovery, Department of Conservation, and AB 2020
2. Recent Beverage Container Recycling Program Challenges
3. AB 2020 History and Overview
4. Processing Fee Theory and Recent Implementation
5. Convenience Zone and Handling Fee Theory, History, and Recent Implementation.

1. Department of Resources Recycling and Recovery, Department of Conservation, and AB 2020

SB 63 (Strickland), Statutes of 2009, implemented a significant change in the management of the Beverage Container Recycling Program. SB 63 created a new Department of Resources Recycling and Recovery (CalRecycle) within the California Natural Resources Agency that combined the activities and mandates of the California Integrated Waste Management Board (CIWMB) and the Department of Conservation (DOC) Division of Recycling (DOR). In doing so, SB 63 eliminated the CIWMB, and shifted the DOR into the newly created CalRecycle. Beginning in January 2010, CalRecycle was vested with the authority, duties, powers, purposes, responsibilities, and jurisdiction of the former CIWMB and DOR.

The new Department of Resources Recycling and Recovery brings the state’s recycling and waste management programs together. CalRecycle’s purpose is as follows: “CalRecycle protects the environment and preserves resources by empowering Californians to reduce, reuse and recycle.” CalRecycle’s Vision is “to inspire and challenge Californian’s to achieve the highest waste reduction, recycling and reuse goals

$$n = \frac{(\sum N_i S_i)^2}{D + \sum N_i S_i^2}$$

in the nation, through innovation and creativity, sound advancements in science and technology, and efficient programs that improve economic vitality and environmental sustainability.”

In October 2010, CalRecycle announced a realignment plan to more effectively blend the responsibilities and activities of the original two agencies. This realignment reflected a more comprehensive assessment of functions and blending similar programs and activities that were conducted separately when CalRecycle was first created. With the realignment, CalRecycle is organized into five Divisions and five Support/Service Offices, as follows:

1. Audits and Analysis Division
2. Administration, Finance, and Information Technology Services Division
3. Compliance and Enforcement Division
4. Materials Management and Local Assistance Division
5. Permits and Certification Division
-
1. Legal Affairs Office
2. Legislative Affairs Office
3. Policy and Planning Office
4. Program Evaluation Office
5. Public Affairs Office.

CalRecycle administers the California Beverage Container Recycling and Litter Reduction Program (Assembly Bill 2020) through activities conducted in these ten (10) Divisions and Offices. The fundamental goal of the recycling program, as defined in the Beverage Container Recycling and Litter Reduction Act, is to achieve and maintain an 80 percent recycling rate for the ten types of beverage containers included in the program.

While the Beverage Recycling Program has withstood the test of time, this innovative and widely recognized program is constantly being examined and challenged by industry, as well as changed by the Legislature. **Exhibit 1**, following this page, summarizes major legislative changes to AB 2020, since 1988. In 2009 and 2010 there were three bills that affected the program, including SB 63 in 2009 and ABX8 7 in 2010. **Figure 1**, on page 8, summarizes significant program changes to the processing fee cost survey, the subject of this RFP, resulting from SB 1357 (Padilla), Statutes of 2008.

Over time, the program has also been evaluated in numerous studies, including a Blue Ribbon Task Force on Processing Fees, the Little Hoover Commission, a reengineering effort requested by the Governor’s office in 1995, and a 2003 report to the legislature by the University of California, Berkeley that compares California’s bottle bill to those of other states. Most recently, in 2010, the program was subject to critical evaluations by the California Legislative Analyst’s Office (LAO) and California Bureau of State Audits (BSA).

While the AB 2020 program faces many challenges at this juncture, it has evolved significantly over the last twenty-four years, and continues to be the most innovative, efficient, cost-effective, and successful beverage container recycling program in the country. The program has strong consumer support, and is responsible for creating a sizeable recycling infrastructure in California. Since the program’s inception, more than 226 billion beverage containers have been recycled back into the economy, and kept off of the roadsides and out of California’s landfills. In 2009, Californians recycled 17.2 billion containers, the largest number of containers recycled in one year in the program’s history.

Statutes of 1989	
<p>AB 1001 (Sher)</p> <ul style="list-style-type: none"> Delayed implementation of new processing fee calculations until October 1, 1991 <p>AB 1020 (Hansen)</p> <ul style="list-style-type: none"> Required curbside programs to submit information to DOR 	<p>AB 1097 (Calderon)</p> <ul style="list-style-type: none"> Required the DOR to report on the effectiveness of convenience zones (the mandate for the <i>Convenience Zone Effectiveness Study</i>) <p>SB 1221 (Hart)</p> <ul style="list-style-type: none"> Increased redemption payments from 1-cent to 2-cents payment into the fund, and increased refund values from 1-cent to 2.5-cents per container
Statutes of 1990	
<p>AB 1490 (Sher)</p> <ul style="list-style-type: none"> Reauthorized payment of the processing fee on or before January 1, 1991 Allowed DOR to adjust the processing fee every six months, or more frequently, if average statewide scrap values dropped Placed a cap on recycling costs for the processing fee calculation at 10% over the 1987 costs, and excluded CIP sites from the calculation Based scrap value calculations on a statistically significant sample of average scrap values from container manufacturers, beverage manufacturers, or willing purchasers, first for 1990, and then for the preceding calendar year 	<ul style="list-style-type: none"> Established Glass Market Development Program, a per/ton payment from the surplus processing fee for purchasers of recycled glass Increased CIPs from \$13 million to \$18.5 million <p>AB 2622 (Eastin)</p> <ul style="list-style-type: none"> Required glass manufacturers to use a minimum percentage of post-consumer containers (recycled content) in new glass food and drink containers. The minimum content began at 15% in January 1992, and gradually increased to 65% in January 2002
Statutes of 1991	
<p>AB 2212 (Sher)</p> <ul style="list-style-type: none"> Increased redemption payments from 2-cents to 2.5-cents per container, to match refund values Reduced funding for Convenience Incentive Payments from \$18.5 million to \$15 million Suspended the January 1, 1992 plastic processing fee of \$428 per ton so long as an “avoided scrap value” of \$997 was paid Placed caps on recycling costs at the January 1, 1991 level Excluded mixed color cullet sold to alternative markets in the average scrap value for glass 	<ul style="list-style-type: none"> Decreased the amount spent on recycling grants from \$8 million to \$7.5 million Placed a \$2.75 million limit on the 1991-1992 advertising budget <p>AB 1340 (Eastin)</p> <ul style="list-style-type: none"> Required a minimum recycled glass content in fiberglass insulation sold in California after January 1992, starting at 10% and increasing to 30% by January 1995
Statutes of 1992	
<p>AB 87 (Sher)</p> <ul style="list-style-type: none"> Replaced CIP payment with a handling fee of 1.7-cents per container for supermarket-site recyclers Limited total funds for handling fee to \$18.5 million, subject to availability of funds Based costs for the 1993 processing fee on the lowest cost recycling sites used for the January 1992 calculation, which when taken together account for no less than 75 percent of the recycling centers surveyed Excluded processors from the cost calculation Established floor of \$807 per ton for the cost of plastic Froze recycling cost calculations until January 1, 1996, except for cost of living adjustments Eliminated the Market Development Payment 	<ul style="list-style-type: none"> Based scrap value calculations on a statistically significant sample of average scrap values from processors, and for glass, benefiting processors only Included all recycled container glass in the scrap calculation Determined processing fee pay-ins on container return rates (plus 5 percentage points), rather than container sales Excluded processors from receiving payments Required DOR to consult with program participants regarding processing fee calculation methodology Authorized a one-time \$2 million payment to registered curbside programs Increased the number of convenience zone exemptions from 20 percent of the total to 25 percent

Exhibit 1

Major Legislative Changes to AB 2020 (continued)

Statutes of 1995

SB 1178 (O'Connell)

- Redefined the processing fee as the amount paid by beverage manufacturers and introduced the term “processing payment” as the amount paid to processors or recycling centers by the DOR
- Established an annual payment to curbside recycling programs of \$5 million
- Increased convenience zone exemptions from 25 percent to 35 percent
- Extended handling fee payments until January 1, 1999, subject to availability of funds
- Reduced the maximum monthly handling fee payment from \$2,300 to \$2,000 per month, made sites redeeming more than 500,000 containers in a month ineligible for handling fees that month, and reduced the minimum proportion of glass and plastic containers for eligibility of handling fees
- Created the PET Processing Fee Account and the Bi-metal Processing Fee account (in addition to the already established Glass Processing Fee Account) with moneys from the redemption payments and processing fee payments, and appropriated money in those funds to reduce processing fees paid by container manufacturers
- Required the DOR to conduct a survey to calculate the statewide weighted average cost to recycle PET containers for 1994
- Required the DOR to establish a processing payment for PET containers only if the scrap value was less than a specified amount, and set the recycling cost for plastic based on the cost survey, but at no less than \$770 or more than \$900 per ton
- Set the glass processing payment at \$65.72 per ton and the bi-metal processing payment at \$340.26 per ton based on estimated average scrap values of \$30 per ton for glass and \$10.67 per ton for bi-metal, and using cost data from the January 1992 processing fee calculation, \$95.72 per ton for glass and \$393.93 per ton for bi-metal
- Reduced the processing fee paid by beverage manufacturers. Calculated the processing fee by multiplying the processing payment by the previous year redemption rate (divided by the estimate of refillable containers) and by 5 percentage points
- Allocated \$7 million for grants to the Community Conservation Corps and \$2 million in grants to nonprofits or government organizations

Statutes of 1999

SB 1 (Sher)

- Extended the provisions of SB 1178 until January 1, 2000, applied retroactively to all containers recycled as of January 1, 1999, through emergency legislation enacted in January 1999
- Set the glass processing payment at \$69.41 per ton and the bi-metal processing payment at \$398.45 per ton, based on estimated average scrap values of \$30 per ton for glass and \$10.67 per ton for bi-metal, and using the January 1992 cost calculation (adjusted for cost-of-living) of \$99.41 per ton for glass and \$409.12 per ton for bi-metal
- Set the avoided scrap payment for PET at \$799.68 per ton, requiring a processing fee for PET if the scrap value falls below that level
- Extended authorization to expend funds for handling fees (\$18.5 million), curbside programs (\$5 million), and Community Conservation Corps (\$9 million) until January 1, 2000
- Provided for the addition of new beverages by adding containers made of plastic resins #2 through #7 to the program
- Reduced the glass recycled content requirement to 25 percent if the manufacturer uses at least 75 percent mixed color cullet
- Established a glass quality incentive payment to curbside programs of up to \$25 per ton (with the total not to exceed \$3 million per calendar year) for color-sorted glass beverage containers that are substantially free of contamination
- Required the DOR to review, and if necessary recalculate, commingled rates
- Established recycling costs for the processing fee calculation for the January 1, 2000 processing fee. Recycling costs for glass were set at \$85.19 per ton, for bi-metal at \$417.96 per ton, for PET plastic at \$642.69 per ton, and for all other non-PET plastic containers at \$642.69 per ton
- Required the DOR to conduct a recycler cost survey for the January 1, 2001 processing fee calculation using the actual costs for a statistically significant sample of certified recycling centers (excluding those receiving handling fees) and a reasonable financial return. Set the recycling cost for non-PET plastic for the January 1, 2001 processing fee at \$642.69 per ton

SB 332 (Sher) and AB 1244 (Olberg)

- Added new beverages to the program. In addition to beer and other malt beverages, wine and distilled spirit coolers, carbonated mineral and soda waters, and carbonated soft drinks, expanded the definition of beverage to include: carbonated and non-carbonated water, non-carbonated soft drinks and sport drinks, specified non-carbonated fruit drinks, coffee and tea drinks, and carbonated fruit drinks in plastic, glass, bi-metal, or aluminum containers. Manufacturers were not required to include the “CRV” label on these new containers until January 1, 2001
- Required the DOR to conduct a recycler cost survey every third year for processing fee calculations
- Reduced the actual processing fee paid by manufacturers to 65 percent of the processing payment, but allowed the DOR to further reduce processing fees, subject to availability of funds in the material-specific processing fee accounts, to an amount equal to 25 percent of the processing payment

Statutes of 1999 (continued)

SB 332 (Sher) and AB 1244 (Olberg) (continued)

- Established requirements for recycling centers in “rural regions”
- Increased the administrative payment to processors to 2 ½ percent of the refund value, with the processor required to pass through ¾ percent of the refund value to the recycler. Increased the administrative fee for distributors to 1 percent of the redemption payment
- Provided funding for curbside and neighborhood drop-off programs of \$15 million annually based on the volume of beverage containers collected. Also provided for \$6.84 million for the City of San Diego curbside program through 2003
- Increased payments for handling fees to \$23.5 million. Increased the per container handling fee to 1.8 cents and the maximum monthly handling fee per site to \$2,300
- Increased funding to the Community Conservation Corps to \$15 million. Provided for \$500,000 for grants for beverage container and litter reduction programs and \$10.5 million for payments to cities and counties for beverage container recycling and litter clean-up activities. Provided an annual grant of \$300,000 to Keep California Beautiful and a one-time \$10 million (over two years) for a statewide public education and information campaign
- Added provisions to ensure that supermarket sites are not using “unfair and predatory pricing”

Statutes of 2000

SB 1906 (Sher)

- Added to the definition of beverage container to include vegetable juice in beverage containers of 16 ounces or less
- Repealed authority to make the quality glass incentive payments as of January 1, 2003
- Required the DOR to certify drop-off and collection programs
- Specified procedures for assessing civil penalties

Statutes of 2001

SB 528 (Sher)

- Deleted the repeal of the quality glass incentive payment (QGIP), thus continuing the \$3 million payment for color-sorted glass from curbsides indefinitely. Extended the QGIP to other entities certified under the program that color sort curbside glass
- Revised procedures to determine “unfair and predatory pricing”
- Revised procedures for certification of recyclers
- Required that the payment of \$15 million to operators of curbside and neighborhood dropoff programs be made only if the program accepts all container types, and modifies the reporting for such payments

Statutes of 2003

AB 28 (Jackson)

- Increased CRV to 4 cents and 8 cents
- Revised the processing fee calculation, based on recycling rate and required the cost of recycling to be calculated every two years
- Established temporary processing fee rebates for manufacturers and supplemental processing payments for recyclers
- Increased payments for handling fees to \$26.5 million and removed the 500,000 container per month limit for handling fee eligibility
- Established the \$10 million per year Recycling Market Development and Expansion Grant Program, and the \$10 million Recycling Infrastructure Loan Guarantee Account
- Increased the amount of the Quality Glass Incentive Payment from \$25 to \$30 per ton
- Required the DOR to review commingled rate calculations
- Established a trigger to increase CRV to 5 cents and 10 cents on July 1, 2007, if the recycling rate is less than 75 percent

SB 607 (Aanestad)

- Provided that a convenience zone in a rural region could be defined to include an area within a three mile radius of a supermarket, if the DOR is petitioned by an interested individual and the new zone would be served by a certified recycling center

SB 968 (Bowen)

- Defined “criminal profiteering activity” to include offenses against the beverage container program and defined “fraud against the beverage container recycling program that is of a conspiratorial nature” as organized crime. Required that penalty proceeds be deposited in the Beverage Container Recycling Fund, with the exception of prosecution costs

Exhibit 1

Major Legislative Changes to AB 2020 (continued)

Statutes of 2005

AB 1763 (Committee on Natural Resources)

- Revised the date by which beverage distributors are required to make redemption payments to the State, and revised conditions under which beverage distributors may make a single annual payment of redemption value
- Revised the conditions under which beverage manufacturers may make a single annual payment of processing fees

AB 1764 (Committee on Natural Resources)

- Increased the total payment of handling fees from \$26.5 million annually to \$30 million for the one-year period July 1, 2004, to June 20, 2005. The total annual payment commencing July 1, 2005 returned to \$26.5 million

Statutes of 2006

AB 3056 (Committee on Natural Resources)

- Increased CRV paid out (only) to 5 cents and 10 cents from January 1, 2006, to June 30, 2006
- Revised the definition of convenience zones in rural regions
- Increased the administrative payment for beverage distributors from 1 percent to 1.5 percent of the redemption payment
- Reduced the processing fee paid by manufacturers in 2007 to zero if the recycling rate is 40 percent or greater
- Replaced the QGIP program with a \$15 million a year quality incentive payment
- Provided a one-year, \$20 million competitive grant program for Community Conservation Corps
- Extended and increased funding to \$20 million annually for the Recycled Beverage Container Market Development and Expansion Grant program
- Established a recycling incentive program of up to \$10 million annually for recycling centers that increase containers recycled

- Established a market development payment of \$5 million annually for plastic that is processed and manufactured into a product in California
- Provided for one time expenditures of \$5 million each to Department of Parks and local governments and non-profits for recycling
- Authorized a one-time \$5 million expenditure for a multilingual multimedia campaign
- Increased the handling fee for three years, starting with fiscal year 2005-2006
- Required the DOR to conduct a cost survey of recycling centers that receive handling fees
- Revised the handling fee payment, as of July 1, 2008, to be the difference between the cost of recycling at sites that receive handling fees, and the cost of recycling at sites that do not receive handling fees

Statutes of 2007

SB 1021 (Padilla)

- Authorized a one-time expenditure of \$15 million from January 1, 2008, to January 1, 2009 to provide grants to place source separated beverage container recycling receptacles in multifamily housing
- Authorized the Department to expend \$198,000 from the fund, on a one-time basis, to administer this grant program

Statutes of 2008

SB 1357 (Padilla)

- Eliminated the requirement to calculate material specific costs per ton for recycling for materials that comprise less than 5 percent of all CRV materials recycled (i.e. plastics #2 to #7 and bi-metal)
- Required the Department, on or after January 1, 2010, to base the cost of recycling for materials that comprise less than 5 percent of all CRV containers recycled, on the most recently measured actual cost, adjusted by the percent change in the most recently measured cost of recycling HDPE (even if HDPE comprises less than 5 percent of all CRV containers recycled)
- Required the Department to adjust recycling costs annually, using a cost of living adjustment, for those materials
- Authorized the Department to provide \$20 million annually, from July 1, 2009 to January 1, 2012, for grants for beverage container recycling and litter reduction programs, including focused, regional community beverage container recycling and litter reduction programs
- Required the Department to publish an evaluation of these grants

AB 2730 (Leno)

- Expanded the definition of “nonprofit convenience zone recycler” to include a recycler that has been at a specified location for at least five years, and is located within one mile of a supermarket that is in an exempted convenience zone

AB 1778 (Ma)

- Required recyclers (or junk dealers) that accept CRV containers for redemption to provide payment to the seller by check or electronic transfer, and to obtain a valid, documented address for the seller by obtaining a copy of a driver’s license or other approved documentation
- Exempted recyclers from this requirement if the recycler completes five or more transactions per month with the seller, has specified documented information on the seller on file, or if the transaction involves less than \$100 in CRV payment

Statutes of 2009

SB 63 (Strickland)

- Abolished the California Integrated Waste Management Board (CIWMB) and created the Department of Resources Recycling and Recovery (Department) within the Natural Resources Agency
- Moved the Division of Recycling (DOR) from the Department of Conservation to the Department of Resources Recycling and Recovery
- Assigned duties of the CIWMB and DOR to the Department of Resources Recycling and Recovery

AB 85 (Berryhill)

- Corrected and removed duplicate provisions in code for junk dealers and recyclers as related to purchases of nonferrous materials

Statutes of 2010

ABX8 7 (Evans/Committee on Budget)

- Revised and restored funding for selected recycling program activities. AB 7 was an urgency measure passed in the eighth extraordinary session (X8) and signed by Governor Schwarzenegger on March 8, 2010
- Required the Department to review the Beverage Container Recycling Fund (Fund) at least once every three months to ensure that there are adequate funds to pay refund values and other required disbursements
- Maintained proportional reductions should the Fund level be inadequate, following notification to the Legislature
- Required Distributors to pay the redemption payment within 60 days from the date of sale, rather than 90 days, between February 1, 2010, and June 30, 2012 (providing a thirteenth month payment into the Fund for the 2009/10 fiscal year)

- Specified that the monies in the Fund be used solely for the purposes authorized, and not used, loaned, or transferred for any other purpose
- Maintained funding for handling fees, \$15 million for curbside programs, \$15 million plus cost of living adjustments for Conservation Corps, \$10.5 million for payments to cities and counties, \$10 million in quality incentive payments for glass, \$10 million in plastic market development payments, and supplemental processing payments
- Restricted funding for supplemental processing payments in 2010 and 2011 to the amount paid, by material type, for calendar year 2008
- Eliminated funding for beverage container recycling and litter reduction grants, public education, market development grants, and collection grants for the 2010 and 2011 calendar years

Figure 1
Major Legislative Changes Resulting from SB 1357 (Padilla)
Related to the 2011 Processing Fee/Handling Fee Cost Survey

SB 1357 Provision	Stakeholder(s) Impacted
Eliminated the requirement to calculate material specific costs per ton for recycling for materials that comprise less than 5 percent of all CRV materials recycled (i.e. plastics #2 to #7 and bi-metal)	<p>Traditional recycling centers</p> <p>Department of Resources Recycling and Recovery</p>
Required the Department, on or after January 1, 2010, to base the cost of recycling for materials that comprise less than 5 percent of all CRV containers recycled, on the most recently measured actual cost, adjusted by the percent change in the most recently measured cost of recycling HDPE (even if HDPE comprises less than 5 percent of all CRV containers recycled)	<p>All recycling centers and curbside programs</p>

2. Recent Beverage Container Recycling Program Challenges

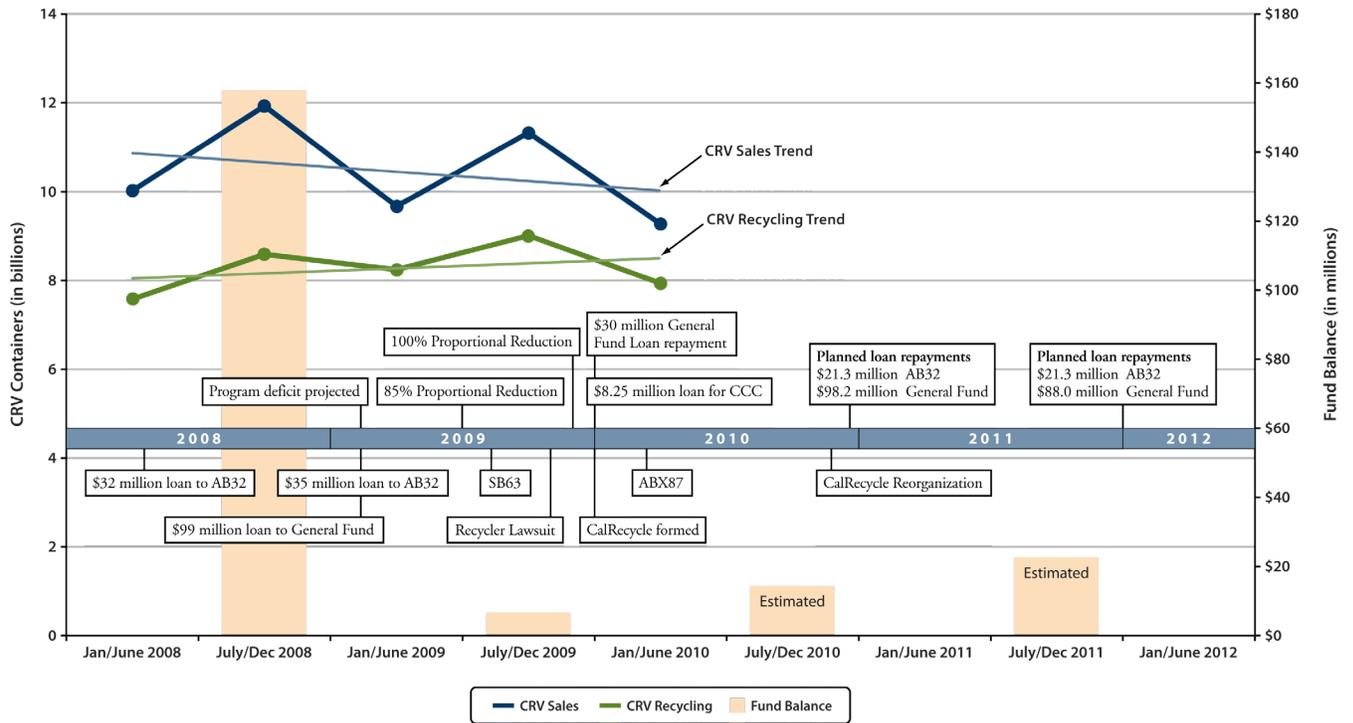
While the beverage container recycling program has been extremely successful on many fronts, the last two years have been among the most challenging since the program was implemented. The combined impact of economic factors and the State’s budget crisis brought the program from an era of high unredeemed fund balances to one of insufficient fund balances. **Figure 2**, on the next page, provides a summary timeline of these challenges.

In 2009, the poor economy resulted in declining beverage container sales, reducing the amount of California Redemption Value (CRV) paid into the program. At the same time, poor economic conditions led to an increase in recycling, as more consumers sought to collect CRV through recycling. Because the program is funded by the balance of funds from unredeemed containers, this situation led to a decline in funds. This is graphically illustrated in Figure 2, in which the area between the CRV sales and CRV recycling lines is essentially equal to the amount of unredeemed funds. As these two lines trend together, the amount of unredeemed funds declines. On top of this, the State borrowed monies from the Beverage Container Recycling Fund to support General Fund and other programs, helping to close severe State budget gaps.

In May 2009, the Division of Recycling (still in the Department of Conservation) announced a negative fund balance, and proposed “Proportionate Reductions” in program payments. Proportionate reductions were required by law (Section 14581(d) of the Public Resources Code), and essentially required the DOR to reduce all program payments, with the exception of CRV payments, equally in the event that there were inadequate funds. The DOR implemented 85 percent reductions in payments in July 2009, and 100 percent reductions in payments (i.e. no payments) in November 2009. An alliance of recycling companies filed a lawsuit against the State, demanding that the General Fund and other loans be reimbursed and handling fees restored. In late 2009, the Governor and Legislature each proposed program changes to alleviate the fund crisis, but could not agree on a solution. Thus, the program essentially halted all but CRV payments into early 2010.

In March 2010, the Governor signed ABX8 7, urgency legislation to alleviate the program’s fund crisis. This new law increased fund revenues by requiring distributors to pay redemption payments within 60 days, rather than 90 days, leading to 13 months of CRV revenue in Fiscal Year (FY) 2009/10. ABX8 7 reinstated handling fees to prior levels, capped processing fee offsets at 2008 levels, eliminated funding to auxiliary programs that

Figure 2
Recent Beverage Container Recycling Program Sales, Recycling, Fund Balance, and Activities



were added when funds were plentiful, made other modifications to remaining program funds, and required CalRecycle to report quarterly on the fund balance. ABX8 7 also specified that “the maintenance of the fund is of utmost importance to the State and that it is essential that any money in the fund be used solely for the purposes authorized in this division and should not be used, loaned, or transferred for any other purpose.” (Section 14580(e)). Also in FY 2009/10, the Governor’s budget provided \$30 million of General Fund loan repayments and a one-time \$8.25 million loan to support Community Conservation Corps. Together, these actions have gotten the major program components such as handling fees and processing fees “back on track”. However, the fund balance is still tenuous, and reliant on repayment of the previous loans.

It is critical to understand these conditions because they influence the attitude of recyclers in

the field – i.e., the participants in the Processing Fee/Handling Fee Cost Survey. For example, NewPoint Group’s 2009 cost survey team was in the field conducting surveys in the summer of 2009 when proportionate reductions were first announced and implemented. Many recyclers were struggling with these new policies, and the fact that we understood the policies and their implications helped our team effectively navigate the sometimes complicated site visit process.

3. AB 2020 History and Overview

In 1986, the California State Legislature enacted the California Beverage Container Recycling and Litter Reduction Act (AB 2020, Chapter 1290, Statutes of 1986). The program is different than traditional beverage deposit systems in other states, providing a unique approach to beverage container recycling legislation in that it allows consumers to

use both existing, and new, recycling centers. This program also avoids formidable handling costs by both retailers and distributors.

The broad goals of AB 2020 are to recycle 80 percent of the aluminum, glass, plastic, and non-aluminum (bi-metal) beverage containers, and to reduce the litter and waste of beverage containers by providing incentives for consumers to redeem and recycle. The program seeks to ensure that every material type prove its own recyclability. In addition, the program aims to make redemption and recycling convenient to consumers and to make beverage container recycling integral to California's economy. The program encourages development of products made from recycled beverage containers, creating and maintaining a profitable beverage container recycling market for those materials recycled under the program.

To accomplish these broad goals, the law established minimum refund values on beverage containers (known as California Redemption Value or CRV), and mandated a convenient system whereby consumers could receive this refund value by redeeming their containers. AB 2020 also stipulated the cost of recycling each beverage container material should be covered, in the event that the scrap value is not equal to or greater than the cost of recycling. The program established a processing fee, originally paid to the State by manufacturers, and distributed by the State to recyclers¹ (and processors), to cover the cost of recycling.

To summarize, AB 2020 has five distinct components.

- It establishes a redemption value on beer, soft drink, wine cooler, water, sports drinks, juices, coffee, and tea drink containers. The

¹ Originally, both the fee paid by manufacturers and the payment to recyclers were referred to as "processing fees." In 1995, SB 1178 specified two terms: "processing fee" as the fee paid to the State by manufacturers; and "processing payment" as the payment from the State to recyclers to cover the costs of recycling. For simplicity, the term "processing fee" is often used to refer to both the fee and the payment.

redemption is paid by consumers when they purchase a beverage, passed through to the State, and returned to the consumer when they return their containers to a recycling center

- It imposes processing fees on beverage manufacturers, which are paid to recyclers as processing payments to help cover their costs of recycling (processing payments are also supported by unredeemed funds)
- It establishes a network of convenience zone recycling centers, and helps support these recycling centers through a handling fee payment
- It provides funds left over after program expenses are paid to support a wide array of recycling-oriented initiatives, including Community Conservation Corps, curbside programs, grant programs and reducing the amount of processing fee paid by beverage manufacturers
- It requires that recyclers be certified by CalRecycle and accept all beverage containers covered in the program in order to pay CRV to consumers.

The Redemption Value

AB 2020's central feature is a redemption value. Originally the redemption value was imposed on every beer and soft drink container returned by anyone – consumer, city, non-profit – through any type of recycling program. In 2000, SB 332 (and later SB 1906) added carbonated and non-carbonated water, non-carbonated soft drinks and sport drinks, coffee and tea drinks, and carbonated and non-carbonated fruit and vegetable drinks. This change added not only new beverage types, but also new container types to the program, adding plastic resins #2 through #7 to the existing aluminum, glass, PET, and bi-metal containers. See **Table 1**, on the next page, for a cross-walk explanation of plastic resin names. The redemption program is self-financing: beer distributors, soft drink bottlers, and other beverage distributors pay the redemption value up-front to the State, and the State passes it along to recycling programs.

Table 1
Plastic Resin Codes

Abbreviation	Number	Name
PET	#1	Polyethylene terephthalate
HDPE	#2	High density polyethylene
PVC	#3	Polyvinyl chloride
LDPE	#4	Low density polyethylene
PP	#5	Polypropylene
PS	#6	Polystyrene
Other	#7	Other (or blended) resins

As of January 2004, the redemption value was 4 cents and 8 cents, depending on container size. AB 3056 provided for an increase in the redemption value paid out to consumers between January 1, 2007, and June 30, 2007, to 5 cents and 10 cents. This additional payout was intended to increase recycling. The redemption value (paid in and paid out) increased on July 1, 2007, to 5 cents and 10 cents. AB 28 (2003), provided a trigger for this additional increase in CRV if recycling rates were below 75 percent. The redemption value has enjoyed relatively broad support from industry, consumers, and environmentalists, as evidenced by the agreement within the legislature to increase CRV.

By using this simple market-based incentive, and enabling people to return containers however they choose – to curbside programs, buyback centers, or supermarket-based centers – results have, in some years, been above or close to AB 2020’s goal: an overall 80 percent recycling rate on all containers it covers. While recycling rates dropped between 1999 and 2003, largely as a result of the increased numbers of containers in the program, recycling rates have increased each year since 2004. A sharp increase in the recycling rate between 2006 and 2007 was likely, in large part, a response to the increased CRV in 2007. Reductions in sales and increases in recycling

since 2007 reflect challenging economic times. In 2009, for the first time since 1995, the overall CRV recycling rate exceeded the 80 percent goal, reaching 82 percent. **Figure 3**, on the next page, illustrates recycling rates over time for aluminum, glass, PET plastic, HDPE plastic (since 2000), and all material types.

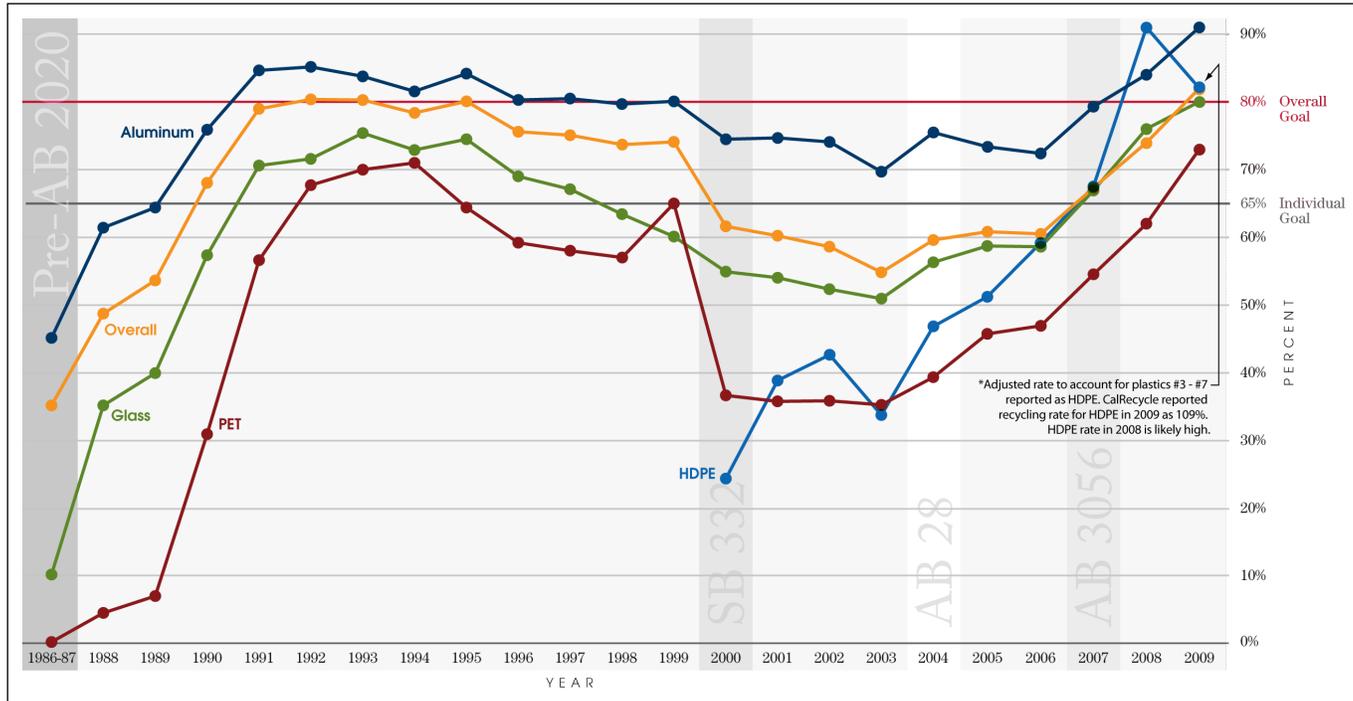
Processing Fees

A broad program support has not typically applied to processing fees, arguably the most complex and controversial aspect of AB 2020. Processing fees were originally meant to be equal to the net cost of recycling certain containers, as measured by studies. Instead, they have, until recently, fluctuated widely from year-to-year, depending on legislative, legal, and regulatory decisions.

For example, recycler costs (without financial returns) that were used to calculate PET plastic processing fees, or avoided scrap values, began at \$270 per ton, were increased and capped at over \$1,000 per ton, were decreased and capped at \$770 per ton, were \$642 per ton, and now stand at \$427 per ton. Glass recycler costs started at \$72 per ton, were capped at \$81 per ton, were increased and later capped at \$95 per ton, dropped to below \$80 per ton, and now stand at \$82 per ton.

Recycling costs of plastic resins #2 through #7 have been determined four times, for the January 2004, January 2006, January 2008, and January 2010 processing fee calculations. These low-volume materials are highly volatile, with costs most recently ranging from \$623 to \$1,858 per ton. SB 1357 eliminates the need to determine costs per ton for plastics #3 to #7 and bi-metal, and will base the January 1, 2012 costs per ton for these six materials on the percent change in costs per ton to recycle HDPE between the 2009 cost survey and this current 2011 cost survey.

Figure 3
Beverage Container Recycling Rates, 1986 to 2009



Scrap values and payment of avoided scrap values – to avoid paying the processing fee – have made for a fluid processing fee, often stabilized by legislatively mandated equations and caps. We provide a summary of the history and evolution of the first fifteen years of processing fees, in **Subsection E.**, Processing Fee History Addendum, at the end of this Section.

Convenient Recycling and Certified Recyclers

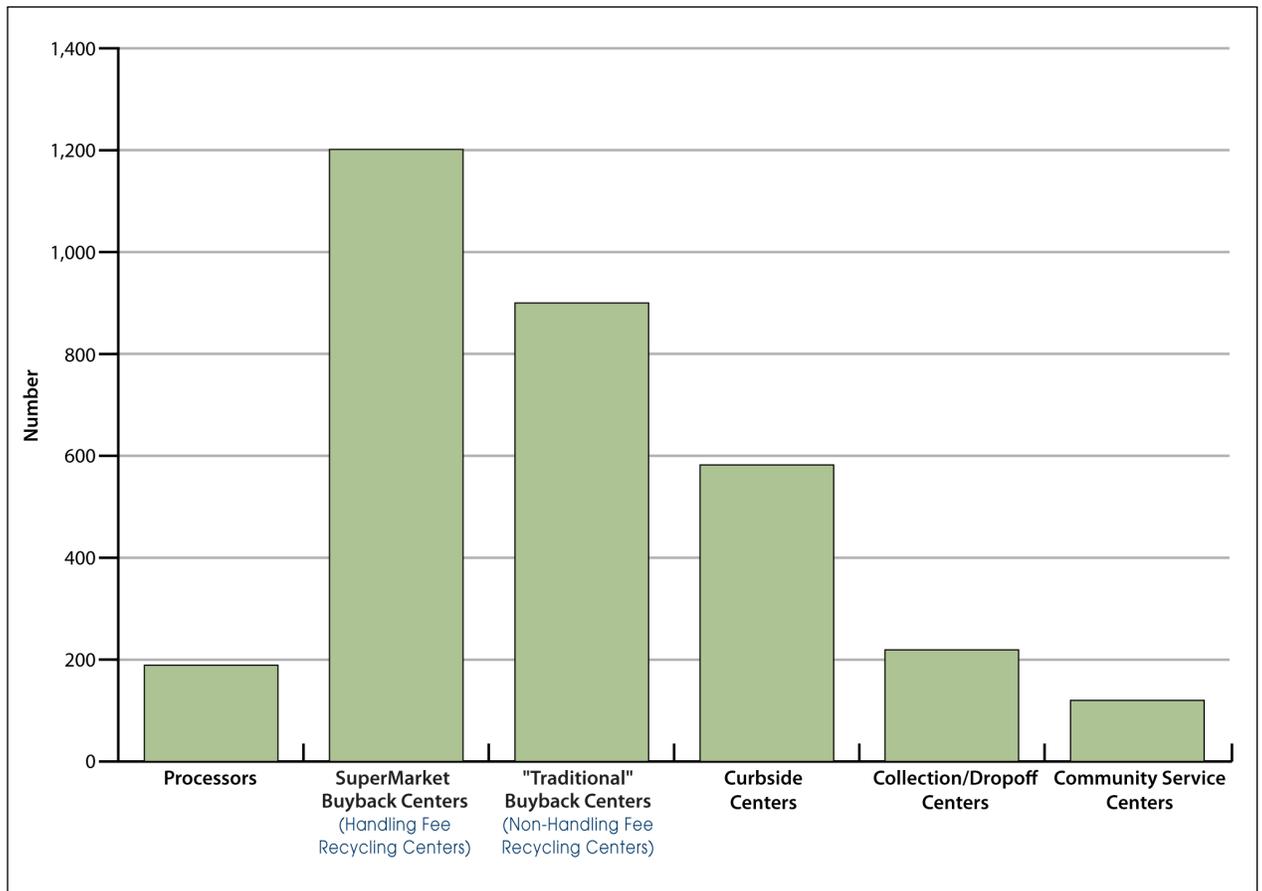
To provide for convenient recycling alternatives, the convenience zone (CZ) system established a network of State certified recycling centers located at supermarket sites, in addition to existing traditional “old-line” recycling centers.² There currently are about 1,200 convenience zone recycling centers in

² The term “traditional recycling center” is often used for those recycling centers not located in supermarket sites, and that do not receive handling fees. These traditional recycling centers, or “non-handling fee recycling centers” comprise the population for the processing fee cost survey.

the state and approximately 900 traditional recycling centers. **Figure 4**, on the following page, illustrates the number of recycling centers of all types in the State. Curbside programs, were virtually non-existent in 1986, but number over 500 programs today. To receive and/or distribute CRV, all recycling centers must be certified with the Division of Recycling.

Like processing fees, convenience zones have been a constant source of legislative maneuvering. In the law’s first year, Convenience Incentive Payments (CIPs) were paid to the sites based on how much money they lost – the greater the loss, the greater the CIP. Not surprisingly, many sites lost money under this system, and a small handful ended up with CIP subsidies that amounted to a dollar or more per container redeemed. Convenience zones and CIPs then were capped, restricted, exempted, and otherwise engineered so that most of the sites could be retained but total costs could be limited. CIP payments increased from \$7 million in 1988 to \$18.5 million in 1991.

Figure 4
Certified Beverage Container Recycling Centers and Processors, 2011



In 1993, AB 87 eliminated CIPs and replaced them with handling fees, akin to the approach used in several other bottle bill states. At 1.7 cents per container, handling fees led to a much more cost-efficient network of CZ recycling sites. But they, too, were subject to careful calibration to appease various interests. For example, handling fees were only paid to CZ sites in supermarket lots and sites only received the maximum \$2,300 per month when they received at least 10 percent glass and plastic. Total annual handling fee payments increased from \$18.5 million in 1992, to \$35 million in Fiscal Year 2007/2008, with per-container payments of 1.8 cents.

AB 3056 provided for significant changes to the handling fee, implemented following the 2007 processing fee and handling fee cost surveys. We provide a more detailed summary of the history and changes of handling fees, starting on page 26.

Other Funded Programs

Over the history of the program, the unredeemed fund has been targeted for a wide variety of uses. With the addition of new beverage containers to the program in 2000, and the increase in CRV in 2004, the unredeemed fund grew. For example, in fiscal year 2007/2008, there were an estimated \$282 million in unredeemed funds. The unredeemed

fund was targeted to support a variety of recycling-related programs, and for loans to the General Fund to help alleviate the State's budget woes. By mid-2009, the fund was projected to go into the red. As a result, there have been significant declines in program funding over the last two years. ABX8 7 specified the current distribution of unredeemed CRV beverage container funds, as illustrated in **Figure 5**, on the next page. This level of funding represents a substantial decline from the \$250-plus million in funds that was scheduled to be distributed in 2009. ABX8 7 suspended payments for four programs: (1) grants for beverage container and litter reduction programs, (2) statewide public education and information campaigns, (3) grants for recycling market development and expansion, and (4) regional beverage container recycling and litter reduction programs.

Even with the program reductions, the expected expenditures for 2011 are significantly higher than the expenditures in 2005. Statutorily, \$15 million (plus cost of living increases) of the fund goes to support Community Conservation Corps, \$15 million for payments to curbside and drop-off programs, and \$10.5 million for payments to cities and counties for beverage container recycling and litter clean-up. ABX8 7 reduced funding for quality incentive payments to \$10 million, eliminated recycling incentive payments, but increased market development payments to \$10 million.

The fund is still being tapped to ease the burden on container manufacturers from processing fees, reducing the processing fee to between 10 percent and 65 percent of the processing payment, depending on the recycling rate and availability of funds. The total amount of processing fee offset is now capped at calendar year 2008 levels, which were approximately \$90 million.

4. Processing Fee Theory and Recent Implementation

The original intent of the processing fee was to hold container manufacturers responsible for internalizing the recycling costs of their containers and to ensure that each material type paid their own cost of recycling. In negotiations surrounding AB 2020, beverage manufacturers wanted to keep the redemption value low (originally one-cent per container). Environmentalists and recyclers accepted this provision, but only on condition that an additional levy, a special processing fee, be established to assure that the market price of used containers was sufficient to cover their costs of recycling. The law specified that a processing fee be assessed on a specific material when the cost of recycling the material (with a reasonable financial return) exceeded the material's scrap value. This fee, unique to AB 2020, established a new link between container manufacturers and recyclers.

Processing fees play a different role than redemption value paid by beverage distributors, and ultimately consumers. The processing fee, in theory, represents an internalization of the net cost of recycling a specific material. This fee is designed and assessed in a manner that makes the fee visible to container manufacturers and also acts as an incentive to container manufacturers to use recyclable materials. The redemption value is an across-the-board financial inducement for consumers to recycle their beverage containers.

In theory, supporters of the processing fee intended that highly recyclable containers would cost less than less recyclable ones, allowing the marketplace to select containers that minimize negative environmental consequences. According to this theory, container manufacturers would compete with one another to design the most recyclable containers, and to build effective systems for recycling them. It was assumed that, by encouraging the recycling of containers, resource

Figure 5
Current Distribution of Unredeemed CRV Beverage Container Funds

Recipient	Amount
Community Conservation Corps	\$15 million plus cost-of-living adjustment to approximately \$20 million total
Cities and Counties	\$10.5 million
Curbside and Neighborhood Programs	\$15 million
Convenience Zone Recyclers – Handling Fees	To be determined, approximately \$40 million
Processing Fee Reduction	For calendar years 2010 and 2011, processing fee reduction is capped at no more than the amount transferred for each material type in calendar year 2008. The totals for FY 2010/11 and FY 2011/12 are estimated at approximately \$70 million
Quality Incentive Payments (glass only)	\$10 million
Market Development Payments (plastic)	\$10 million annually to January 1, 2012
TOTAL	Approximately \$175 million in 2011

consumption and pollution would be minimized. On the other side, many parties questioned the philosophy of the fee and the theory of how it would impact the marketplace and environment. Some believed it was improper for the processing fee to alter the consumer mix of beverage containers in the marketplace. The fee also was criticized for the financial burden it placed on glass and plastic container manufacturers.

Whether or not processing fees have achieved their intent is arguable. Beverage container markets have changed substantially over the program’s twenty-four years, mostly due to influences beyond California’s policies. However, in the early years of the program, market shares of aluminum (which have never had a processing fee) increased, while market shares of plastic and glass (which had processing fees) decreased. Over time, reflecting national trends, and as the processing fee paid by manufacturers has been reduced, plastics market share has increased relative to aluminum. Glass market share has dropped or been stable since the program began. More recently, the imposition of sometimes significant processing fees for beverage containers

in plastic resins #3 to #7 appears to be causing manufacturers to shift towards less costly resins, such as PET, or to pouches and cartons that are not in the program.

While the market impacts of processing fees have been difficult to determine, the processing payment has provided significant, and some argue essential, support to recyclers. For example, PET plastic recycling was essentially non-existent before the program required the plastic industry to support PET recycling. Because the law requires certified recycling centers to accept all beverage container types, the Legislature designed the payment to enable certified recyclers (and, prior to 1993, processors) to recover allowable operating costs and to earn a reasonable financial return, even on those materials that are not inherently profitable to recycle.

Because of aluminum’s high scrap value, there has never been a processing fee for aluminum. Bi-metal containers, which make up a very small portion of the market, have had a processing fee since the program’s inception. Many issues surrounding the processing fee focus on glass and plastic beverage containers.

After several years of legal challenges and payment of avoided scrap value, the processing fee was implemented in 1991. The glass industry began paying a processing fee. Rather than pay the processing fee, PET plastic beverage container manufacturers met their responsibility by paying an avoided scrap value to recyclers, an amount essentially equal to the costs of recycling PET. Initially, the glass and plastic fees represented an internalization of the net cost of recycling a specific material. Over the years, the fee has been recalculated, capped, and reduced through legislation, so while it still determines that the cost of recycling is covered for each material type, its market-incentive impact is minimized.

Public Resources Code Section 14575 directs CalRecycle to calculate the processing fee as the difference between the average cost of recycling the material, including a reasonable profit, and the scrap value for the material.

Currently, processing fees are assessed on beverage manufacturers, and along with supplemental funds from unredeemed containers, these two sources of funds are used to make processing payments to recyclers. If the scrap value is high enough to cover costs, no fee is imposed. If the scrap value is less than average costs, then the processing fees (and supplemental funds) make up the difference.

Below, we describe activities related to implementation of processing fees and processing payments over the last eight years, beginning with the first of the every-two-years processing fee cost surveys, conducted in 2003. **Exhibit 2**, on the next page, provides a brief summary of changes to the processing fee, starting in 2003. The upcoming 2011 processing fee and handling fee cost survey will be the fifth time that cost surveys have been conducted on an every-two-year basis.

2003 Processing Fee Cost Survey

As specified by SB 332, the DOR conducted the 2003 recycler cost survey, to determine recycling costs for calendar year 2002, to be used for the January 1, 2004, processing fee calculation. The DOR contracted with NewPoint Group, through a competitive procurement process, to conduct the cost survey during 2003. NewPoint Group conducted over 180 recycler site visits to determine the costs per ton for each of the ten beverage container materials. This was the first time that actual recycling costs for plastic resins other than PET were estimated, as described, below.

For the first time, the 2003 processing fee cost survey results met and exceeded all statistical requirements. In all cases, the error rate at the 85 percent confidence level was below 10 percent. In addition, the error rate for each material also was less than 10 percent at the 90 percent confidence level. It was a significant accomplishment to achieve error rate goals in this cost survey as compared to previous cost surveys.

There were two reasons for these improved error rates. The first reason was a significantly increased sample size, with 136 sites in the random sample, versus approximately 110 sites in 1999. The second reason was that NewPoint Group's methodology included extensive site file oversight and quality control review. NewPoint Group conducted five levels of quality control review for each site, and sent back many site files to the original survey teams for additional investigation, and often times revisions, before finally approving them. As one outcome of the high degree of accuracy, results of the 2003 processing fee cost survey were not subject to litigation, one of the first cost surveys for which this was the case.

Costs per ton for each of the ten materials, including a financial return of 2.55 percent, are shown in **Table 2**, on page 18.

Exhibit 2

Brief Summary of Processing Fee Program, 2003 to 2011

2003	DOR, with contractor NewPoint Group, conducts largest cost survey (181 recyclers), determines cost of recycling in 2002, for the January 2004 processing fee and payment calculations. NewPoint Group develops sub-allocation models to determine costs per ton for aluminum, bi-metal, and each of the seven plastic resins. AB 28 reduces processing fee to a specified percentage of the processing payment, depending on the recycling rate of that container type. DOR publishes and collects court ordered revised retroactive processing fees for calendar year 2002, based on number of containers sold.
2004	DOR implements new processing fees and payments effective January 1, 2004, based on the cost survey conducted during 2003. Processing fees and payments established for glass, all seven plastic resins, and bi-metal. DOR implements supplemental processing payments and processing fee rebates. NewPoint Group updates cost model to incorporate sub-allocation models in preparation for next cost survey. DOR publishes January 1, 2005, processing fees and payments, based on the results of the previous cost survey. DOR issues RFP for 2005 processing fee cost survey.
2005	DOR, with contractor NewPoint Group, conducts largest cost survey (189 recyclers), determines cost of recycling in 2004, for the January 2006 processing fees and processing payments. The survey consisted of three separate samples: a stratified random sample of traditional recycling centers to determine the costs of recycling aluminum, glass, PET, and HDPE; a simple random sample of traditional recycling centers recycling bi-metal; and a census of all traditional recycling centers recycling any of the plastics #3 to #7. Supplemental processing payments to recyclers are in place for the first half of the year. Processing payments for glass are adjusted upwards, and for PET and HDPE are adjusted downwards on July 1, due to changes in average scrap values. DOR publishes the January 1, 2006, processing fees and payments in December 2005.
2006	DOR implements new processing fees and payments effective January 1, 2006, based on the cost survey conducted during 2005. Processing fees and payments established for glass, all seven plastic resins, and bi-metal. DOR publishes January 1, 2007, processing fees and payments, based on the results of the previous cost survey, and changes resulting from AB 3056.
2007	DOR issues RFP to implement cost survey to determine 2006 costs of recycling for the January 1, 2008, processing fees and payments. AB 3056 reduces the processing fee to zero (for 2007 only) for those containers with a recycling rate equal to or greater than 40 percent (glass, PET, and HDPE). DOR, with contractor NewPoint Group, conducts combined processing fee and handling fee cost surveys. The processing fee survey component included 189 traditional recyclers. The processing fee survey consisted of four separate samples of traditional recyclers: a stratified random sample to determine the costs of recycling aluminum, glass, PET, and HDPE; a simple random sample to determine bi-metal costs; a simple random sample to determine plastic Other #7 costs; and a census of all recycling centers that handled any of the plastics #3 to #6. DOR publishes the January 1, 2008, processing fees and payments in December.
2008	DOR implements new processing fees and payments effective January 1, 2008, based on the processing fee cost survey conducted during 2007. Processing fees and payments established for glass, all seven plastic resins, and bi-metal. DOR publishes January 1, 2009, processing fees and payments in December 2008, based on results of the previous cost survey, and adjusted for cost of living and a reasonable financial return. In December 2008, DOR also issues an RFP to implement cost survey to determine 2008 costs of recycling for the January 1, 2010, processing fees and payments.
2009	DOR awarded a contract to conduct combined processing fee and handling fee cost surveys of 2008 recycler costs. Survey results determined January 1, 2010, processing fees and payments, and July 1, 2010, handling fees. In March 2009, the DOC increased processing payments to recyclers for PET and HDPE due to reductions in scrap value for those materials. On May 29, 2009, the DOC notified the legislature of the inadequacy of available funds, as required by Section 14581(c) of the Public Resources Code. The DOC announced 85 percent proportional reductions in program payments in June, effective July 1, 2009. This increased processing fees paid by manufacturers, and reduced processing payments to recyclers for glass and HDPE. In October 2009, the DOC announced 100 percent proportional reductions, effective November 1, 2009. This further increased processing fees paid by manufacturers for glass, PET, and HDPE, and further reduced processing payments to recyclers for glass, PET, and HDPE. In December 2009, the DOC announced new processing payments and processing fees based on the processing fee cost survey conducted by NewPoint Group for the DOC during 2009. However, processing fees were increased, and processing payments were decreased, to reflect the 100 percent proportional reduction implemented as of November 2009.
2010	Passage of ABX8 7 in March 2010 retroactively reinstated processing fees and payments to original levels determined as of January 1, 2010. The amount of processing fee offset paid by CalRecycle was capped at the amount transferred into each material's processing fee account during calendar year 2008, approximately \$90 million for all materials. In December 2010, CalRecycle announced the processing fees and processing payments for calendar year 2011. These new processing fees and processing payments reflected a cost of living adjustment over the costs determined during the 2009 processing fee cost survey. Per ABX8 7, CalRecycle recalculated the processing fee for HDPE because the projected processing fee offset exceeded the calendar year 2008 offset.
2011	CalRecycle will award a contract to conduct combined processing fee and handling fee cost surveys during 2011 of 2010 recycler costs. Survey results will be used to determine January 1, 2012, processing fees and payments, and July 1, 2012, handling fees.

Table 2
Cost per Ton Requirements (including Financial Return) for January 1, 2004 Processing Fees

Material	Cost per Ton
1. Aluminum	\$429.64
2. Glass	81.85
3. PET #1	491.87
4. HDPE #2	662.40
5. PVC #3	1,091.69
6. LDPE #4	3,409.76
7. PP #5	1,516.52
8. PS #6	6,293.96
9. Other #7	778.70
10. Bi-metal	521.15

Indirect Cost Allocation Sub-Models for All Plastics and Aluminum/Bi-metal

As a result of the introduction of new containers to the Beverage Container Recycling Program in 2000, the 2003 processing fee cost survey (of 2002 recycler costs) was the first time that costs per ton were calculated for plastic resins other than PET. In addition, this cost survey was the first time that actual costs for bi-metal were determined.

The labor allocation approach to determining costs has proven to be accurate for the three majority material types (aluminum, glass, and PET). However, this approach alone was not sufficient to determine costs for the seven minority material types (HDPE #2, PVC #3, LDPE #4, PP #5, PS #6, Other #7, and bi-metal).

As part of the 2003 cost survey, NewPoint Group conducted extensive field research to determine an accurate method of calculating recycling costs for minority materials. The results were two Indirect Cost Allocation Sub-Models to separate the larger indirect costs of two categories, aluminum/bi-metal and all plastics, into material-specific costs.

To do so, the sub-models utilize operational and material handling factors: weight of containers, number of containers, size (volume) of containers; and proportion of CRV versus non-CRV containers (commingled rate). Recyclers surveyed during the field research validated that each of these four factors contributes to the cost of recycling a given material type. The relative relationships are as follows:

- As the *weight of a material* **increases**, the cost of recycling **increases**
- As the *number of containers* **increases**, the cost of recycling **increases**
- As the *size (volume) of a container* **increases**, the cost of recycling **increases**
- As the *commingled rate* (percent of CRV material) **decreases** (i.e. more non-CRV containers), the cost of recycling **increases**.

NewPoint Group developed the quantitative economic cost sub-models to determine recycling costs for the minority materials. NewPoint Group also conducted extensive testing and calibration prior to implementing the sub-models.

Exhibit 3, on the following page, illustrates the relationships between the Labor Allocation Model and Indirect Cost Allocation Sub-Models. The resulting calculations provided a fair, reasonable, and consistent approach to allocate indirect costs between major and minor material types. The sub-models have been incorporated into the Labor Allocation Model spreadsheet. The Cost Allocation Sub-Models were also utilized in the 2005 processing fee cost survey, the 2007 and 2009 processing fee and handling fee cost surveys, and will be updated for the 2011 processing fee and handling fee cost surveys to reflect the cost survey changes implemented by SB 1357. For the 2011 cost surveys, we will utilize the sub-models to determine the costs of aluminum, PET, and HDPE, and the combined costs from the sub-models to determine costs per container.

Exhibit 3
Flow of Data and Results - Labor Allocation Model
and Indirect Cost Allocation Sub-Models

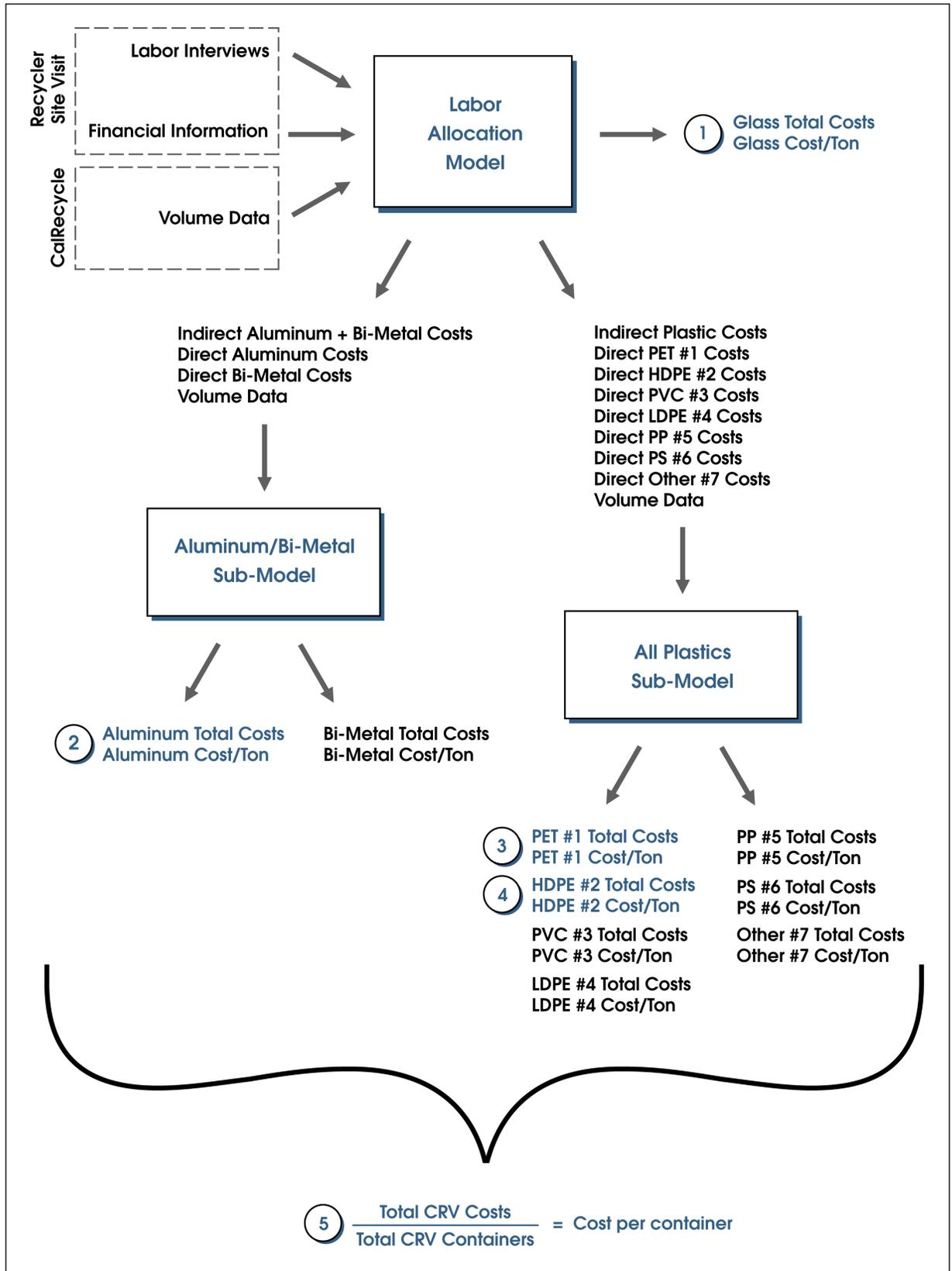


Table 3
Processing Fees as a Percent of Processing Payments, as of January 1, 2005

Recycling Rate	Percent of Processing Payment
75% or above	10%
65 to 74%	11%
60 to 64%	12%
55 to 59%	13%
50 to 54%	14%
45 to 49%	15%
40 to 44%	18%
30 to 39%	20%
Less than 30%	65%

AB 28 (Statutes of 2003)

AB 28 specified a number of changes to processing fees and processing payments. One provision modified the recycler cost survey time period from every three years to every two years.

In addition, AB 28 made significant revisions to the way the actual processing fee paid by beverage manufacturers is calculated. The processing fee actually paid is based on recycling rates for each material in the previous 12-month period. In 2004, the processing fee for glass and PET was equal to 12 percent of the processing payment. The processing fee for HDPE was equal to 20 percent of the processing payment. The processing fee for each of the other materials was equal to 65 percent of the processing payment.

Effective January 1, 2005, the processing fees were adjusted to a specified percentage of the processing payment, depending on the recycling rate. These adjustment factors are shown in **Table 3**, above.

AB 28 established supplemental processing payments for glass, PET, and HDPE, of \$40.86, \$182.54, and \$228.75 per ton, respectively, to be paid to recyclers for a 12-month period beginning July 1, 2004. In addition, AB 28 established a

processing fee rebate for manufacturers for beverages sold in 2002 and 2003.

January 1, 2004, Processing Fees

In December 2003, the DOR announced the January 1, 2004, processing fees and payments. These fees and payments were based on results of the 2003 processing fee cost survey, and adjusted as specified in AB 28. The DOR set processing fees for glass and plastic at 12 percent of the processing payment, and further reduced these for glass to utilize surplus funds. The DOR set the processing fee for HDPE at 20 percent of the processing payment, and set the processing fees for bi-metal and plastics #3 to #7 at 65 percent of the processing payments. The DOR adjusted processing fees and payments effective July 1, 2004, to reflect changes in scrap value for glass, PET, and HDPE. In addition, the DOR implemented supplemental processing payments to recyclers, as set in statute.

January 1, 2005, Processing Fees

In December 2004, the DOR announced the January 1, 2005, processing fees and payments. The DOR based these fees and payments on results of the 2003 processing fee cost survey, and adjusted for cost of living and reasonable financial return (3.60 percent). These costs are provided in **Table 4**, on the next page. The DOR adjusted processing fees paid by manufacturers, by material type, depending on recycling rate. The DOR continued supplemental processing payments, as set in statute. The supplemental processing payments were in effect through June 30, 2005.

In June 2005, the DOR announced mid-year processing payment adjustments for glass, PET, and HDPE effective July 1, 2005, based on changes of more than 5 percent in scrap value (compared to the scrap value used for the initial

payment calculation). The glass processing payment increased due to a 43 percent reduction in glass scrap value, the PET processing payment decreased due to a 9 percent increase in scrap value, and the HDPE processing payment decreased due to a 22 percent increase in scrap value.

2005 Processing Fee Cost Survey

As specified in AB 28, in 2005 the DOR conducted the 2005 recycler cost survey to determine calendar year 2004 recycling costs for recycling centers not receiving handling fees. The DOR contracted with NewPoint Group through a competitive procurement process to conduct the cost survey. NewPoint Group developed three separate samples to determine statistically valid costs for each of the ten beverage container materials. Aluminum, glass, PET, and HDPE recycler costs were based on a stratified random sample of all traditional recycling centers (674 recycling centers). Bi-metal recycler costs were based on a simple random sample of the 158 traditional recyclers that handled bi-metal in 2004. Plastics #3 to #7 costs were based on a census of all 76 recycling centers that handled these materials in 2004. In total, NewPoint Group conducted site visits at 189 recycling centers.

As in 2003, the 2005 processing fee cost survey results met and exceeded all statistical requirements. These requirements were more rigid than in 2003, as the sample was set to achieve a 90 percent confidence level, at or below 10 percent error rate. Error rates were below 10 percent in all cases. These lower error rates were achieved even with fewer sites in the stratified random sample.

Table 4
Cost per Ton Requirements (including Financial Return) for January 1, 2005, Processing Fees^a

Material	Cost per Ton
1. Glass	\$84.83
2. PET #1	509.80
3. HDPE #2	686.54
4. PVC #3	1,131.49
5. LDPE #4	3,534.05
6. PP #5	1,571.80
7. PS #6	6,523.39
8. Other #7	807.09
9. Bi-metal	540.15

^a This is an interim year calculation, and there is no aluminum processing fee.

In the 2005 processing fee cost survey, NewPoint Group continued the extensive site file oversight and quality control procedures established in 2003. In addition, most of the site survey field team was extremely experienced, having conducted surveys in 2003.

The 2005 processing fee cost survey utilized the Indirect Cost Allocation Sub-Models for aluminum/bi-metal and all plastics established in 2003. While the costs per ton for the major material types exhibited high stability, the costs per ton the minor material types (bi-metal and plastics #3 to #7) were highly variable. This variability was attributed to the extremely low number of containers recycled, and the resulting difficulty in allocating costs.

Table 5, on the next page, illustrates the costs per ton results from the 2005 processing fee cost survey, with a 5.43 percent financial return.

January 1, 2006, Processing Fees

In December 2005, the DOR announced January 1, 2006, processing fees and payments. The DOR based these fees and payments on results of the 2005 processing fee cost survey, and a reasonable financial return (5.43 percent). The DOR adjusted processing

fees paid by manufacturers, by material type, depending on recycling rate. The processing fee manufacture discount rate for glass was 13 percent, for PET was 18 percent, and for HDPE was 14 percent. All other plastics (#3 to #7) and bi-metal manufacturers were required to pay processing fees equal to 65 percent of processing payments.

January 1, 2007, Processing Fees

In December 2006, the DOR announced the January 1, 2007, processing fees and payments. The DOR based these fees and payments on results of the 2005 processing fee cost survey, and adjusted for cost of living and reasonable financial return. These costs are provided in **Table 6**, right. Based on AB 3056, the processing fees paid by glass, PET, and HDPE manufacturers were reduced to zero for 2007. As in 2006, all other plastics (#3 to #7) and bi-metal manufacturers were required to pay processing fees equal to 65 percent of processing payments.

In July 2007, the DOR announced processing payment adjustments, effective August 1, 2007. These adjustments were the result of declines in the scrap values of glass and HDPE of 7.44 percent and 11.86 percent, respectively. The glass processing payment was increased from \$84.19 per ton to \$84.60 per ton. The HDPE processing payment was increased from \$378.75 per ton to \$420.54 per ton.

2007 Processing Fee Cost Survey

The DOR conducted the 2007 processing fee cost survey to determine calendar year 2006 costs for recycling centers not receiving handling fees. As specified in AB 3056, the DOR also, for the first time, conducted a handling fee cost survey to determine costs per container for recycling centers not receiving handling fees, and for recycling centers receiving handling fees, in conjunction with the processing fee cost survey. We describe results of the handling fee cost survey in the next subsection.

Table 5
Cost per Ton Requirements (including Financial Return) for January 1, 2006, Processing Fees

Material	Cost per Ton
1. Aluminum	\$491.20
2. Glass	86.93
3. PET #1	520.10
4. HDPE #2	708.20
5. PVC #3	1,669.72
6. LDPE #4	1,992.10
7. PP #5	853.37
8. PS #6	3,217.53
9. Other #7	1,333.13
10. Bi-metal	639.99

Table 6
Cost per Ton Requirements (including Financial Return) for January 1, 2007, Processing Fees^a

Material	Cost per Ton
1. Glass	\$89.72
2. PET #1	536.80
3. HDPE #2	730.95
4. PVC #3	1,723.34
5. LDPE #4	2,056.08
6. PP #5	880.78
7. PS #6	3,320.87
8. Other #7	1,375.95
9. Bi-metal	660.55

^a This is an interim year calculation, and there is no aluminum processing fee.

The DOR contracted with NewPoint Group through a competitive procurement process, to conduct the cost surveys. For the processing fee cost survey, NewPoint Group developed four separate samples to determine statistically valid costs for each of the ten beverage container materials. Aluminum, glass, PET, and HDPE recycler costs were based on a stratified random sample of all traditional recycling centers (679

recycling centers). Bi-metal recycler costs were based on a simple random sample of the 182 traditional recycling centers that handled bi-metal in 2006. Other plastic #7 recycler costs were based on a simple random sample of the 103 recycling centers that handled Other #7 in 2006. Finally, Plastics #3 to #6 recycler costs were based on a complete census of all 26 traditional recycling centers that handled any of these plastics in 2006. In total, NewPoint Group conducted site visits of 189 recycling centers for the processing fee cost survey.

As in the previous two cost surveys, the 2007 processing fee cost survey results met and exceeded all statistical requirements. The sample was set to achieve a 90 percent confidence level, at or below 10 percent error rate. Error rates were below 10 percent in all cases.

NewPoint Group continued to implement the extensive site file oversight and quality control procedures established in 2003, and further refined in 2005. In addition, all of the project management and quality control team, and a portion of the survey field team were extremely experienced, having participated in both the 2003 and 2005 cost surveys.

In comparing the 2006 cost per ton results to that of the previous cost survey, aluminum increased 11 percent, glass increased 15 percent, and PET decreased by 3 percent. The cost per ton for HDPE decreased. Bi-metal costs per ton followed the general trend of aluminum, also increasing between 2004 and 2006. The costs per ton for the minority plastic resins #3 to #7 all decreased as compared to 2004, but continued to demonstrate a high degree of variation.

Table 7, above, illustrates costs per ton results from the 2007 processing fee cost survey, with a 5.60 percent financial return.

Table 7
Cost per Ton Requirements (including Financial Return) for January 1, 2008, Processing Fees

Material	Cost per Ton
1. Aluminum	\$545.03
2. Glass	100.30
3. PET #1	504.48
4. HDPE #2	528.68
5. PVC #3	772.33
6. LDPE #4	1,962.14
7. PP #5	831.95
8. PS #6	658.00
9. Other #7	783.48
10. Bi-metal	933.03

The 2007 cost survey represented the first time that cost data was formally utilized for additional economic analyses. Using both the processing fee recycler and handling fee recycler data, NewPoint Group conducted an economic impact analysis of certified beverage recycling centers in California. The analyses focused on only the collection aspect of the program, and determined direct, indirect, and induced jobs, payroll, and economic impacts.

The economic impact analysis study found that the economic contribution of beverage container recycling centers collection activities to the California economy was \$235 million in 2006. This figure was equivalent to \$415 in economic activity per every ton of beverage containers recycled in 2006, just at the recycling center level. Certified recycling centers employed over 12,000 individuals in 2006. The study did not consider the overall economic impact of the beverage container recycling program. Such a full economic analysis would have required additional economic data from curbside recycling, processing, end-use manufacturing, DOR grant programs, California Conservation Corps recycling programs, and other DOR programs.

Table 8
Cost per Ton Requirements (including Financial Return) for January 1, 2009, Processing Fees^a

Material	Cost per Ton
1. Glass	\$105.96
2. PET #1	532.95
3. HDPE #2	558.51
4. PVC #3	815.91
5. LDPE #4	2,072.88
6. PP #5	878.90
7. PS #6	695.14
8. Other #7	827.69
9. Bi-metal	985.68

^a This is an interim year calculation, and there is no aluminum processing fee.

January 1, 2008, Processing Fees

In December 2007, the DOR announced the January 1, 2008, processing fees and payments. The DOR based these fees and payments on results of the 2007 processing fee cost survey, and a reasonable financial return of 5.60 percent. The DOR adjusted processing fees paid by manufacturers by material type, depending on recycling rate. The processing fee manufacturer discount rate for glass was 12 percent, for PET was 14 percent, and for HDPE was 12 percent. All other plastics (#3 to #7) and bi-metal manufacturers were required to pay processing fees equal to 65 percent of processing payments.

January 1, 2009, Processing Fees

In December 2008, the DOR announced the January 1, 2009, processing fees and payments. The DOR based these fees and payments on results of the 2007 processing fee cost survey, and adjusted for cost of living and reasonable financial return. These costs are provided in **Table 8**, above. The processing fee manufacturer discount rate for glass was 11 percent, for PET was 13 percent, and for

HDPE was 10 percent. Again, all other plastics (#3 to #7) and bi-metal manufacturers were required to pay processing fees equal to 65 percent of processing payments.

2009 Processing Fee Cost Survey

The DOR conducted the 2009 processing fee cost survey to determine calendar year 2008 costs for recycling centers not receiving handling fees. As specified in AB 3056, the DOR also, for the second time, conducted a handling fee cost survey to determine costs per container for recycling centers not receiving handling fees, and for recycling centers receiving handling fees, in conjunction with the processing fee cost survey. We describe results of the handling fee cost survey in the next subsection.

The DOR contracted with NewPoint Group through a competitive procurement process to conduct the cost surveys. For the processing fee cost survey, NewPoint Group developed four separate samples to determine statistically valid costs for each of the ten beverage container materials. Aluminum, glass, PET, and HDPE recycler costs were based on a stratified random sample of all traditional recycling centers (729 recycling centers). Bi-metal recycler costs were based on a simple random sample of the 251 traditional recycling centers that handled bi-metal in 2008. Other plastic #7 recycler costs were based on a simple random sample of the 169 recycling centers that handled Other #7 in 2008. Finally, Plastics #3 to #6 recycler costs were based on a complete census of all 51 traditional recycling centers that handled any of these plastics in 2008. In total, NewPoint Group conducted site visits of 198 recycling centers for the processing fee cost survey.

As in the previous three cost surveys, the 2009 processing fee cost survey results met and exceeded all statistical requirements. The sample was set to achieve a 90 percent confidence level, at or below 10 percent error rate. Error rates were below 10 percent in all cases.

Table 9
Cost per Ton Requirements (including Financial Return) for January 1, 2010, Processing Fees

Material	Cost per Ton
1. Aluminum	\$591.44
2. Glass	86.30
3. PET #1	451.34
4. HDPE #2	530.57
5. PVC #3	834.62
6. LDPE #4	1,190.65
7. PP #5	1,068.17
8. PS #6	661.63
9. Other #7	724.92
10. Bi-metal	668.64

NewPoint Group continued to implement the extensive site file oversight and quality control procedures established in 2003, and further refined in 2005 and 2007. In addition, all of the project management and quality control team, and a portion of the survey field team were extremely experienced, having participated in up to three of the previous cost surveys.

In comparing the 2008 cost per ton results to that of the previous cost survey, aluminum increased 8 percent, glass decreased 14 percent, and PET decreased by 11 percent. The cost per ton for HDPE stayed flat. Bi-metal costs per ton decreased significantly, primarily due to higher volumes. The costs per ton for the minority plastic resins #3 to #7 continued to demonstrate a high degree of variability, but fell within a smaller overall range.

Table 9, above, illustrates costs per ton results from the 2009 processing fee cost survey, with a 5.76 percent financial return.

Table 10
Cost per Ton Requirements (including Financial Return) for January 1, 2011, Processing Fees^a

Material	Cost per Ton
1. Glass	\$84.49
2. PET #1	441.88
3. HDPE #2	519.44
4. PVC #3	817.12
5. LDPE #4	1,165.69
6. PP #5	1,045.77
7. PS #6	647.77
8. Other #7	709.73
9. Bi-metal	654.62

^a This is an interim year calculation, and there is no aluminum processing fee.

January 1, 2010, Processing Fees

In December 2009, CalRecycle announced the January 1, 2010, processing fees and payments. CalRecycle based these fees and payments on results of the 2009 processing fee cost survey and a reasonable financial return of 5.76 percent. CalRecycle adjusted processing fees paid by manufacturers by material type, depending on the recycling rate, the amount of processing fee offset paid in 2008, and a 100 percent proportional reduction. The proportional reduction was eliminated retroactive to January 1, 2010, after passage of ABX8 7.

January 1, 2011, Processing Fees

In December 2010, CalRecycle announced the January 1, 2011, processing fees and payments. CalRecycle based these fees and payments on results of the 2009 processing fee cost survey, and adjusted for cost of living (which declined) and reasonable financial return. These costs are provided in **Table 10**, above. The processing fee manufacturer discount rate for glass and HDPE was 10 percent, and for PET was 10 percent. The

processing fee for HDPE was further increased because the processing fee offset of \$5.6 million exceeded the \$4.6 million offset cap established under ABX8 7. As previously, all other plastics (#3 to #7) and bi-metal manufacturers were required to pay processing fees equal to 65 percent of processing payments.

Table 11, on the following page, illustrates the actual recycling costs, without financial return, determined since the program's inception in 1987.³ When legislation did not dictate otherwise, the DOR (or CalRecycle) used these costs for the processing fee calculations. Despite various approaches to the recycler cost survey, and legislative capping and setting of costs, the recycling costs for glass have remained relatively stable over the last twenty years. The cost of recycling aluminum has increased each year since 1999, while the cost of recycling PET has decreased each year since 1989, with the exception of a slight increase in 2004. In 2008, for a second time, the aluminum cost per ton to recycle was more than the PET cost per ton to recycle.

5. Convenience Zone and Handling Fee Theory, History, and Recent Implementation

AB 2020 established specific goals for convenient recycling in order to allow consumers to redeem their containers and receive back their refund value. While a traditional deposit system requires beverage retailers (dealers) to accept and sort returned empty containers, part of the compromise behind AB 2020 was to develop a mechanism to avoid, or minimize, dealer take-back requirements, which were viewed as costly and unwieldy. While California had about 500 pre-existing recycling centers, these were not deemed adequate to ensure convenient recycling

opportunities, as many of these sites did not accept all materials, and/or were in industrial locations.

Rather than requiring all dealers to accept empty containers, AB 2020 established redemption centers close to where people shopped. Thus was born the “convenience zone”, defined as the areas within a one-half mile circular radius surrounding each supermarket in California with annual sales exceeding \$2 million.⁴ Each convenience zone (CZ) was to contain at least one recycling center that redeemed all types of beverage containers, and was to be open at least 30 hours per week, including at least five off-business hours. If a recycling center was not established within a zone, then all dealers within the zone would be required to take back containers. Through this mechanism, the law created incentives for dealers to ensure that a recycling center was located in their zone.

The intent of AB 2020 was to balance equity, efficiency, and effectiveness in providing recycling opportunities. The convenience zone mandate was established to be equitable, i.e. providing consumers with an easy mechanism to get back the redemption value. At the same time, this mechanism was intended to be more efficient and effective than a traditional deposit system.

The CZ system has proven to be equitable, and it is significantly more efficient and cost effective than in-store dealer take-back. However, conventional wisdom is that recycling in convenience zones on average costs more than recycling at pre-existing recycling centers. This was confirmed by the results of the 2007 and 2009 handling fee cost surveys. Some program stakeholders disagree with subsidizing CZ recyclers, and the CZ program is still considered by many to be less efficient than it should be.

³ Costs are shown for recyclers only, as processors were removed from the processing fee calculation in 1993.

⁴ This definition is still in place today.

Table 11
Recycler Costs (without Financial Return) used for Processing Fee Calculations^a (Costs per Ton)

Cost Survey Year	Aluminum	Glass	PET Plastic
1987	\$342.09	\$72.52	\$270.29
1989	366.39	74.84	930.42
1990	324.32	88.69	930.42
1991	322.02	86.98	785.56
1994	349.07	93.75	754.16
1997	417.60	81.09	611.74
1998	394.41	84.85	606.62
1999	354.30	86.25	584.14
2002	418.95	79.81	479.63
2004	465.90	82.45	493.31
2006	516.13	94.98	477.73
2008	559.23	81.60	426.76

^a These costs were used to determine the processing fee when legislation did not dictate otherwise. They do not include reasonable financial return (allowable profit).

Much of the controversy that has surrounded convenience zones over the program’s twenty-four years is based around the question: *How much should the State pay for convenience?* One of the earliest evaluations of the program, the June 1991 *Convenience Zone Effectiveness Study*, was mandated by AB 1097 (Statutes of 1989) to report on the effectiveness of convenience zones. While the study made several recommendations to improve convenience zones, it also determined that “California’s statewide beverage container recycling system is a well-conceived program for meeting the challenging goals established by the Legislature.”⁵ However, the study was not the last word on convenience zones. Similar to processing fees, the controversies related to convenience zones have led to frequent legislative adjustments over the history of the program, and continuing most recently with AB 3056. **Exhibit 4**, on the following page, provides a brief summary of legislation related to convenience zones.

⁵ California Department of Conservation, *Convenience Zone Effectiveness Study: A Report to the California Legislature*, June 1991, p.2.

Initially, AB 2020 included a “safety net”, Convenience Incentive Payments (CIPs) to help pay the cost of recycling centers located in CZs. CIPs were paid from unredeemed funds. Only sites that were the sole redemption location in a zone, and that realized a net average monthly financial loss, were eligible. However, in the early program years, up to two-thirds of new CZ redemption centers received CIPs.

Realizing that CIPs were “getting out of hand,” the legislature adopted restrictions on CIP amounts and how they were allocated. For example, CIP was first awarded to centers in low population areas, then to other centers in order of volume (high to low). CIP was capped at \$1,500 per site, and no more than 5 cents per container. In the early years of the program, there was annual legislation related to CIPs: first extending them to December 1992; then increasing the total payout from \$13 million to \$18.5 million; and then decreasing the total payout from \$18.5 million to \$15 million. The biggest concern with the CIP system was that it was “needs based”, and discouraged improvements in operating efficiency.

Exhibit 4

Brief Legislative History of the Convenience Zone Program

1986	AB 2020 becomes law, establishing convenience zones as the location within a ½ mile radius of a supermarket with \$2 million or more in annual sales. AB 2020 also established Convenience Incentive Payments (CIPs) for recycling centers in convenience zones that were losing money. CIPs were to provide a funding safety net so that supermarket sites were not left bearing the costs of hosting a recycling center when other dealers had no such requirements. CIPs were originally capped at \$13 million per year total. The Department could exempt a percentage of convenience zones from the requirement to have a recycling center in the zone
1988	SB 1730 extended the sunset from January 1, 1991, to December 31, 1992
1989	AB 1097 required the Department to report on the effectiveness of convenience zones. The resulting <i>Convenience Zone Effectiveness Study</i> was completed in June 1991. AB 1001, effective January 1, 1990, limited the maximum CIP per container to no more than 7-cents, and the total payment to no more than \$1,145 per recycling center per month. AB 1001 increased the total number of convenience zone exemptions first to 15 percent, and then to 20 percent as of June 1, 1991.
1990	AB 1490 increased the total annual CIP payment to \$18.5 million. This bill, effective September 25, 1990, also reduced the maximum per container CIP to 5-cents, and increased to total monthly payment per site to \$1,500. It also allowed that 15 percent of CIP recipients could receive \$2,000 per month
1991	AB 2212 reduced the total annual CIP payment to \$15 million
1992	AB 87 replaced the CIP with a 1.7 cent per container handling fee. Sites could receive a maximum of \$2,300 in handling fees per month, with eligible containers determined by the proportion of glass and plastic containers compared to all containers. The law also set a minimum number of containers recycled in order to be eligible for handling fees. The maximum payment was set at \$18.5 million, and the number of convenience zone exemptions increased from 20 percent to 25 percent
1993	AB 1488 added the provision that containers 24 ounces or larger count as two containers for the purposes of determining the eligibility percentage of glass and plastic for the handling fee, thus increasing the number of eligible sites
1995	SB 1178 reduced the monthly maximum handling fee payment to \$2,000 per month, reduced the minimum proportion of glass and plastic containers from 30 percent to 10 percent, and made sites recycling more than 500,000 containers per month ineligible. The number of convenience zone exemptions were again increased, this time to 35 percent
1999	SB 1, emergency legislation, extended authorization to expend funds for handling fees, still at \$18.5 million
2000	SB 32 increased the annual handling fee payments to \$23.5 million, increased the per container payment to 1.8 cents, and increased the maximum monthly payment back to \$2,300 per month. The law also established requirements for recycling centers in rural regions, and their handling fee eligibility
2003	AB 28 increased annual payments for handling fees to \$26.5 million, and deleted the limit of recycling 500,000 containers per month for handling fee eligibility
2005	AB 1764 increased the total payment of handling fees from \$26.5 million annually to \$30 million for the one-year period July 1, 2004, to June 20, 2005. The total annual payment commencing July 1, 2005, returned to \$26.5 million
2006	AB 3056 increased the total handling fee payments for three years, starting with fiscal year 2005-2006. The law requires the DOR to conduct a cost survey of recycling centers that receive handling fees, and use this cost, as of July 1, 2008, to determine handling fee payments. As of July 1, 2008, handling fee payments will be equal to the difference between the cost of recycling at sites that receive handling fees, and the cost of recycling at sites that do not receive handling fees. The law removes some restrictions on handling fee eligibility, removing the \$2,300 per month cap, and the 60,000 containers per month minimum. AB 3056 also revised the definition of convenience zones in rural regions
2007	As per AB 3056, DOR conducted the first handling fee cost survey, used to determine the July 1, 2008, handling fee payments. DOR contracted with NewPoint Group to conduct the cost survey. NewPoint Group determined costs per container based on a stratified random sample of 63 recyclers that did not receive handling fees, and a stratified random sample of 115 recyclers that did receive handling fees
2008	As per AB 3056, DOR announced the July 1, 2008, handling fees, based on the 2007 handling fee cost survey. The new per container handling fee was set at \$0.0098. During the first three months of FY 2008/2009, handling fee distributions increased as compared to the same time period in FY 2007/2008
2009	The handling fee was kept at \$0.0098 per container during 2009. However, in June 2009, the DOR announced 85 percent proportional reductions in response to a negative fund balance. As of July 1, 2009, handling fee payments were reduced to \$0.00147 per container. In November 2009, the DOR implemented a 100 percent proportional reduction, eliminating handling fee payments entirely. Handling fee and other recyclers filed a lawsuit against the State in response.
2010	In March 2010, ABX8 7 reinstated the handling fee at \$0.0098 cents per container, retroactive to January 1, 2010. In July 1, 2010, the new handling fee payment, calculated from the results of the 2009 processing fee and handling fee cost surveys, went into effect, at \$0.00859
2011	CalRecycle will award a contract to conduct combined processing fee and handling fee cost surveys of 2010 recycler costs. Survey results will be used to determine January 1, 2012, processing fees and payments, and July 1, 2012, handling fees.

In 1992, AB 87 enacted a number of major changes to the still-young AB 2020 program. One of the most significant changes was the elimination of the CIP, and the establishment of a “performance-based” 1.7-cent per container handling fee to pay for the cost of convenience at CZ sites. AB 87 provided for handling fee payments of up to \$2,300 per month per site, with priority going to those sites with the highest eligible monthly volume. To be eligible, sites had to be the only recycling center in a convenience zone; be located at, or in, the parking lot of the supermarket; and meet specified total monthly redemption volumes, initially of 45,000 containers per month, increasing to 60,000 containers per month in January, 1994. Further, to ensure that sites receiving handling fee were recycling adequate glass and plastic, AB 87 required that glass and plastic must be at least 30 percent of a site’s eligible volume. The total amount allocated for handling fees was set at \$18.5 million per year.

With the exception of changes to the amount of total funding, this basic handling fee system was in place between 1993 and 2008 as a means to help pay for the cost of convenient recycling, with only relatively modest modifications. In 1995, the handling fee was extended to January 1, 1999, and the monthly payment was reduced to a maximum of \$2,000 per site. The minimum proportion of glass and plastic was reduced from 30 percent to 10 percent. In addition, a site was declared ineligible for handling fees if they recycled more than 500,000 containers per month. These changes increased the number of eligible containers for some sites, and also eliminated funding for those high-volume sites that were thought to be less costly.

In 1999, handling fees were authorized for another year. The per-site maximum payment was increased back to \$2,300, and the per container payment was increased to 1.8 cents. The total annual handling fee payment was

capped at \$23.5 million. In 2003, AB 28 increased the total annual handling fee payment to \$26.5 million, and eliminated the 500,000 container provision. In 2005, AB 1764 increased the total handling fee payment for fiscal year 2004/2005 only, to \$30 million.

These increases in total handling fee payments, starting with AB 28, were in response to insufficient funds to pay all otherwise eligible handling fee claims. In fiscal year 2002/2003, there were not sufficient funds in May or June 2003 to pay handling fees to all eligible recyclers. In fiscal year 2003/2004, there were insufficient funds to pay all eligible recyclers in June 2004; in fiscal year 2004/2005 there were insufficient funds to pay all eligible recyclers in May and June 2005; and in fiscal year 2005/2006 there were insufficient funds to pay all eligible recyclers in May and June 2006. In all years except fiscal year 2003/2004, legislation was passed to increase available funds, and eligible recycling centers received handling fees after the fact.

AB 3056 increased the annual handling fee payments retroactively for fiscal year 2005/2006 from \$26.5 million to \$31 million to cover the funding gap in May and June 2006, and increased the annual payments for the following two fiscal years to \$33 million and \$35 million, respectively. AB 3056 also implemented the most significant changes to the handling fee since they were instituted in 1993.

As per AB 3056, on July 1, 2008, the handling fee changed dramatically. At that point, provision for the maximum annual funding cap was removed (constrained only by available unredeemed funds); the 60,000 minimum containers per site per month was removed; the \$2,300 maximum payment per site per month was removed; the 1.8 cents per container was removed; and counting containers 24 ounces and above as two containers was removed.

Figure 6
Handling Fee Calculation as of July 1, 2012

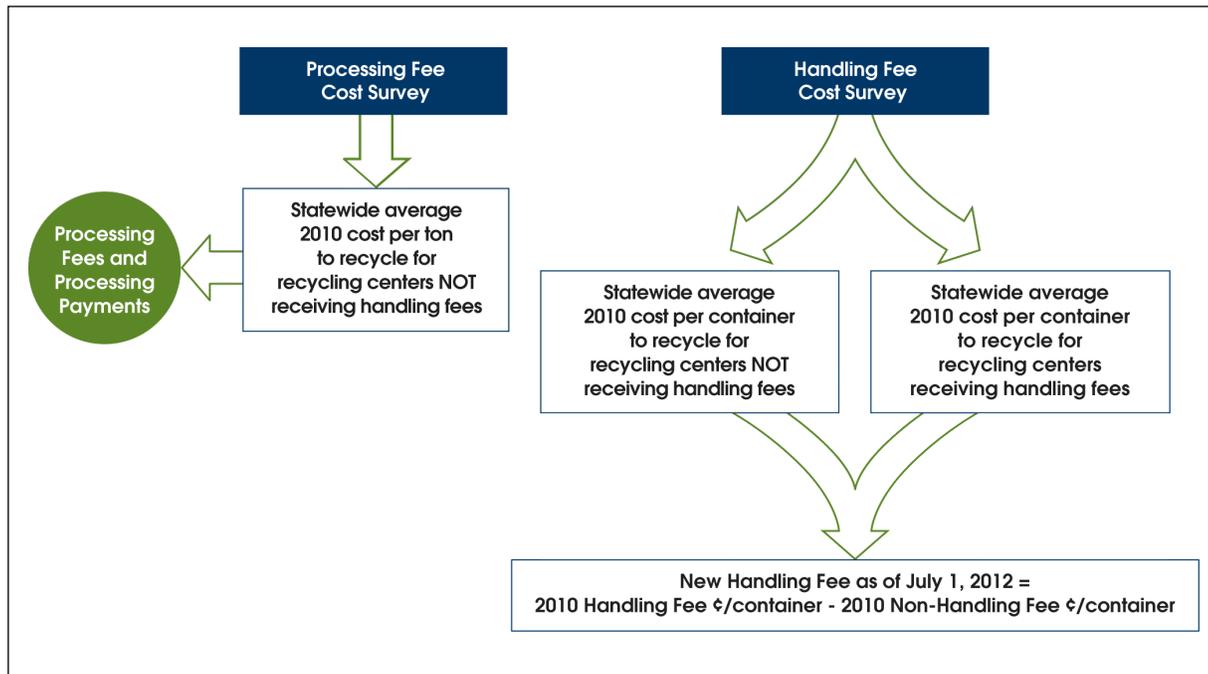


Table 12
Costs per Container (2006 and 2008)
Handling Fee Cost Surveys

Recycler Type	2008 Statewide, Weighted-Average, Cost per Container	2006 Statewide, Weighted-Average, Cost per Container
1. Handling Fee Recycler	2.196 Cents	2.410 Cents
2. Non-Handling Fee Recycler	1.337 Cents	1.430 Cents
3. Handling Fee Recycler Cost per Container minus Non-Handling Fee Recycler Cost per Container	0.859 Cents	0.980 Cents

Instead, on July 1, 2008, the per container handling fee payment was based on the results of the handling fee cost survey. The new handling fee was calculated by subtracting the statewide weighted average cost per container to recycle from sites that **do not** receive handling fees, from the statewide weighted average cost per container to recycle from sites that **do** receive handling fees. This process to determine handling fees is illustrated in **Figure 6**, above. The July 1, 2008,

handling fee, calculated from the results of the 2007 handling fee cost survey, was \$0.0098 per container (\$0.0241 per container minus \$0.0143 per container).

The July 1, 2010, handling fee, calculated from the results of the 2009 handling fee cost survey, was \$0.00859 per container (\$0.02196 minus \$0.01337 per container). **Table 12**, above, illustrates the 2007 and 2009 handling fee cost survey results (measuring

costs for 2006 and 2008). During this time, the costs per container for handling fee and non-handling fee recyclers decreased 9 percent and 7 percent, respectively. The calculated handling fee decreased by 12 percent.

CalRecycle is required to conduct a handling fee cost survey every two years, in conjunction with the processing fee cost survey, to determine a new handling fee. During alternate years without cost surveys, CalRecycle shall adjust the costs of the previous survey using cost of living changes as measured by the U.S. Bureau of Labor Statistics. The next handling fee will be effective July 1, 2012. Current handling fee eligibility requirements are as follows:

- Eligible sites include: recycling centers at supermarket sites, non-profit convenience zone recyclers, or rural regional recyclers⁶
- The number of containers eligible for handling fees is determined by dividing the site's monthly volume of glass and plastic containers by the monthly volume of all containers. If this quotient is at least equal to 10 percent, the total monthly volume of the site is eligible for handling fees. If the quotient is less than ten percent, then the maximum eligible volume is determined by dividing the

⁶ These categories of recycler are defined in statute: a supermarket site means any certified recycling center which redeems all types of beverage containers in accordance with Section 14572, and which is located within, or outside and immediately adjacent to the entrance of, or at, or within a parking lot or loading area surrounding, a supermarket which is the focal point of a convenience zone, or a dealer that is located within that zone, and which is accessible to motor traffic (Section 14526.5). A nonprofit convenience zone recycler means a recycling center that is operated by an organization established as a 501(c) or 501(d) entity in U.S. Code, is certified by the Department, and is located within a convenience zone, but is not necessarily a supermarket site, or has operated in the same site for a at least five years, and is located within one mile of an exempted convenience zone (Section 14514.7). A rural regional recycler means an operator that is certified by the Department as being in a nonurban area identified using loan eligibility criteria of the Rural Housing Service of the US Department of Agriculture, or is within an area designated by the Department as a rural region with a population of between 10,000 and 50,000 persons (Sections 14525.5.1 and 14571).

volume of glass and plastic containers by 10 percent. Plastic recycling volumes have increased significantly since this provision was added to the program, and essentially all recyclers meet this requirement

- Handling fee payments may be made to only one certified recycling center in a convenience zone. If a dealer is in two zones, only one payment will be made to a recycler located at that dealer. If another recycler is operating in a zone without receiving handling fee payments, the Division shall not pay handling fees to a convenience zone recycler in that zone, and neither may the other recycler receive handling fees
- There are separate eligibility criteria for rural region recyclers, related to hours of operation, operation in more than one zone, and location of other recyclers.

CalRecycle manages both the status of convenience zones and the distribution of handling fee payments. Twice each year, CalRecycle utilizes the Progressive Grocer Marketing Guidebook to update the list of supermarkets with annual sales of \$2 million or more, and identify the resulting zones.

In the beginning of 2011, there were almost 4,000 convenience zones in the State. Typically there are about 150 to 180 newly activated convenience zones each year. CalRecycle also specifies exemption criteria for zones, and exempts some number of zones each year.

The maximum number of zones that may be exempted from hosting a recycling center is 35 percent of the total number of designated zones. Currently, there are over 1,000 exempted zones, equal to approximately 25 percent of all zones. In those zones that are not exempted, and do not contain a recycling center, every beverage dealer in the zone (not just the supermarket) must accept containers for redemption.

Table 13
Number and Funding of Handling Fee Sites, 2001 to 2009

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Typical number of HF sites	1,278	1,178	1,165	1,212	1,244	1,251	1,236	1,276	1,330
Average number of HF sites funded	958	991	944	1,093	1,153	1,172	1,163	1,119	1,224
Average HF per site per month	\$2,058	\$2,080	\$1,917	\$2,151	\$2,157	\$2,163	\$2,206	\$2,775	\$2,317

Table 14
Participant Shares for Calendar Year 2009, in Percent of Total Redemption Weight*

Recycler Type	Total CRV	Aluminum	Glass	PET #1	HDPE #2
Traditional Recycling Centers	55%	60%	48%	52%	44%
Supermarket Sited HF Recycling Centers	22	23	18	23	18
Supermarket Sited non-HF Recycling Centers	12	12	11	12	15
Curbside Programs	9	4	20	10	18
Community, Dropoff, and Collection Programs	3	1	4	3	6

*Due to rounding, figures may not total to 100 percent.

Over the last several years, and for most years of the program, the number of handling fee recycling centers has been about 1,200. **Table 13**, above, provides the typical number of handling fee sites, average number of these sites funded, and the average handling fee payment per month, per site, for the most recent nine years for which data are available. There currently are approximately 1,200 handling fee sites in the State that receive handling fee payments. This number is consistent with previous years. This may represent a rebound from the reported closure of hundreds of convenience zone sites in late 2009 when handling fees were proportionally reduced to zero.

In 2009, supermarket sites receiving handling fees recycled, by weight, 22 percent of all CRV containers redeemed. **Table 14**, above, summarizes the shares of containers for each of five recycler categories for 2009 for the four major material types. Comparing across material types, on average, handling fee sites recycle

slightly more high-profit aluminum and PET, and less glass and HDPE. Supermarket handling fee sites account for less than one-half the volume of recycling as traditional recyclers. However, these sites contribute significantly more to overall recycling volumes than curbside programs. As compared to 2007, in 2009, there was a shift toward more recycling at traditional recyclers and non-handling fee supermarket recyclers, and less recycling at handling fee recyclers and curbside programs. This likely represents customers' interest in maximizing CRV and scrap value payments due to the poor economic climate.

Upon implementation of the new cost-based handling fee on July 1, 2008, total handling fee payments have increased significantly. Although the per container handling fee decreased from 1.8 cents to 0.98 cents, the elimination of payment caps and minimum redemption volumes meant that more containers, and more recyclers, are eligible for handling fee payments. Typical total

monthly handling fee payments in the first half of 2008, under the old handling fee system, were \$2.6 million. After July 2008, under the new handling fee system, total monthly handling fee payments were often over \$4 million. In the four months of 85 percent proportional reductions (July 2009 through October 2009), total monthly handling fee payments shrank to approximately \$650,000. There were no handling fee payments in November and December of 2009 due to the 100 percent proportional reduction. Total monthly handling fee payments for the first three months of 2010, the most recent data available, ranged from \$3 million to \$3.7 million.

B. Key Project Challenges

NewPoint Group has successfully completed four prior cost survey projects for the DOR, including the first two combined processing fee and handling fee cost surveys in 2007 and 2009. While our NewPoint Group team is confident that we can successfully conduct a fifth cost survey for CalRecycle, we do not underestimate the logistical and execution challenges that this project presents to the contractor and CalRecycle.

Each cost survey effort provides a new set of challenges and issues. Not only do the “old” challenges of a cost survey come into play, but there always seem to be an entirely new set of challenges resulting from legislative changes, recycler activities, or the broader economic climate. This third-ever combined processing fee and handling fee cost survey effort is still a significantly more logistically challenging, and politically risky, proposition than prior processing-fee-only cost surveys.

CalRecycle must obtain a contractor they can trust and can work closely with to successfully execute both the processing fee and handling fee cost surveys, and to maneuver inevitable difficulties that will arise during this contract work.

“Old” Challenges

A cost survey presents a unique set of challenges. The results must be reliable and defensible; recycling centers are sometimes reluctant to provide financial information; information recycling centers do provide is often unconventional; and strict confidentiality and quality control procedures are essential. Each of these challenges is doubled with the combined processing fee and handling fee cost surveys.

Processing fees are complex, the work required to calculate them is time-consuming and tedious, and it is extremely difficult to completely satisfy conflicting special interests of industries and organizations affected by processing fees and processing payments. The handling fee cost survey, not only increases the workload, but it heightens the importance of obtaining accurate, defensible, reliable, and reasonable cost survey results.

Over the twenty-four years of the program, the State has committed significant resources in meeting the responsibility imposed by processing fee (and now handling fee) cost surveys. Comprehensive on-site cost surveys are an essential step in obtaining accurate, reliable, and useful cost data from recyclers and processors. In addition, it is necessary to allocate time and resources to ensure recycler confidentiality, and to review each site visit. Implementing strong measures to ensure confidentiality is essential to gaining the trust of recyclers. In turn, implementing strong quality control procedures, at each step of the cost survey, is essential to obtaining more reliable and defensible end results. These same, tried and tested, cost survey approaches will be applied to two populations of recyclers.

“New” Challenges

The first combined processing fee and handling fee cost survey, conducted for the DOR by NewPoint Group in 2007, presented many

unknown challenges. Now, having conducted a second combined processing fee and handling fee cost survey in 2009, the NewPoint Group team recognizes and understands many of the difficulties inherent in the combined cost survey effort. With the knowledge and experience gained in 2007 and 2009, we can better address these challenges in 2011. Of course, at the same time, we must be ready to handle the inevitable unexpected difficulties that will arise during the course of the survey.

One of the most challenging aspects of this 2011 cost survey will be meeting CalRecycle's schedule. This survey will start at least two months later than previous cost surveys. However, CalRecycle and the contractor must still meet the legislatively mandated December 15, 2011 deadline for announcing January 1, 2012 processing fees and processing payments. This essentially means that the contractor must provide CalRecycle with cost per ton results by November 15, 2011, two weeks ahead of the schedule outlined in the RFP Description of Work. NewPoint Group is prepared to meet this challenging schedule, and our performance on previous cost surveys demonstrates that we have the capability to do so.

During the 2009 processing fee and handling fee cost survey, NewPoint Group scheduled approximately 20 recycling center site visits per week, typically 2 weeks prior to the actual site visit. In the peak months of May, June, and July our teams conducted approximately 80 visits per month. Actual file completion lags a bit behind site visits due to the time to complete the site file and conduct the independent quality control steps.

In 2009, our survey team completed the final review of between 50 and 80 files per month during the peak review months of July, August, September, and October. Completing this 2011 cost survey in time to meet CalRecycle's statutory deadlines will require that our team complete (through final review), an average of 40 sites per

month between June and January. While ambitious, NewPoint Group has the proven capability to meet, or exceed, this target. Section 4 of this proposal provides additional details on NewPoint Group's project schedule.

While the execution of site visits and site file review are essential to completing the cost survey on schedule, they are not the only key factors. The ability of the contractor to start this project quickly and efficiently will be essential. During the first month of the survey, the contractor must implement two critical components of the project: training and sample selection. An effective training program is necessary to ensure that the field team understands and implements site survey procedures in order to complete site files accurately.

In order to meet the required schedule, survey team training must start within the first few weeks of the contract. This means that the contractor must review and update the 700-page training manual within a three to four week window. NewPoint Group personnel assisted the DOR in developing the first cost survey training manual in 1995. We are extremely familiar with the training materials, and will be ready to start training during the last week in May.

Sample selection provides the foundation for the entire survey and for the validity and accuracy of the survey results. The selected contractor must have the statistical expertise to design and execute a survey sample plan within the first few weeks of the contract. If the sample design is flawed, the results of the entire survey will be questioned (or worse, litigated). If the sample design is not developed quickly, the field work will be delayed. Any further delay in the start of the 2011 survey would make it almost impossible to meet CalRecycle's statutory deadlines. NewPoint Group has the statistical sampling expertise and experience to quickly and accurately design and select the 2011 processing fee and handling fee survey samples.

Table 15
Processing Fee Cost Survey Time-Series and Cross-Sectional Comparisons

Material Type	Non-Handling Fee Recycling Centers				
	2002 Statewide Costs Per Ton ^a	2004 Statewide Costs Per Ton ^a	2006 Statewide Costs Per Ton ^a	2008 Statewide Costs Per Ton ^a	2010 Statewide Costs per Ton ^a
1. Aluminum	\$418.95	\$465.90	\$516.13	\$559.23	?
2. Bi-metal	508.18	607.03	883.55	632.22	N/A
3. Glass	79.81	82.45	94.98	81.60	?
4. PET #1	479.63	493.31	477.73	426.76	?
5. HDPE #2	645.91	671.73	500.64	501.67	?
6. PVC #3	1,064.52	1,583.72	731.37	789.16	N/A
7. LDPE #4	3,324.89	1,889.50	1,858.09	1,125.80	N/A
8. PP #5	1,478.77	809.42	787.83	1,009.99	N/A
9. PS #6	6,137.30	3,051.82	623.11	625.60	N/A
10. Other #7	759.32	1,264.47	741.93	685.44	N/A

^a Without RFR.

Table 16
Handling Fee Cost Survey Time-Series and Cross-Sectional Comparisons

Recycler Type	2006 Statewide Costs Per Container	2008 Statewide Costs Per Container	2010 Statewide Costs Per Container
1. Non-Handling Fee Recyclers	1.430¢	1.337¢	?
2. Handling Fee Recyclers	2.410¢	2.196¢	?

A second challenge for this cost survey is that CalRecycle must conduct consistent procedures and obtain reliable, reasonable, and rational results for traditional recyclers, for four beverage container material types, over a five-cost survey time series. Within any one time period, CalRecycle must obtain reasonable and consistent results across the beverage container material types. In addition, CalRecycle must conduct consistent procedures and obtain reliable, reasonable, and rational results between processing fee and handling fee recyclers, for the current processing fee and handling fee cost surveys, for beverage container costs to recycle. Finally, CalRecycle must conduct consistent procedures

and obtain reliable, reasonable, and rational results for costs per container to recycle across the 2007 and 2009 handling fee surveys, and the 2011 handling fee survey. **Table 15** and **Table 16**, above, illustrate these many and dynamic relationships, representing forty-six separate cost comparison calculations. **Table 17**, on the next page, illustrates the six key metrics CalRecycle and the contractor must obtain from the 2011 processing fee and handling fee cost surveys.

The processing fee and handling fee cost survey places a tremendous fiduciary responsibility on CalRecycle. Processing fees must be fair, equitable, accurate, and defensible. Handling fees must be fair, equitable, accurate,

and defensible. This upcoming cost survey will represent only the third time that the actual costs of non-handling fee recycling centers and handling fee recycling centers, on a per container basis, are directly compared.

This third combined processing fee and handling fee cost survey represents a quality and accuracy check on the first two processing fee and handling fee cost surveys. This will be an inherently risky endeavor. It will be critically important to apply a consistent methodology across both processing fee and handling fee surveys, and across 2007, 2009, and 2011 surveys, so that the resulting differences reflect actual cost differences. There will be no room for survey bias or methodological errors in this cost survey effort.

A third area of significant challenge relates to the evolving requirements for costs per ton for plastics #3 to #7 and bi-metal, and for costs per container. The 2009 processing fee cost survey was the last time that the survey was used to determine the actual costs to recycle minority materials (plastics #3 to #7 and bi-metal). SB 1357 (Padilla), enacted in 2008, requires CalRecycle to use results of the 2009 processing fee cost survey, adjusted by the percentage change in costs to recycle HDPE beverage containers from future cost surveys, for materials that make up less than five (5) percent of the total number of beverage containers returned for recycling. As the last column of **Table 18**, on the next page, illustrates, this change will apply to plastics #3 to #7, and bi-metal.⁷ Thus, the cost per ton to recycled HDPE determined in this 2011 processing fee cost survey will determine the costs per ton to recycle plastics #3 to #7 and bi-metal.

Table 17
Matrix of Processing Fee and Handling Fee Cost Survey Metrics

Metric Category	Non-Handling Fee Recyclers	Handling Fee Recyclers
Cost/Ton	4 material types	N/A
Cost/Container	1 combined for all material types	1 combined for all material types

At the same time, the volume of HDPE recycled has grown. While HDPE still makes up a small fraction of total recycling, HDPE volumes may be large enough that the costs of HDPE could be determined without use of the indirect cost allocation sub-models described previously. NewPoint Group recommends that CalRecycle utilize this 2011 cost survey to test whether the direct labor allocation approach can be utilized for HDPE. This will require additional Visual Basic programming within the labor allocation cost model during the survey start-up period. NewPoint Group has done such programming in the past, and is qualified to make the necessary cost model modifications.

Making these cost model changes for HDPE does not eliminate the need for the indirect allocation sub-models. The handling fee calculation requires that CalRecycle determine the cost per container for all containers recycled at a site, including the minority materials. To do so, NewPoint Group will utilize the labor allocation sub-models to determine costs for minority materials. These minority material costs and containers, while small, will contribute to the total CRV costs and containers needed to determine cost per container at any given site.

⁷ SB 1357 specifies that the DOR shall use the percentage change in costs of recycling HDPE, even if HDPE beverage containers are less than 5 percent of the total volume of returned containers.

Table 18
Beverage Containers Sold, Recycled, and Shares of Recycled, 2009

Type	Number Sold	Number Recycled	Recycling Rate	Percent of all Containers Recycled
1. Aluminum	9,200,376,864	8,354,269,499	90.8%	48.4%
2. Glass	3,131,130,270	2,519,321,210	80.5%	14.6%
3. PET #1	8,181,154,963	6,005,759,655	73.4%	34.8%
4. HDPE #2	333,773,107	363,460,377	108.9%*	2.1%
5. PVC #3	986,777	1,846	0.2%	0.00001%
6. LDPE #4	10,939,343	85,146	0.8%	0.0005%
7. PP #5	1,353,506	12,435	0.9%	0.0001%
8. PS #6	62,646,529	1,309,518	2.1%	0.01%
9. Other #7	37,945,726	2,998,099	7.9%	0.02%
10. Bi-metal	38,733,488	3,694,325	9.5%	0.02%
Total	20,999,040,573	17,250,912,110	82.2%	100%

*HDPE published recycling rate is greater than 100% due to reporting errors and other issues.

The 2011 survey is the first processing fee and handling fee cost survey that will be conducted under the new CalRecycle organization. While this alone should not present unique challenges to the survey, it is important to recognize that the beverage recycling program has been under scrutiny over the last few years. The State's budget crisis, economic crisis, proportional reductions, and audits by the Legislative Analyst's Office and Bureau of State Audits have put additional focus on this program.

Processing fees, processing payments, and handling fees were not among the program areas that were criticized in these recent reviews. These fees and payments represent mainstays of the beverage recycling program. With this current cost survey, it is more important than ever that the results be credible, fair, and accurate.

Determining accurate, defensible, and reliable costs to recycle is critical. This must be achieved within the context of a highly demanding logistical exercise. Meeting the 85 percent or higher

confidence level statistical requirement for six different recycling cost calculations within a maximum sample of 300 sites will be difficult. Furthermore, just the process of deploying well-trained survey teams across the State to conduct these 300 site visits between June and November, creates its own unique set of operational challenges.

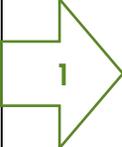
Just as in previous cost surveys, CalRecycle and its contractor must consider a number of key challenges related to processing fees in general, the processing fee cost survey, and the handling fee cost survey, in conducting the processing fee and handling fee cost surveys during 2011.

Exhibit 5, starting on the next page, illustrates many of these issues. The NewPoint Group team, with extensive experience with the AB 2020 program, processing fees, convenience zones, handling fees, survey sample design, recycler operations, recycling markets, the labor allocation model, and indirect cost allocation sub-models, looks forward to meeting the many challenges these issues present.

Exhibit 5

Selected 2011 Processing Fee/Handling Fee Cost Survey Key Challenges and Implications

Key Challenge	Implications for Processing Fee Cost Survey and/or Handling Fee Cost Survey
<p>In the first weeks of the project, determining the sample sizes for each of the two cost surveys that meet: (1) the statistical significance requirement of an 85 percent confidence level or higher, (2) the historical statistical significance of a 90 percent confidence level or higher, and (3) the maximum site constraint of 300, is a critical first step of the engagement. This step is a primary driver of the successful outcome of the entire 13-month effort.</p> <p>Implementing the processing fee cost survey will require a stratified random sample of approximately 120 non-handling fee recyclers. Implementing the handling fee cost survey will require two stratified random samples, one for non-handling fee recyclers of approximately 85 recyclers, and one for handling fee recyclers of approximately 105 recyclers. Of the two samples of 120 and 85 non-handling fee recyclers there will be some overlap resulting in approximately 195 unique non-handling fee recyclers. Therefore 195 non-handling fee recyclers plus 105 handling fee recyclers equals a total of 300 recyclers. The actual number of recyclers in the sample will depend on 2010 population characteristics and site overlaps. A larger population of recyclers in 2010 may increase the required sample size, while larger volumes of recycling may decrease the required sample size. Site closures may also impact the sample.</p>	<ul style="list-style-type: none"> ■ Our team recognizes that sample design and selection is the foundation of a successful cost survey effort. As soon as the contract is signed, the contractor must determine the ideal sampling scenario, determine the number of non-handling fee and handling fee recycling centers to be visited, and select the samples. The contractor must work closely with CalRecycle to finalize a sampling plan that maximizes statistical accuracy, given the number of sites to be visited. ■ NewPoint Group will develop a sampling strategy that accounts for site closures. When a closed recycling center is selected in one of the sample populations, NewPoint Group will identify whether the site owner is still available to meet and discuss the operation. Often, recycling center owners operate multiple sites, so that we may be able to obtain data for a closed site. Because the survey utilizes 2010 data, our preferred option will be to keep closed sites in the sample, as long as we can obtain accurate data. If not, we will select a new site from the random sample, using the original random sampling order. ■ NewPoint Group’s experienced management team will be ready to design and implement the sample methodology immediately after signing the contract. This will facilitate an earlier start to notifying recyclers in the sample, and to deploying the field survey teams.



<p>The results for the processing fee cost survey and handling fee cost survey must be reliable, reasonable, accurate and defensible across a minimum of thirty-eight different cost per ton estimates, and eight different cost per container estimates (see Tables 15 and 16).</p> <p>Not only must the results stand alone, but they must be reasonable within the historical time-series context of previous processing fee and handling fee cost surveys, and reasonable within the cross-walk between processing fee and handling fee cost surveys.</p>	<ul style="list-style-type: none"> ■ The contractor conducting the survey must be respected and seen as unbiased, experienced, and knowledgeable by all program stakeholders. ■ The contractor conducting the survey must carefully apply the same processes and procedures to the two survey populations. Non-handling fee recycling center site visits and calculations, and handling fee recycling center site visits and calculations, must be completed in exactly the same manner. ■ The extensive quality control procedures applied by NewPoint Group in the previous four cost surveys will be even more critical for this cost survey project. Each recycler site file must be carefully reviewed to determine that results are accurate, and that all data are validated throughout the cost survey process.
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Key Challenge	Implications for Processing Fee Cost Survey and/or Handling Fee Cost Survey
<p>This cost survey effort will require significant resources and management of complex logistics.</p> <p>Completing 300 cost survey site visits within eight-month timeframe (June through January) will be logistically challenging.</p> <p>Completing 300 accurate and defensible cost survey site visits within a eight-month timeframe will be technically challenging.</p> <p>This cost survey is starting at least two months later than previous cost surveys. However, CalRecycle is subject to the same December 15, 2010 statutory deadline for processing fee cost survey results.</p>	 <ul style="list-style-type: none"> ■ Conducting the cost survey requires both CalRecycle and contractor to work closely to coordinate and execute the many aspects of this project. With the current size of the cost survey, this coordination will be critically important. ■ CalRecycle must be able to rely on the contractor to aggressively implement the project work plan; to identify problems and recommend solutions as they arise; and to understand the tasks at hand. There will be no room for slack within this contract, and no tolerance for poorly executed site visits. Each of the 300 site visits is critically important to the success of this project. ■ The team must be efficient, but also thorough in conducting the cost surveys. NewPoint Group’s experienced team already has an appreciation of the cost survey methodology, and is ready to meet the logistical challenge. An efficient, experienced, and knowledgeable team, and an extensive quality control process, will ensure that the surveys are conducted correctly, and on time. ■ NewPoint Group developed a customized Site Status Reporting System for the 2009 cost survey that allowed project management to monitor the status and location of each recycler site file on any given day. This new tool, which we will utilize again in 2011, significantly enhanced our ability to track and manage the project.

Exhibit 5

Selected 2011 Processing Fee/Handling Fee Cost Survey Key Challenges and Implications (continued)

Key Challenge	Implications for Processing Fee Cost Survey and/or Handling Fee Cost Survey
<p>This processing fee and handling fee cost survey is a politically risky endeavor.</p> <p>The success of convenience zone recycling centers rests on the handling fee calculation.</p> <p>Because this cost survey will represent only the third time that handling fees have been calculated from actual costs, stakeholders will carefully scrutinize and compare the 2008 handling fee and the 2010 handling fee. The results of the current handling fee cost survey will reflect on the credibility of the contractor's and DOR/CalRecycle's current and previous efforts.</p> <p>Recyclers are still rebounding from the proportional reductions and program cutbacks of recent years. There will be more political focus on processing fees, processing payments, and handling fees.</p> <p>The beverage container recycling program has been under increased scrutiny in the last few years. It is important that this mainstay of the recycling program continue without controversy</p>	<div style="text-align: center; font-size: 2em; font-weight: bold; color: green;">4</div> <ul style="list-style-type: none"> ■ It is more important than ever that results of both surveys be accurate, defensible, and reliable. CalRecycle and program stakeholders must be confident that the new handling fees represent the actual cost differential. ■ The results of this third handling fee cost survey must seem reasonable in a historical context. DOR/CalRecycle (and NewPoint Group) have a long history of implementing processing fee cost surveys. As a result, cost per ton results between surveys provide a historical record that reflect long-term trends in materials handling. It will be important to apply the same consistency over time to the handling fee cost survey, so that cost per container changes over time represent real differences in handling costs, not aberrations due to an inconsistent survey methodology. ■ Execution of the handling fee cost survey must bring the same attention to detail and quality control as the processing fee cost survey. ■ The methodology, allowable costs, structure of the labor allocation interviews, and survey team approach must be identical for both surveys in order to ensure that differences in costs reflect actual differences, not survey bias. ■ The contractor must be available to explain and defend the handling fee cost survey results, processing fee cost survey results, and calculation of per container handling fees to program stakeholders. ■ The results of this cost survey must not be controversial. The results must be sound, defensible, and historically consistent. There is no room for error. NewPoint Group has the experience necessary for this job.

Key Challenge	Implications for Processing Fee Cost Survey and/or Handling Fee Cost Survey
<p>Recyclers participating in the cost survey must be comfortable, and confident in, the process.</p> <p>While recyclers benefit from the end results of cost surveys, the site visit process can be cumbersome for recyclers, and site visits are often viewed as an imposition.</p> <p>Recyclers are required to provide confidential financial information, and they must be confident that the contractor can be trusted.</p> <p>Recyclers that have been surveyed in the last few cost surveys may be suffering from survey fatigue, and be less cooperative.</p> <p>Recyclers that have been surveyed in the last few cost surveys may try to “game” the system to increase the cost of recycling.</p>	 <ul style="list-style-type: none"> ■ The contractor must be willing and able to work closely with recyclers, listen to their concerns, and be courteous and sensitive to recycler’s needs, language, and political and ethnic diversity. ■ The contractor must also be efficient and able to obtain all the necessary information while minimizing the imposition on the recycler. ■ The contractor should maintain a single contact person for recycler communications, such as for scheduling, questions, follow up, etc. NewPoint Group’s scheduling coordinator for this cost survey has successfully fulfilled this role in the last two cost surveys. She is extremely effective, and has established good communication with recyclers. ■ NewPoint Group has assisted the State with multiple cost surveys over the history of the program. During this time we have gained the trust of program recyclers, and proven our ability to safely maintain confidential information. ■ NewPoint Group does not take this trust for granted, and will enhance control measures to ensure that recycler data is not disclosed. ■ The contractor must also understand the nuances of the program, recycler operations, and recycler costing. NewPoint Group has the experience to take a critical look at recyclers’ books. This is not a simple accounting exercise, it is an economic study. Survey team members are trained to (politely) question recyclers to determine actual recycling-related costs. NewPoint Group has the field experience to question recyclers when necessary to ensure that data we are gathering are accurate, and are the appropriate data, but at the same time be sensitive to recyclers concerns.

Exhibit 5

Selected 2011 Processing Fee/Handling Fee Cost Survey Key Challenges and Implications (continued)

Key Challenge	6	Implications for Processing Fee Cost Survey and/or Handling Fee Cost Survey
<p>Cost information provided by the recycler is often unconventional.</p> <p>Many recyclers do not maintain thorough financial or operating records. Even with extensive training, surveyors are not always prepared for the complications that may occur during site visits.</p>		<ul style="list-style-type: none"> ■ A contractor with experience will be prepared for recycler site visit complications, and able to flexibly and creatively address complications as they arise. ■ Because the NewPoint Group team is experienced, we can spend more time in training discussing common complications to be expected during site visits, such as the many different, and unconventional, cost structures and labor arrangements that surveyors are likely to find in the field. Emphasizing a strong, hands-on approach speeds the learning curve for auditors. ■ The NewPoint Group cost survey team includes twenty members out of a total of 25 project staff who have prior experience with the cost surveys. ■ To speed the learning curve for those surveyors that will be new to cost surveys, NewPoint Group will again conduct a field trip component during training. The field trip will entail one or more site visits to Sacramento area recyclers to demonstrate actual cost survey practices, view recycler operations and equipment, and discuss potential site visit complications.
<p>Calculation of the cost per ton for HDPE will be particularly important in this cost survey, as it will determine the cost per ton for plastics #3 to #7 and bi-metal.</p> <p>The elimination of the requirement to determine the costs per ton for plastics #3 to #7 and bi-metal will reduce the number of sites to be surveyed in 2011. It will also increase focus on the HDPE cost per ton.</p>	7	<ul style="list-style-type: none"> ■ The contractor must utilize consistent methods to determine the cost to recycle HDPE as in previous cost surveys, and between material types. NewPoint Group will utilize the historical cost per ton calculation method for HDPE in the cost survey (i.e. the indirect labor allocation sub-model), but also calculate a cost per ton for HDPE utilizing direct labor interviews as a back-up method of determining HDPE costs.



Handout 2
**California Beverage Container Recycling
and Litter Reduction Act, Statutes,
Revised October 2010**

California Beverage Container Recycling & Litter Reduction Act

Revised October 2010



CalRecycle 

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REVISED EDITION

This publication has been prepared by the Department of Resources Recycling and Recovery and contains statutes implementing programs administered by its Division of Recycling. This revised edition contains code sections in effect March 8, 2010, and October 19, 2010. While every effort has been made to ensure accuracy, any errors or omissions do not negate the rights and duties of program participants. In addition, this edition does not correct grammatical or typographical errors that appear in the chaptered versions of the legislation amending Divisions 12.1, 12.7, and 12.9 of the Public Resources Code.

LEGEND:

Additions = underlined

Deletions = ~~strikeout~~

**PUBLIC RESOURCES CODE
DIVISION 12.1
CALIFORNIA BEVERAGE CONTAINER RECYCLING
AND LITTER REDUCTION ACT**

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PUBLIC RESOURCES CODE
DIVISION 12.1
**CALIFORNIA BEVERAGE CONTAINER RECYCLING
AND LITTER REDUCTION ACT**

(Division 12.1 was added by Chapter 1290 (AB 2020), Statutes of 1986; effective September 29, 1986)
AS AMENDED THROUGH 1/1/2011
(see annotations)

CHAPTER 1. FINDINGS

14500. This division shall be known and may be cited as the California Beverage Container Recycling and Litter Reduction Act.

14501. The Legislature finds and declares as follows:

(a) Experience in this state and others demonstrates that financial incentives and convenient return systems ensure the efficient and large-scale recycling of beverage containers. Accordingly, it is the intent of the Legislature to encourage increased, and more convenient, beverage container redemption opportunities for all consumers. These redemption opportunities shall consist of dealer and other shopping center locations, independent and industry operated recycling centers, curbside programs, and other recycling systems that assure all consumers, in every region of the state, the opportunity to return beverage containers conveniently, efficiently, and economically.

(b) California grocery, beer, soft drink, container manufacturing, labor, agricultural, consumer, environmental, government, citizen, recreational, taxpayer, and recycling groups have joined together in calling for an innovative program to generate large-scale redemption and recycling of beverage containers.

(c) This division establishes a beverage container recycling goal of 80 percent.

(d) It is the intent of the Legislature to ensure that every container type proves its own recyclability.

(e) It is the intent of the Legislature to make redemption and recycling convenient to consumers, and the Legislature hereby urges cities and counties, when exercising their zoning authority, to act favorably on the siting of multimaterial recycling centers, reverse vending machines, mobile recycling units, or other types of recycling opportunities, as necessary for consumer convenience, and the overall success of litter abatement and beverage container recycling in the state.

(f) The purpose of this division is to create and maintain a marketplace where it is profitable to establish sufficient recycling centers and locations to provide consumers with convenient recycling opportunities through the establishment of minimum refund values and processing fees and, through the proper application of these elements, to enhance the profitability of recycling centers, recycling locations, and other beverage container recycling programs.

(g) The responsibility to provide convenient, efficient, and economical redemption opportunities rests jointly with manufacturers, distributors, dealers, recyclers, processors, and the Department of Conservation.

CHAPTER 1. FINDINGS

(h) It is the intent of the Legislature, in enacting this division, that all empty beverage containers redeemed shall be recycled, and that the responsibilities and regulations of the department shall be determined and implemented in a manner that favors the recycling of redeemed containers, as opposed to their disposal.

(i) Nothing in this division shall be interpreted as affecting the current business practices of scrap dealers or recycling centers, except that, to the extent they function as a recycling center or processor, they shall do so in accordance with this division.

(j) The program established by this division will contribute significantly to the reduction of the beverage container component of litter in this state.

14501.5. This division does not apply to any beverage container which is sold and delivered to a railroad, sleeping car, or steamship company, or common carrier operating vessels, as defined in Section 238 of the Public Utilities Code, operating under a certificate of public convenience and necessity, or an air common carrier, for use and consumption on trains, vessels, or airplanes.

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14502. Unless the context otherwise requires, the definitions in this chapter govern the construction of this division.

14503. "Aluminum beverage container" means a beverage container which consists primarily of aluminum.

14503.5. "Average monthly volume" means the average number of empty beverage containers per month received by a certified recycling center.

14503.6. "Beneficiating processor" means any person certified by the department as a processor who also beneficiates purchased cullet so that it is furnace ready for glass container manufacturers, consistent with prevailing standards in the manufacturing industry. Cullet shall be deemed furnace ready when it has been cleansed, is free of nonglass contaminants, and has been crushed or otherwise processed in such a manner as to be acceptable without further processing by the purchasing glass container manufacturer.

14504. (a) Except as provided in subdivision (b), "beverage" means any of the following products if those products are in liquid, ready-to-drink form, and are intended for human consumption:

- (1) Beer and other malt beverages.
- (2) Wine and distilled spirit coolers.
- (3) Carbonated water, including soda and carbonated mineral water.
- (4) Noncarbonated water, including noncarbonated mineral water.
- (5) Carbonated soft drinks.
- (6) Noncarbonated soft drinks and "sport" drinks.
- (7) Except as provided in paragraph (4) of subdivision (b), noncarbonated fruit

drinks that contain any percentage of fruit juice.

- (8) Coffee and tea drinks.
- (9) Carbonated fruit drinks.

(10) Vegetable juice in beverage containers of 16 ounces or less.

(b) "Beverage" does not include any of the following:

(1) Any product sold in a container that is not an aluminum beverage container, a glass container, a plastic beverage container, or a bimetal container.

(2) Wine, or wine from which alcohol has been removed, in whole or in part, whether or not sparkling or carbonated.

(3) Milk, medical food, or infant formula.

(4) One hundred percent fruit juice in containers that are 46 ounces or more in volume.

(c) For purposes of this section, the following definitions shall apply:

(1) "Infant formula" means any liquid food described or sold as an alternative for human milk for the feeding of infants.

(2)(A) "Medical food" means a food or beverage that is formulated to be consumed, or administered enterally under the supervision of a physician, and that is intended for specific dietary management of diseases or health conditions for which distinctive nutritional requirements, based on recognized scientific principles, are established by medical evaluation.

(B) A "medical food" is a specially formulated and processed product, for the partial or exclusive feeding of a patient by means of oral intake or enteral feeding by

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tube, and is not a naturally occurring foodstuff used in its natural state.

(C) "Medical food" includes any product that meets the definition of "medical food" in the federal Food, Drug, and Cosmetic Act (21 U.S.C. Sec. 360ee (b)(3)).

(3) "Noncarbonated soft drink" means a nonalcoholic, noncarbonated naturally or artificially flavored water containing sugar or sweetener or trace amounts of various elements from both natural and synthetic sources.

14505. "Beverage container" means the individual, separate bottle, can, jar, carton, or other receptacle, however denominated, in which a beverage is sold, and which is constructed of metal, glass, or plastic, or other material, or any combination of these materials. "Beverage container" does not include cups or other similar open or loosely sealed receptacles.

14506. "Beverage manufacturer" means any person who bottles, cans, or otherwise fills beverage containers, or imports filled beverage containers, for sale to distributors, dealers, or consumers.

14506.3. "Bimetal container" means a beverage container which consists of one or more metals and which is composed primarily of steel.

14506.5. "Commingled" means a mix of empty beverage containers, as defined in Section 14512, and all other containers of the same material type.

14506.7. "Commingled rate" means the ratio of empty beverage containers, as defined in Section 14512, to all other containers, of the same material type, as determined by the department.

14507.5. (a) "Community Conservation Corps" means a nonprofit public benefit corporation formed or operating pursuant to Part 2 (commencing with Section 5110) of

Division 2 of Title 1 of the Corporations Code, or an agency operated by a city, county, or city and county, that is certified by the California Conservation Corps as meeting all of the following criteria:

(1) The corps is organized in the form of supervised work crews and selects young men and women for participation on the basis of motivation for hard work, personal development, and public service, without regard to their prior employment or educational background, and consistent with Section 14402. Participation shall be for a period of one year, and may be extended.

(2) The corps' program is based upon a highly disciplined work experience, includes an educational component, and is designed to develop corpsmembers' character and civic consciousness through rigorous work on public projects. The educational component of the corps' program includes enrollment in a vocational education program, public or charter high school, or postsecondary community college.

(3) The corps compensates corpsmembers at not less than the federal minimum wage, and provides corpsmembers assistance in obtaining permanent employment following their participation in the corps program.

(4) The corps engages in recycling and litter abatement projects as well as projects that accomplish the conservationist and other purposes described in subdivisions (a) to (h), inclusive, of Section 14300, and that assist agencies of local government and other nonprofit community organizations in developing, rehabilitating, and restoring parklands, recreational facilities, and other community resources.

(5) The corps consists of an average annual enrollment of not less than 50 corpsmembers between 18 and 25 years of age. In determining the average annual

enrollment of a community conservation corps for the purposes of subdivision (a) of Section 14581, the California Conservation Corps shall not include special corpsmembers, as described in Section 14303, who are employed by a community conservation corps.

(b) The California Conservation Corps shall evaluate a community conservation corps for the purpose of determining its eligibility for certification, pursuant to this section, after it has completed 12 months of continuous operation, and annually thereafter.

14508. “Consumer” means every person who, for his or her use or consumption, purchases a beverage in a beverage container from a dealer. “Consumer” includes, but is not limited to, a lodging, eating, or drinking establishment, and soft drink vending machines.

14509. “Container manufacturer” means any person who produces beverage containers for filling by beverage manufacturers, including any person who imports these beverage containers from outside of this state for filling by beverage manufacturers.

14509.3. “Cullet” means scrap glass that is derived from postfilled food, drink, or beverage container glass produced or imported for sale in the state.

14509.4. “Convenience zone” means either of the following:

(a) The area within a one-half mile radius of a supermarket.

(b) The area designated by the department pursuant to Section 14571.5.

14509.5. “Curbside program” means a recycling program which meets all of the following criteria:

(a) The program picks up empty beverage containers from individual or

multiple family residences, or both, and the empty beverage containers are separated from waste materials prior to being picked up.

(b) The program is operated by, or pursuant to a contract with, a city, county, or other public agency, or is acknowledged, in writing, by a city, county, or other public agency.

(c) The program accepts empty beverage containers from consumers with the intent to recycle them, but does not pay the refund value.

14510. “Dealer” means a retail establishment which offers the sale of beverages in beverage containers to consumers. However, any lodging, eating, or drinking establishment, or soft drink vending machine operator who engages in the sale of beverages in beverage containers to consumers shall not be deemed a dealer for the purposes of this division, except that these sales are subject to Section 14560. To determine which retail establishments are dealers, the department shall use annual or more frequent updates provided by American Business Information, Inc., as long as the information provided by American Business Information, Inc., is updated at least annually.

14510.5. “Department” means the Division of Recycling in the Department of Resources Recycling and Recovery.

14510.6. “Director” means the Director of Resources Recycling and Recovery.

14511. “Distributor” means every person who engages in the sale of beverages in beverage containers to a dealer in this state, including any manufacturer who engages in these sales. “Distributor” includes any person who imports beverages from outside of this state for sale to dealers or consumers in this state.

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14511.5. “Drink” means fruit juice or any other noncarbonated drink.

14511.7. “Dropoff or collection program” means any person, association, nonprofit corporation, church, club, or other organization certified by the department, and that accepts or collects empty beverage containers from consumers with the intention to recycle them, or any waste reduction facility that separates beverage containers from the waste stream with the intent to recycle them. “Dropoff or collection program” does not include a certified recycling center or curbside program.

14512. “Empty beverage container” means a beverage container which meets all of the following requirements:

(a) Has the seal or closure installed by the manufacturer broken or removed.

(b) Does not contain foreign materials other than the residue of the beverage originally packaged in the beverage container by the manufacturer.

(c) Bears the message required by Section 14561, or is a refillable beverage container.

(d) Has a refund value established pursuant to Section 14560.

14512.5. “Food or drink packaging material” means any material which is not a beverage container in which a food or drink is sold in a retail establishment and the food or drink is not intended for consumption on the seller’s premises.

14512.6. “For recycling” means that an empty beverage container has been received by a processor who has an arrangement whereby that container will actually be recycled.

14512.7. “Fund” means the California Beverage Container Recycling Fund

established pursuant to subdivision (a) of Section 14580.

14513. “Glass beverage container” means a beverage container which has a body consisting primarily of glass.

14513.2. (a) Except as provided under Section 14549, “glass container manufacturer” means a person who manufactures commercial containers, whose principal component part or parts consist of virgin glass, postfilled glass, or any combination of both, for sale in California or for export to other states or countries.

(b) “Glass container manufacturer” includes, but is not limited to, all commercial manufacturing operations which produce beverage containers, food or drink packaging material made primarily of glass, or any combination of both of those items. For beer and other malt beverages manufactured outside the state, the container manufacturer shall be deemed to be the person or entity named on the certificate of compliance issued pursuant to Section 23671 of the Business and Professions Code.

14513.3. “Glass food or drink container” means any nonbeverage container, whose principal component part or parts consist of virgin glass, postfilled glass, or any combination of both, in which any food or drink is sold or offered for sale in California.

14513.4. “Handling fee” means an amount paid to an operator of a supermarket site, a rural region recycler, as defined in Section 14525.5.1, or a nonprofit convenience zone recycler, as defined in Section 14514.7, that is located in a convenience zone for every beverage container redeemed by the operator at the supermarket or within the zone in which the supermarket site is located, by the rural region recycler, or by the nonprofit convenience zone recycler.

14513.5. "HDPE" means a plastic beverage container labeled with a "2" for high-density-polyethylene resin pursuant to Section 18015 and subject to this division.

14514. "Managing employee" includes, but is not limited to, any person who manages the operation of a facility or is authorized by the certified operator to sign shipping reports.

14514.4.1. "Neighborhood dropoff program" means a recycling program which meets all of the following criteria:

(a) The program is certified by the department as a dropoff or collection program, as defined by Section 14511.7.

(b) The program has been designated by a city, county, or city and county to provide a recycling opportunity in residential neighborhoods specified by the city, county, or city and county.

(c) The program is located in a rural region, as identified pursuant to subparagraph (A) of paragraph (2) of subdivision (b) of Section 14571.

14514.6. "Not for recycling" means that an empty beverage container has been received by a processor who does not have an arrangement whereby that container will actually be recycled.

14514.7. "Nonprofit convenience zone recycler" means a recycling center that meets the criteria described in subdivision (a) or (b):

(a) The recycling center is all of the following:

(1) Operated by an organization established under Section 501(c) or 501 (d) of Title 26 of the United States Code.

(2) Certified by the department pursuant to Section 14538.

(3) Located within a convenience zone, but is not necessarily a supermarket site.

(b) The recycling center is all of the following:

(1) Operated by an organization established under Section 501(c) or 501(d) of Title 26 of the United States Code and has operated in the same location for a period of not less than five years.

(2) Certified by the department pursuant to Section 14538.

(3) Located within one mile of a supermarket that is in a convenience zone that is exempt from the requirements of subdivision (a) of Section 14571.

14515. "Other beverage container" means a beverage container which has a body consisting of metal, glass, plastic, other materials, or a combination of these, but which is not an aluminum, bimetal, glass, or plastic beverage container.

14515.1. "Out-of-state container" means a used beverage container or used beverage container component that is not subject to Section 14560, and that is brought into this state.

14515.5. "PET container" means a plastic beverage container labeled with a "1" pursuant to Section 18015 and subject to this division.

14515.6. "Physical recycling location" means the area in a convenience zone served by one or more reverse vending machines which accept all empty aluminum, glass, and plastic beverage containers and issue a cash refund or a redeemable credit slip and are located within 10 feet of each other. The physical recycling location shall redeem odd sized empty beverage containers or empty beverage containers made from other material types in a manner approved by the department. "Physical recycling location" does not include a combination of reverse vending machines which accept less than all

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empty aluminum, glass, and plastic beverage containers and one or more dropoff bins.

14516. “Place of business of the dealer” means the location at which a dealer sells, or offers for sale, beverages in beverage containers to consumers.

14517. “Plastic beverage container” means a beverage container which has a body consisting primarily of plastic.

14517.5. “Postfilled container” means any container which had been previously filled with a beverage or food.

14518. “Processor” means any person, including a scrap dealer, certified by the department who purchases empty aluminum beverage containers, bimetal beverage containers, glass beverage containers, plastic beverage containers, or any other beverage containers, including any one or more of those beverage containers, which have a refund value established pursuant to this division, from recycling centers in this state for recycling, or, if the container is not recyclable, not for recycling, and who cancels, or who certifies to the department in a form prescribed by the department the cancellation of, the refund value of these empty beverage containers by processing empty beverage containers, in any manner which the department may prescribe. However, the department shall not take any action regulating scrap dealers or recycling centers who are processors or recycling centers unless authorized by and pursuant to the goals of this division.

14518.4. “Processing fee” means the amount paid by beverage manufacturers to the department pursuant to Section 14575.

14518.5. “Processing payment” means an amount paid to processors, dropoff or collection programs, curbside programs, and recycling centers by the department pursuant to subdivision (a) of Section 14573 and subdivision (a) of Section 14573.5 when the

department determines that the scrap value being offered by container manufacturers, beverage manufacturers, or willing purchasers for a particular container material is insufficient to insure the economic recovery of the container type at the minimum number of recycling centers or locations required pursuant to Section 14571. The processing payment shall be determined by the department pursuant to Section 14575.

14519. “Recycle,” “recycled,” “recycling,” or “recyclable” means the reuse or refilling of empty beverage containers, or the process of sorting, cleansing, treating, and reconstituting empty postfilled beverage containers for the purpose of using the altered form. “Recycle,” “recycled,” “recycling”, or “recyclable” does not include merely sorting, shredding, stripping, compressing, storing, landfilling with, or disposing of an empty beverage container.

14519.5. “Recycler” means a recycling center, dropoff or collection program, or curbside program.

14520. “Recycling center” means an operation which is certified by the department and which accepts from consumers, and pays or provides the refund value pursuant to Section 14572 for, empty beverage containers intended to be recycled.

14520.5. “Recycling location” means a place, mobile unit, reverse vending machine, or other device where a certified recycling center accepts one or more types of empty beverage containers from consumers, and pays or provides the refund value for one or more types of empty beverage containers.

14520.6. “Noncertified recycler” means a person, entity, or operation which is not certified by the department and which purchases empty beverage containers from consumers, or from dropoff or collection programs.

14521. “Recycling rate” means the proportion of empty beverage containers by type returned to processors for recycling, measured in the manner prescribed in Section 14551.

14522.5. “Redemption” and “redeem” means the return to a recycling center or location of an empty beverage container for a refund of at least the refund value.

14523. “Redemption payment” means the minimum amount paid by a distributor to the department for every beverage container sold or transferred to a dealer.

14523.5. “Redemption rate” means the proportion of empty beverage containers returned to processors measured in the manner prescribed in Section 14551.

14524. “Refund value” means the amount established for each type of beverage container pursuant to Section 14560 that is paid by the following:

(a) A certified recycling center to the consumer or dropoff or collection center for each beverage container redeemed by the consumer or dropoff or collection center. With respect to consumers returning containers to recycling centers, the refund value shall not be subject to tax under the Personal Income Tax Law (Part 10 (commencing with Section 17001) of Division 2 of the Revenue and Taxation Code) or the Corporation Tax Law (Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code).

(b) A processor to a certified recycling center, dropoff or collection program, or curbside program, for each beverage container received from the certified recycling center, dropoff or collection program, or curbside program.

(c) The department to a processor, for each beverage container received by the

processor from a certified recycling center, curbside program, or dropoff or collection program.

14525. “Refillable beverage container” means any aluminum beverage container, bimetal beverage container, glass beverage container, plastic beverage container, or other beverage container, holding 150 fluid ounces or less of beverage, which has a minimum deposit of three cents (\$ 0.03), and which ordinarily would be returned to the manufacturer to be refilled and resold.

14525.5. “Reverse vending machine” means a mechanical device which accepts one or more types of empty beverage containers and issues a cash refund or a redeemable credit slip with a value not less than the container’s refund value. The refund value payments shall be aggregated and then paid, if more than one container is redeemed in a single transaction.

14525.5.1. “Rural region recycler” means an operator that is certified pursuant to subparagraph (A) of paragraph (2) of subdivision (b) of Section 14571, and who accepts or collects empty beverage containers from consumers pursuant to Section 14572 with the intention to recycle them.

14526. “Scrap value” means the price paid for container material types subject to this division, after shipping and handling costs are deducted.

14526.5. “Supermarket” means a full-line, self-service retail store with gross annual sales of two million dollars (\$2,000,000), or more, and which sells a line of dry grocery, canned goods, or nonfood items and some perishable items. For purposes of determining which dealers are supermarkets, the department shall use the annual updates of the Progressive Grocer Marketing Guidebook and any computer

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printouts developed in conjunction with the guidebook.

14526.6. “Supermarket site” means any certified recycling center which redeems all types of empty beverage containers in accordance with Section 14572, and which is located within, or outside and immediately adjacent to the entrance of, or at, or within a parking lot or loading area surrounding, a supermarket which is the focal point of a convenience zone, or a dealer that is located within that zone, and which is accessible to motor traffic.

14527. “Use or consumption” includes the exercise of any right or power over a beverage incidental to the beverage’s ownership, including, but not limited to, drinking the beverage. “Use or consumption” does not include the sale, or the keeping or retention, of a beverage for the purposes of sale.

14528. “Universal product code” is an 11-digit, all-numeric code that represents a beverage container or other consumer package of a particular brand, size, type, and manufacturer by using a series of alternating bars and spaces for electronic scanning.

14528.1. “Voluntary artificial scrap value” means a price paid by a willing purchaser of empty PET containers, that reflects the payment of the scrap value for all PET containers sold, and that, when combined with payments made from the PET processing fee account pursuant to clause (ii) of subparagraph (A) of paragraph (6) of subdivision (a) of Section 14581, is equal to, or more than, the recycling cost for empty PET containers, as determined in subdivision (d) of Section 14575.

14528.5. “Wine and distilled spirit cooler” means a beverage containing wine or distilled spirits to which is added concentrated or unconcentrated juice or

flavoring material and containing not more than 7 percent alcohol by volume.

14529. This division is a matter of statewide interest and concern and is applicable uniformly throughout the state. Accordingly, this division occupies the whole field of regulation of recycling-related refund values, redemption payments, deposits, and similar fees relating to beverage containers, as provided in this division, and to containers of wine and distilled spirits products. No city, county, or other public agency may enforce or implement any existing or new ordinance, resolution, regulation, or rule establishing recycling-related refund values or redemption payments, deposits, or similar fees relating to these containers in the state unless expressly authorized by this division. If a federal law is enacted which establishes recycling-related refund values, redemption payments, deposits, and similar fees, relating to beverage containers, other than a federal law only affecting federal lands, or if a state law is enacted by initiative, which establishes recycling-related refund values, redemption payments, deposits, and similar fees relating to beverage containers, this division shall become inoperative. This section does not prohibit the implementation or enforcement of any ordinance or regulation governing curbside or dropoff recycling programs operated by, or pursuant to a contract with, a city, county, or other public agency, including actions relating to fees, or establishing fees, for these programs.

14529.5. Any action to increase recycling taken by the department, or by any person or entity, affecting scrap values, the quantities of materials being recycled, or the method of invoicing the sale of beverages pursuant to this division is not a violation of the Cartwright Act (Chapter 2 (commencing

with Section 16700) of Part 2 of Division 7 of the Business and Professions Code) and the Unfair Practices Act (Chapter 4 (commencing with Section 17000) of Part 2 of Division 7 of the Business and Professions Code). This section does not apply to any action taken by a recycling center to increase the recycling of beverage containers.

14529.7. (a) Except as provided in subdivision (b), this division does not apply to any program involving the collection and payment of deposits for beverage containers sold, used, or consumed at national parks and monuments, military installations, or any other property owned by and under the jurisdiction of the United States.

(b) To the extent permitted by federal law, this division, including, but not limited to, Section 14560.5, shall apply to a national park or monument, military installation, or

any other property owned by, and under the jurisdiction of, the United States, with regard to a beverage container not otherwise subject to a program involving the collection and payment of deposits for beverage containers.

(c) For purposes of this section, "a program involving the collection and payment of deposits" means a program, other than one imposed pursuant to this division, at a national park or monument, military installation, or any other property owned by, and under the jurisdiction of, the United States, that imposes a deposit on a beverage container at the time of sale and provides an opportunity for the beverage container purchaser to redeem the deposit at the national park or monument, military installation, or other property owned by, and under the jurisdiction of, the United States.

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CHAPTER 3. ADMINISTRATION

14530. This division shall be administered by the department. Notwithstanding Section 607, the department may, for organizational purposes, create a new division, bureau, or office to administer this division. If a new division, bureau, or office is created, any reference to “department” or “director” in this division shall be deemed to be a reference to that entity and the officer in charge of that entity.

14530.1. There is hereby created within the department a recycling financial analysis and policy development unit, to develop, analyze, consolidate, and evaluate economic and policy proposals to carry out the objectives of this division, including, but not limited to, all of the following:

(a) Evaluate the solvency of the fund on an ongoing basis in order to make recommendations and report to the Legislature.

(b) Identify the fiscal impacts of proposed recycling programs, or changes to existing recycling programs.

(c) Assess the economic impacts of recycling proposals and programs on the state’s citizens and businesses, including the impact of adding new container types into existing law.

(d) Develop recommendations to better integrate the various recycling alternatives available from state government, local government and private industry with the objective of reducing recycling costs to citizens and businesses and meeting the 80-percent recycling goal established by this division.

14530.2. The Division of Recycling shall be administered by an assistant director who is appointed by the Governor. The

appointment shall be exempt from civil service.

14530.5. (a) For purposes of entering into contracts for consulting, promotional, or advisory services necessary to implement this division, the requirements of Sections 11042 and 14615 of the Government Code and Sections 10295 and 10318 of the Public Contract Code do not apply to the activities of the department pursuant to this division, except that any sole source contract awarded by the department shall be reviewed and approved by the Department of General Services.

(b) In addition to any regulations which the department is required by statute to adopt, the department may adopt any other rules and regulations pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code which the department determines may be necessary or useful to carry out this division or any of the department’s duties or responsibilities imposed pursuant to this division.

(c) The department may prepare, publish, and issue printed pamphlets, promotional materials, and bulletins which the director determines to be necessary for the dissemination of information to the public concerning the activities of the department pursuant to this division.

14530.6. Upon the request of the department, the Attorney General shall represent the department and the state in litigation concerning affairs of the department.

14536. (a) Except as provided in subdivision (b), the director shall adopt, amend, or repeal all rules and regulations in accordance with Chapter 3.5 (commencing

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with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

(b)(1) The director shall adopt regulations, and may adopt emergency regulations for the purposes of implementing Sections 14538, 14539, 14541, 14549.1, 14549.2, 14549.7, 14550, 14561, 14574, 14575, 14585, 14588.1, 14588.2, and 14591.

(2) Any emergency regulations, if adopted, shall be adopted in accordance with Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, and for the purposes of that chapter, including Section 11349.6 of the Government Code, the adoption of these regulations is an emergency and shall be considered by the Office of Administrative Law as necessary for the immediate preservation of the public peace, health and safety, and general welfare.

Notwithstanding Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, including subdivision (e) of Section 11346.1 of the Government Code, any emergency regulations adopted pursuant to this section shall be filed with, but not be repealed by, the Office of Administrative Law and shall remain in effect until revised by the director.

14536.1. Notwithstanding Section 14536, if the department determines that it is necessary to adopt or amend regulations to implement Section 14575, the department may adopt or amend those regulations as emergency regulations. The Office of Administrative Law shall consider those regulations to be necessary for the immediate preservation of the public peace, health and safety, and general welfare for purposes of Section 11349.6 of the Government Code. Notwithstanding subdivision (e) of Section 11346.1 of the Government Code, the emergency regulations adopted or amended pursuant to

this section shall be repealed 180 days after the effective date of the regulations, unless the department complies with Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

14536.5. (a) In carrying out the division, the department may solicit and use all expertise available in other state agencies and where an existing state agency performs functions of a similar nature to the department's functions, the department may contract with, or cooperate with, the agency in carrying out this division.

(b) Notwithstanding subdivision (a), the Department of Food and Agriculture may, as requested by the department, collect, compile, and report information regarding the importation of filled or postfilled beverage containers. Border agricultural inspection stations and any other appropriate information gathering focal points may be used and the plant quarantine officers and supervisors of the Department of Food and Agriculture shall collect, compile, and report information requested by the department pursuant to this subdivision. Recovery of costs incurred by the Department of Food and Agriculture shall be accomplished through an interagency agreement with the department.

14537. The department shall keep accurate books, records, and accounts of all of its dealings, and these books, records, and accounts are subject to an annual audit by an auditing firm selected by the department. The auditing firm or the department shall also conduct a selective audit of entities making payments to, or receiving payments from, the department to determine whether redemption payments and applicable processing fees are being paid to the department on all beverage containers sold in California, and that refund values and

processing payments are being paid out properly by the department.

14538. (a) The department shall certify the operators of recycling centers pursuant to this section. The director shall adopt, by regulation, a procedure for the certification of recycling centers, including standards and requirements for certification. These regulations shall require that all information be submitted to the department under penalty of perjury. A recycling center shall meet all of the standards and requirements contained in the regulations for certification. The regulations shall require, but shall not be limited to requiring, that all of the following conditions be met for certification:

(1) The operator of the recycling center demonstrates, to the satisfaction of the department, that the operator will operate in accordance with this division.

(2) If one or more certified entities have operated at the same location within the past five years, the operations at the location of the recycling center exhibit, to the satisfaction of the department, a pattern of operation in compliance with the requirements of this division and regulations adopted pursuant to this division.

(3) The operator of the recycling center notifies the department promptly of any material change in the nature of his or her operations which conflicts with information submitted in the operator's application for certification.

(b) A certified recycling center shall comply with all of the following requirements for operation:

(1) The operator of the recycling center shall not pay a refund value for, or receive a refund value from any processor for, any food or drink packaging material or any beverage container or other product that

does not have a refund value established pursuant to Section 14560.

(2) The operator of a recycling center shall take those actions that satisfy the department to prevent the payment of a refund value for any food or drink packaging material or any beverage container or other product that does not have a refund value established pursuant to Section 14560.

(3) Unless exempted pursuant to subdivision (b) of Section 14572, a certified recycling center shall accept, and pay at least the refund value for, all empty beverage containers, regardless of type.

(4) A certified recycling center shall not pay any refund values, processing payments, or administrative fees to a noncertified recycler.

(5) A certified recycling center shall not pay any refund values, processing payments, or administrative fees on empty beverage containers or other containers that the certified recycling center knew, or should have known, were coming into the state from out of the state.

(6) A certified recycling center shall not claim refund values, processing payments, or administrative fees on empty beverage containers that the certified recycling center knew, or should have known, were received from noncertified recyclers or on beverage containers that the certified recycling center knew, or should have known, come from out of the state.

(7) A certified recycling center shall prepare and maintain the following documents involving empty beverage containers, as specified by the department by regulation:

(A) Shipping reports that are required to be prepared by the recycling center, or that

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are required to be obtained from other recycling centers.

(B) Consumer transaction receipts.

(C) Consumer transaction logs.

(D) Rejected container receipts on materials subject to this division.

(E) Receipts for transactions with beverage manufacturers on materials subject to this division.

(F) Receipts for transactions with beverage distributors on materials subject to this division.

(G) Documents authorizing the recycling center to cancel empty beverage containers.

(H) Weight tickets.

(8) In addition to the requirements of paragraph (7), a certified recycling center shall cooperate with the department and make available its records of scrap transactions when the review of these records is necessary for an audit or investigation by the department.

(c) The department may recover, in restitution pursuant to paragraph (5) of subdivision (c) of Section 14591.2, payments made from the fund to the certified recycling center pursuant to Section 14573.5 that are based on the documents specified in paragraph (7), that are not prepared or maintained in compliance with the department's regulations, and that do not allow the department to verify claims for program payments.

(d) The department may certify a recycling center that will operate less than 30 hours a week, as specified in paragraph (2) of subdivision (b) of Section 14571.

14539. (a) The department shall certify processors pursuant to this section. The director shall adopt, by regulation, requirements and standards for certification.

The regulations shall require, but shall not be limited to requiring, that all of the following conditions be met for certification:

(1) The processor demonstrates to the satisfaction of the department that the processor will operate in accordance with this division.

(2) If one or more certified entities have operated at the same location within the past five years, the operations at the location of the processor exhibit, to the satisfaction of the department, a pattern of operation in compliance with the requirements of this division and regulations adopted pursuant to this division.

(3) The processor notifies the department promptly of any material change in the nature of the processor's operations that conflicts with the information submitted in the operator's application for certification.

(b) A certified processor shall comply with all of the following requirements for operation:

(1) The processor shall not pay a refund value for, or receive a refund value from the department for, any food or drink packaging material or any beverage container or other product that does not have a refund value established pursuant to Section 14560.

(2) The processor shall take those actions that satisfy the department to prevent the payment of a refund value for any food or drink packaging material or any beverage container or other product that does not have a refund value established pursuant to Section 14560.

(3) Unless exempted pursuant to subdivision (b) of Section 14572, the processor shall accept, and pay at least the refund value for, all empty beverage containers, regardless of type, for which the processor is certified.

(4) A processor shall not pay any refund values, processing payments, or administrative fees to a noncertified recycler. A processor may pay refund values, processing payments, or administrative fees to any entity that is identified by the department on its list of certified recycling centers.

(5) A processor shall not pay any refund values, processing payments, or administrative fees on empty beverage containers or other containers that the processor knew, or should have known, were coming into the state from out of the state.

(6) A processor shall not claim refund values, processing payments, or administrative fees on empty beverage containers that the processor knew, or should have known, were received from noncertified recyclers or on beverage containers that the processor knew, or should have known, come from out of the state. A processor may claim refund values, processing payments, or administrative fees on any empty beverage container that does not come from out of the state and that is received from any entity that is identified by the department on its list of certified recycling centers.

(7) A processor shall take the actions necessary and approved by the department to cancel containers to render them unfit for redemption.

(8) A processor shall prepare or maintain the following documents involving empty beverage containers, as specified by the department by regulation:

(A) Shipping reports that are required to be prepared by the processor or that are required to be obtained from recycling centers.

(B) Processor invoice reports.

(C) Cancellation verification documents.

(D) Documents authorizing recycling centers to cancel empty beverage containers.

(E) Processor-to-processor transaction receipts.

(F) Rejected container receipts on materials subject to this division.

(G) Receipts for transactions with beverage manufacturers on materials subject to this division.

(H) Receipts for transactions with distributors on materials subject to this division.

(I) Weight tickets.

(9) In addition to the requirements of paragraph (7), a processor shall cooperate with the department and make available its records of scrap transactions when the review of these records is necessary for an audit or investigation by the department.

(c) The department may recover, in restitution pursuant to paragraph (5) of subdivision (c) of Section 14591.2, any payments made by the department to the processor pursuant to Section 14573 that are based on the documents specified in paragraph (8), of subdivision (b) of this section that are not prepared or maintained in compliance with the department's regulations, and that do not allow the department to verify claims for program payments.

14539.5. (a) The department shall certify dropoff and collection programs pursuant to this section. The director shall adopt, by regulation, requirements and standards for certification and a dropoff or collection program shall meet all the standards and requirements contained in the regulations for certification. The regulations shall require that all information be submitted to the department under penalty of perjury. The

regulations shall require, in addition to any other conditions that may be imposed by the department, that both of the following conditions be met for certification:

(1) The dropoff or collection program demonstrates, to the satisfaction of the department, that the dropoff or collection program will operate in accordance with this division.

(2) The dropoff or collection program notifies the department promptly of any material change in the nature of its operations that conflicts with the information submitted in the application for certification.

(b) A certified dropoff or collection program shall not receive any refund value or processing payment on an empty beverage container that the certified dropoff or collection program knew, or should have known, was received from a noncertified recycler, on any beverage container that the certified dropoff or collection program knew or should have known came from out of this state, or any other beverage container or other product that does not have a refund value established pursuant to Section 14560.

(c) The department may recover, in restitution pursuant to paragraph (5) of subdivision (c) of Section 14591.2, any payment made from the fund to a dropoff or collection program pursuant to Section 14573.5 that is based on a document that is not prepared or maintained in compliance with any applicable recordkeeping requirements required pursuant to this division or the department's regulations and that does not allow the department to verify the claims for those payments.

14540. The department may review and verify all applications for certification of recycling centers and processors, and may conduct a comprehensive field investigation of any applicant in any manner which the

department deems necessary to promote the purposes of this division. This division does not prohibit the department from certifying the same location or entity as both a processor and a recycling center.

14541. (a) The department may issue a certificate pursuant to an initial or renewal application for certification as probationary, and the department may issue any other certificate as probationary pursuant to an enforcement action.

(b) A probationary certificate issued pursuant to this section shall be issued for a limited period of not more than two years. Before the end of the probationary period, the department shall issue a nonprobationary certificate, extend the probationary period for not more than one year, or, after notice to the probationary certificate holder, revoke the probationary certificate. Subsequent to the revocation, the former probationary certificate holder may request a hearing, which, notwithstanding, Section 11445.20 of the Government Code, shall be conducted in the same form as a hearing for an applicant whose original application for certification is denied.

(c) If a hearing is requested pursuant to subdivision (b) and the party requesting the hearing fails to appear on the date scheduled, and does not notify the department at least five days prior to the hearing date that the party will not appear, the department may recover from the party all costs and fees incurred by the department, including attorneys' and experts' fees, and any other cost associated with preparing for, or conducting, the hearing.

(d) If conditions are imposed on the certificate holder as part of a disciplinary proceeding conducted pursuant to Section 14591.2, the certificate shall be considered probationary. If, at any time, the certificate holder violates any term or condition of the

probationary certificate, the certificate may be revoked or suspended, after three days' notice, without any further hearing by the department.

14541.5. Any certification or registration granted by the department is a privilege and not a vested right or interest.

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14549. (a) Every glass container manufacturer shall report to the department each month, by a method as determined by the department, the amount of total tons of new glass food, drink, and beverage containers made in California by that glass container manufacturer and the tons of California postfilled glass used in the manufacturing of those new containers.

(b) Each glass container manufacturer in the state shall use a minimum percentage of 35 percent of postfilled glass in the manufacturing of their glass food, drink, or beverage containers measured in the aggregate, on an annual basis, except that if a glass container manufacturer demonstrates to the satisfaction of the department that its use of postfilled glass during the annual period is made up of at least 50 percent mixed-color cullet, then that manufacturer shall use a minimum percentage of 25 percent postfilled glass in the manufacturing of its glass food, drink, or beverage containers, measured in the aggregate, on an annual basis.

(c) A glass container manufacturer may seek a reduction or waiver of the minimum postfilled glass percentage required to be used in the manufacture of glass food, drink, or beverage containers pursuant to subdivision (b). The department may grant a reduction or waiver of the percentage requirement if it finds and determines that it is technologically infeasible for the glass container manufacturer to achieve the percentage requirement or if the department determines that a glass container manufacturer cannot achieve the minimum percentage because of a lack of available glass cullet.

(d) For the purposes of this section, "mixed-color cullet" means cullet that does not meet the American Society for Testing

and Materials (ASTM) standard specifications for color mix of color sorted postfilled glass as raw material for the manufacture of glass containers.

14549.1. (a) In order to improve the quality and marketability of empty beverage containers collected for recycling in the state by curbside recycling programs or dropoff or collection programs, the department may, consistent with Section 14581 and subject to the availability of funds, pay a quality incentive payment for each material type, as specified in subdivision (c).

(b) The department may make a quality incentive payment pursuant to this section to either an operator of a curbside recycling program registered pursuant to Section 14551.5, or to any other entity certified pursuant to this division.

(c) Subject to subdivision (a), the department shall pay a quality incentive payment for each type of beverage container material in accordance with the following conditions:

(1) For quality incentive payments for empty glass beverage containers, all of the following shall apply:

(A) The department may make a quality incentive payment only for color-sorted glass beverage containers that are substantially free of contamination.

(B) The department may make a quality incentive payment for empty glass beverage containers that are either collected color sorted by curbside recycling programs or dropoff or collection programs, or that are collected mixed color by curbside recycling programs or dropoff or collection programs and are subsequently color sorted by the collector or any other entity certified pursuant to this division.

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(C) The amount of the quality incentive payment for empty glass beverage containers shall be up to sixty dollars (\$60) per ton, as determined by the department.

(2) For quality incentive payments for empty plastic beverage containers, both of the following shall apply:

(A) The department may make a quality incentive payment only for plastic beverage containers collected by curbside recycling programs or dropoff or collection programs, that are sorted by resin type, consistent with any quality specifications that the department may adopt.

(B) The amount of the quality plastic incentive payment shall be up to one hundred eighty dollars (\$180) per ton, as determined by the department.

(3) For quality payments for empty aluminum beverage containers, all of the following shall apply:

(A) The department may make a quality incentive payment only for aluminum beverage containers that are free of any and all metallic and nonmetallic items, other than used aluminum containers.

(B) The department may make a quality incentive payment for empty aluminum beverage containers that are collected commingled by curbside recycling programs or dropoff or collection programs, and subsequently cleaned by the collector or any other entity certified pursuant to this division, of any and all metallic and nonmetallic items, other than used aluminum containers, consistent with any quality specifications that the department may adopt.

(C) The amount of the quality incentive payment for empty aluminum beverage containers shall be up to one hundred twenty-five dollars (\$125) per ton, as determined by the department.

(d) An operator of a curbside recycling program or any other certified entity receiving a quality incentive payment shall make available for inspection and review any relevant record that the department determines is necessary to verify the accuracy of data upon which the quality incentive payment is based and the operator's or certified entity's compliance with any applicable regulation.

(e) The department may make only one quality incentive payment for each empty beverage container collected pursuant to this section.

(f) This section shall become operative on January 1, 2007.

14549.2. (a) For purposes of this section, the following definitions shall apply:

(1) "Certified entity" means a recycling center, processor, or dropoff or collection program certified pursuant to this division.

(2) "Product manufacturer" means any person who manufactures a plastic product in this state.

(b) In order to develop California markets for empty plastic beverage containers collected for recycling in the state, the department may, consistent with Section 14581 and subject to the availability of funds, pay a market development payment to a certified entity or product manufacturer for empty plastic beverage containers collected and managed pursuant to this section.

(c) The department shall make a market development payment to a certified entity or product manufacturer in accordance with this section, only if the plastic beverage container is collected and either recycled or used in manufacturing, in the state, as follows:

(1) The department shall make a market development payment to a certified entity

for empty plastic beverage containers that are collected for recycling in the state, that are subsequently washed and processed by a certified entity into a flake, pellet, or other form in the state, and made usable for the manufacture of a plastic product by a product manufacturer.

(2) The department shall make a market development payment to a product manufacturer for empty plastic beverage containers that are collected for recycling in the state, that are subsequently washed and processed into a flake, pellet or other form in the state, and used by that product manufacturer to manufacture a product in this state.

(3) The department shall determine the amount of the market development payment, which may be set at a different level for a certified entity and a product manufacturer, but shall not exceed one hundred fifty dollars (\$150) per ton.

(4) The department may make a market development payment to both a certified entity and a product manufacturer for the same empty plastic beverage container.

(d) This section shall remain in effect only until January 1, 2012, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2012, deletes or extends that date.

14549.5. On or before the 90th day after the effective date of the act amending this section, and annually thereafter, or more frequently as determined to be necessary by the department, the department shall review and, if necessary in order to ensure payment of the most accurate commingled rate feasible, recalculate commingled rates paid for beverage containers and postfilled containers paid to curbside recycling programs, collection programs, and recycling centers. Prior to recalculating a

commingled rate pursuant to this section, the department shall do all of the following:

(a) Consult with private and public operators of curbside recycling programs, collection programs, and recycling centers concerning the size of the statewide sample, appropriate sampling methodologies, and alternatives to exclusive reliance on a statewide commingled rate.

(b) At least 60 days prior to the effective date of any new commingled rate, hold a public hearing, after giving notice, to make available to the public and affected parties the department's review and any proposed recalculations of the commingled rate.

(c) At least 60 days prior to the effective date of any new commingled rate, and upon the request of any party, make available documentation or studies which were prepared as part of the department's review of a commingled rate.

(d)(1) Notwithstanding this division, the department may calculate a curbside recycling program commingled rate pursuant to this subdivision for bimetal containers and a combined commingled rate for all plastic beverage containers displaying the resin identification code "3," "4," "5," "6," or "7" pursuant to Section 18015.

(2) The department may enter into a contract for the services required to implement the amendments to this section made by the act of the first half of the 2003-04 Regular Session of the Legislature amending this section. The department may not expend more than two hundred fifty thousand dollars (\$250,000) for each year of the contract. The contract shall be paid only from revenues derived from redemption payments and processing fees paid on plastic beverage containers displaying the resin identification code "3," "4," "5," "6," or "7" pursuant to Section 18015. If the

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department determines that insufficient funds will be available from these revenues, after refund values are paid to processors and the reduction is made in the processing fee pursuant to subdivision (f) of Section 14575 for these containers, the department may determine not to calculate a commingled rate pursuant to this subdivision.

14549.6. (a) The department, consistent with Section 14581 and subject to the availability of funds, shall annually pay a total of fifteen million dollars (\$15,000,000) per fiscal year to operators of curbside programs and neighborhood dropoff programs that accept all types of empty beverage containers for recycling. The payments shall be for each container collected by the curbside or neighborhood dropoff programs and properly reported to the department by processors, based upon all of the following:

(1) The payment amount shall be calculated based upon the volume of beverage containers collected by curbside and neighborhood dropoff programs during the 12-month calendar year ending on December 31 of the fiscal year for which payments are to be made.

(2) The per-container rate shall be calculated by dividing the total volume of beverage containers collected, as determined pursuant to paragraph (1), into the sum of fifteen million dollars (\$15,000,000).

(3) The amount to be paid to each operator of a curbside program or neighborhood dropoff program shall be based upon the per-container rate, calculated pursuant to paragraph (2), multiplied by the program's total reported beverage container volume calculated pursuant to paragraph (1).

(b) The amounts paid pursuant to this section shall be expended by operators of curbside and neighborhood dropoff

programs only for activities related to beverage container recycling.

(c) The department shall disburse payments pursuant to this section not later than the end of the fiscal year following the calendar year for which the payments are calculated pursuant to paragraph (1) of subdivision (a), subject to the availability of funds.

(d) The operator of a curbside program or neighborhood dropoff program shall make available for inspection and review any relevant record that the department determines is necessary to verify compliance with this section.

14550. (a)(1) Every processor shall report to the department for each month the amount of empty beverage containers, by material type and weight of container or material, excluding refillable beverage containers, received from recycling centers and curbside programs for recycling, and the scrap value paid for glass, PET, and bimetal containers and any beverage container that is assessed a processing fee. Every processor shall also report to the department for each month the amount of other postfilled aluminum, glass, and plastic food and drink packaging materials sold filled to consumers in this state and returned for recycling. These reports shall be submitted within 10 days after each month, in the form and manner that the department may prescribe.

(2) The department shall treat all information reported pursuant to this section by a processor as commercial or financial information subject to the procedures established pursuant to Section 14554.

(b) Every distributor who sells or offers for sale in this state beverages in aluminum beverage containers, nonaluminum metal beverage containers, glass beverage containers, plastic beverage containers, or other beverage containers, including

refillable beverage containers of these types, shall report to the department for each month the number of beverages sold in these beverage containers in this state which are labeled pursuant to Section 14561, by material type and size and weight of container or any other method as the department may prescribe. These reports shall be submitted by the day when payment is due, consistent with the applicable payment schedule specified in subdivision (a) of Section 14574, in the form and manner which the department may prescribe.

(c) Every distributor who sells or offers for sale in this state beverages in refillable beverage containers and who pays a refund value to distributors, dealers, or consumers who return these containers for refilling, shall report to the department for each month the number of these beverage containers returned empty to be refilled, by material type and size of container or any other method which the department may prescribe. These reports shall be submitted by the day when payment is due, consistent with the schedule specified in subdivision (a) of Section 14574, in the form and manner which the department may prescribe.

(d) Notwithstanding subdivision (b), a distributor who elects to make an annual payment pursuant to subdivision (b) of Section 14574 may, upon the approval of the department, submit the reports required by this section annually to the department. The reports shall accompany the annual payment submitted pursuant to Section 14574.

14551. (a) The department shall establish reporting periods for the reporting of redemption rates and recycling rates. Each reporting period shall be six months. The department shall determine all of the following for each reporting period and shall

issue a report on its determinations, within 130 days of the end of each reporting period:

(1) Sales of beverages in aluminum beverage containers, bimetal beverage containers, glass beverage containers, plastic beverage containers, and other beverage containers in this state, including refillable beverage containers.

(2) Returns for recycling, and returns not for recycling, of empty aluminum beverage containers, bimetal beverage containers, glass beverage containers, plastic beverage containers, and other beverage containers in this state, including refillable beverage containers returned to distributors pursuant to Section 14572.5. These numbers shall be calculated using the average current weights of beverage containers, as determined and reported by the department. To these numbers shall be added and separately reported the following, if greater than, or equal to, zero:

(A) All empty postfilled aluminum, glass, and plastic food or drink packaging materials sold in the state, returned for recycling, and reported by weight to the department which do not have a refund value less the number specified in subparagraph (B).

(B) The number of beverage containers which comprise the first five percentage points of the redemption rate without including the empty postfilled aluminum, glass, and plastic food or drink packaging materials sold in the state, returned for recycling and reported by weight to the department which do not have a refund value.

(3) An aluminum beverage container redemption rate, the numerator of which shall be the number of empty aluminum beverage containers returned, including refillable aluminum beverage containers and

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empty postfilled aluminum food or drink packaging material included in paragraph (2), and the denominator of which shall be the number of aluminum beverage containers sold in this state.

(4) An aluminum beverage container recycling rate, the numerator of which shall be the number of empty aluminum beverage containers returned for recycling, including refillable aluminum beverage containers, and the denominator of which shall be the number of aluminum beverage containers sold in this state.

(5) A bimetal beverage container redemption rate, the numerator of which shall be the number of empty bimetal beverage containers returned, and the denominator of which shall be the number of bimetal beverage containers sold in this state.

(6) A bimetal beverage container recycling rate, the numerator of which shall be the number of empty bimetal beverage containers returned for recycling, including refillable bimetal beverage containers, and the denominator of which shall be the number of bimetal beverage containers sold in this state.

(7) A glass beverage container redemption rate, the numerator of which shall be the number of empty glass beverage containers returned, including refillable glass beverage containers and empty postfilled food or drink packaging materials included in paragraph (2), and the denominator of which shall be the number of glass beverage containers sold in this state.

(8) A glass beverage container recycling rate, the numerator of which shall be the number of empty glass beverage containers returned for recycling, including refillable glass beverage containers, and the denominator of which shall be the number

of glass beverage containers sold in this state.

(9) A plastic beverage container redemption rate, the numerator of which shall be the number of empty plastic beverage containers returned, including refillable plastic beverage containers and empty postfilled food or drink packaging materials included in paragraph (2), and the denominator of which shall be the number of plastic beverage containers sold in this state.

(10) A plastic beverage container recycling rate, the numerator of which shall be the number of empty plastic beverage containers returned for recycling, including refillable plastic beverage containers, and the denominator of which shall be the number of plastic beverage containers sold in this state.

(11) A redemption rate for other beverage containers, the numerator of which shall be the number of empty beverage containers other than those containers specified in paragraphs (1) to (10), inclusive, returned, and the denominator of which shall be the number of beverage containers, other than those containers specified in paragraphs (1) to (10), inclusive, sold in this state.

(12) A recycling rate for other beverage containers, the numerator of which shall be the number of empty beverage containers other than those containers specified in paragraphs (1) to (10), inclusive, returned for recycling, and the denominator of which shall be the number of beverage containers, other than those containers specified in paragraphs (1) to (10), inclusive, sold in this state.

(13) The department may define categories of other beverage containers, and report a redemption rate and a recycling rate for each such category of other beverage containers.

(14) The volumes of materials collected from certified recycling centers, by city or county, as requested by the city or county, if the reporting is consistent with the procedures established pursuant to Section 14554 to protect proprietary information.

(b) The department shall determine the manner of collecting the information for the reports specified in subdivision (a), including establishing procedures, to protect any proprietary information concerning the sales and purchases.

14551.4. The department shall make available the information collected pursuant to subdivision (a) of Section 14551, concerning the volumes of materials collected from certified recycling centers, only to a governmental agency which requests the information, including a city or county, or an entity specifically designated by the city or county to receive the information if the entity requests the information, if all of the following conditions are met:

(a) The request is made in writing.

(b) All information provided by the department is provided using the aggregate amounts collected in the city or county unless the city or county, or an entity specifically designated by the city or county to receive the information, requests the information provided by each individual certified recycling center.

(c) All information provided to the governmental agency, including a city or county, or an entity specifically designated by the city or county to receive the information, is considered proprietary and confidential in nature and protected in accordance with the requirements of subdivision (b) of Section 14551 of the Public Resources Code, Section 14554 of the Public Resources Code, and subdivision

(e) of Section 6254.5 of the Government Code.

14551.5. (a) The department shall register the operators of curbside programs pursuant to this section.

(b) Each curbside program that receives refund values and administrative fees from certified processors, or that receives refund values from certified recycling centers, shall register with the department for an identification number. No curbside program may receive refund values or administrative fees without a valid identification number.

(c) The director shall adopt, by regulation, a procedure for the registration of curbside programs. This procedure shall include standards and requirements for registration. These regulations shall require that all information be submitted to the department under penalty of perjury. A curbside program shall meet all of the standards and requirements contained in the regulations for registration.

(d) The department shall require that the identification numbers received pursuant to this section be used on shipping reports for material collected by curbside programs pursuant to Sections 14538 and 14539 and on all other reports or documentation required by the department to administer this division.

(e) An operator of a curbside program registered pursuant to this section shall be deemed a certificate holder for purposes of this division.

14552. (a) The department shall establish and implement an auditing system to ensure that the information collected, and refund values and redemption payments paid pursuant to this division, comply with the purposes of this division. Notwithstanding Sections 14573 and 14573.5, the auditing system adopted by the department may

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include prepayment or postpayment controls.

(b)(1) On or after January 1 of each year, the department may audit or investigate any action taken up to three years before the onset of the audit or investigation and may determine if there was compliance with this division and the regulations adopted pursuant to this division, during that period.

(2) Notwithstanding any other provision of law establishing a shorter statute of limitation, the department may take an enforcement action, including, but not limited to, an action for restitution or to impose penalties, at any time within two years after the department discovers, or with reasonable diligence, should have discovered, a violation of this division or the regulations adopted pursuant to this division.

(c) During the conduct of any inspection, including, but not limited to, an inspection conducted as part of an audit or investigation, the entity that is the subject of the inspection shall, during its normal business hours, provide the department with immediate access to its facilities, operations, and any relevant record, that, in the department's judgment, the department determines are necessary to carry out this section to verify compliance with this division and the regulations adopted pursuant to this division.

(1) The department may take disciplinary action pursuant to Section 14591.2 against any person who fails to provide the department with access pursuant to this subdivision including, but not limited to, imposing penalties and the immediate suspension or termination of any certificate or registration held by the operator.

(2) The department shall protect any information obtained pursuant to this section in accordance with Section 14554, except

that this section does not prohibit the department from releasing any information that the department determines to be necessary in the course of an enforcement action.

(d) The auditing system adopted by the department shall allow for reasonable shrinkage in material due to moisture, dirt, and foreign material. The department, after an audit by a qualified auditing firm and a hearing, shall adopt a standard to be used to account for shrinkage and shall incorporate this standard in the audit process.

(e) If the department prevails against any entity in any civil or administrative action brought pursuant to this division, and money is owed to the department as a result of the action, the department may offset the amount against amounts claimed by the entity to be due to it from the department. The department may take this offset by withholding payments from the entity or by authorizing all processors to withhold payment to a certified recycling center.

(f) If the department determines, pursuant to an audit or investigation, that a distributor or beverage manufacturer has overpaid the redemption payment or processing fee, the department may do either of the following:

(1) Offset the overpayment against future payments.

(2) Refund the payment pursuant to Article 3 (commencing with Section 13140) of Chapter 2 of Part 3 of Division 3 of Title 2 of the Government Code.

14552.5. (a) The department shall supply all certified processors with a standardized rejection form that shall include, but not be limited to, the names of the parties rejecting the postfilled beverage container material, the date of the rejections, the reasons for the rejections, the amount of rejected material, and a detailed accounting

of the steps taken by the processor and container manufacturer to avert landfilling or disposal of the material, as required by subdivision (c) of Section 14552.51.

(b) Every container manufacturer shall fill out the standardized rejection form specified in subdivision (a) whenever that container manufacturer rejects a load of redeemed beverage container materials physically delivered to the manufacturer's place of business and offered for sale by a certified processor. The rejection form shall be filled out by the container manufacturer at the time of the rejection and immediately given to the certified processor for submittal to the department. Any container manufacturer who refuses to fill out the standardized rejection form required by this subdivision is in violation of this division and is subject to the fines and penalties in Sections 14591 and 14591.1.

(c) If a processor has made a good faith effort, as determined by the department, to locate a willing purchaser and is unsuccessful, the processor may fill out the standardized rejection form specified in subdivision (a) and submit it to the department. The processor rejection form shall include, but is not limited to, the name of the processor, the container manufacturers and other potential purchasers contacted, a detailed accounting of the methods used to contact the potential buyers, the date of the rejections, the reasons given for the rejections, the amount of postfilled beverage container material rejected, and any other steps taken to avert landfilling or disposal of the material.

(d) If a container manufacturer rejects a load of postfilled containers by telephone, written correspondence of any kind, or other similar method, the container manufacturer shall, in a manner prescribed by the department, keep accurate logbooks of the offer of loads by the certified processor, and

make that logbook available for inspection by the department upon demand. The logbook shall contain, but is not limited to, the same information required in the rejection form pursuant to subdivision (a).

(e) The standardized rejection form specified in subdivision (a) shall be submitted to the department by the certified processor with the written request to dispose of the redeemed material submitted pursuant to Section 14552.51. This material shall not be disposed of without a written authorization to do so by the department pursuant to Section 14552.51.

(f) Nothing in this section shall be interpreted to lessen certified processors' and container manufacturers' responsibilities relating to beverage container recycling, or diminish in any way the department's authority to carry out the intent and goals of this division.

14552.51. (a) A certified processor seeking to dispose of rejected postfilled containers may not dispose of rejected postfilled containers unless the certified processor first submits to the department, in writing, a request to dispose of the rejected material. No certified processor shall dispose of the rejected material prior to obtaining written permission from the department. If the department fails to respond to a written request to dispose of rejected postfilled beverage container materials within 10 days of receipt of the request, the processor's request for disposal is deemed approved by the department.

(b) All rejected loads of postfilled containers shall be available and subject to inspection by the department.

(c) All possible steps to avert the disposal of the loads of postfilled containers, as determined by the department, shall be taken by all container manufacturers and processors. All transactions or attempted

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transactions involving rejecting postfilled containers shall be thoroughly documented on the standardized rejection form pursuant to Section 14552.5. The container manufacturer and the certified processor are jointly and severally responsible for this effort.

14553. (a) All reports, claims, and other information required pursuant to this division and submitted to the department shall be complete, legible, and accurate, as determined by the department by regulation, and shall be signed, by an officer, director, managing employee, or owner of the certified recycling center, processor, distributor, beverage manufacturer, container manufacturer, or other entity.

(b) The department may inspect the operations, processes, and records of any entity required to submit a report to the department pursuant to this division to determine the accuracy of the report and compliance with the requirements of this division.

(c) A violation of this section is subject to the penalties specified in Section 14591.1.

14554. The department shall establish procedures to protect any privileged, confidential, commercial, or financial information obtained while collecting information for carrying out the requirements of this division. Any privileged, confidential, commercial, or financial information obtained in confidence by the department is not a public record for purposes of Chapter 3.5 (commencing with Section 6250) of Division 7 of Title 1 of the Government Code.

14556. (a) *Not less than once every three months, the department shall provide to the Legislature pursuant to subdivision (b), at a minimum, all of the following information for the current fiscal year and the budget year:*

(1) *An updated fund condition statement that includes the revenues, transfers, and expenditures in to and out of the fund.*

(2) *The recycling rate, by beverage container material type, that is inferred using the revenues.*

(3) *An explanation of significant changes to the fund condition statement from the prior report and significant changes to the methodology used for forecasting the fund condition statement.*

(4) *Projected sales, which include all actual data available since the last reporting period, by beverage container material type and size, and actual or projected returns, which include all actual data available since the last reporting period, by beverage container material type, including an explanation in any case where the actual returns are more than 100 percent of actual sales.*

(5) *Projected handling fee payments, which include all actual data available since the last reporting period, the per beverage container handling fee amount, and the number of beverage containers projected to be eligible for a handling fee payment.*

(6) *Projected processing payments, which include all actual data available since the last reporting period, by beverage container material type, showing the total processing fee offsets, processing fees, and processing payments for each type of beverage container material.*

(7) *Total grants awarded during the current fiscal year.*

(b) *Notwithstanding Section 9795 of the Government Code, not less than once every three months, the department shall provide a written copy of the information required in subdivision (a) to the Joint Legislative Budget Committee and to the appropriate policy and fiscal committees of both houses*

of the Legislature and shall also post the most recent information required in subdivision (a) on the department's Internet Web site.

(c) The department shall review the information included in the fund condition statement frequently, but not less than once

every three months, to determine if adequate funds exist to pay the disbursements required pursuant to this division and to make the determinations required pursuant to subdivision (c) of Section 14581.

(Added by Chapter 718, Statutes of 2010 (SB 855); effective October 19, 2010.)

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CHAPTER 5. MINIMUM REDEMPTION VALUE

14560. (a)(1) Except as provided in paragraph (3), a beverage distributor shall pay the department, for deposit into the fund, a redemption payment of four cents (\$0.04) for a beverage container sold or offered for sale in this state by the distributor.

(2) A beverage container with a capacity of 24 fluid ounces or more shall be considered as two beverage containers for purposes of redemption payments paid pursuant to paragraph (1).

(3) ~~On and after July 1, 2007, the~~ The amount of the redemption payment and refund value for a beverage container with a capacity of less than 24 fluid ounces sold or offered for sale in this state by a dealer shall equal five cents (\$0.05), and the amount of redemption payment and refund value for a beverage container with a capacity of 24 fluid ounces or more shall be ten cents (\$0.10), if the aggregate recycling rate reported pursuant to Section 14551 for all beverage containers subject to this division is less than 75 percent for the 12-month reporting period from January 1, 2006, to December 31, 2006, or for any calendar year thereafter.

(b) Except as provided in paragraph (3) of subdivision (e) (a), a beverage container sold or offered for sale in this state has a refund value of four cents (\$0.04) if the beverage container has a capacity of less than 24 fluid ounces and eight cents (\$0.08) if the beverage container has a capacity of 24 fluid ounces or more.

~~(e) Notwithstanding subdivision (b), the department may, on and after January 1, 2007, but not after July 1, 2007, increase the amount of the refund value specified in subdivision (b), by no more than one cent (\$0.01), if the container has a capacity of~~

~~less than 24 fluid ounces, and by two cents (\$0.02) if the container has a capacity of 24 fluid ounces or more, if the department determines, as specified in subdivision (f) of Section 14581, there are sufficient moneys remaining in the fund to make these increased payments.~~

~~(d)(1) The department shall review the fund at least once every three months to ensure that there are adequate funds in the fund to pay refund values and other disbursements required by this division.~~

~~(2) If the department determines, pursuant to a review made pursuant to paragraph (1), that there may be inadequate funds to pay the refund values and necessary disbursements required by this division, the department shall immediately notify the Legislature of the need for urgent legislative action.~~

~~(3) On or before 180 days, but not less than 90 days, after the notice is sent pursuant to paragraph (2), the department may reduce or eliminate expenditures, or both, from the fund as necessary, according to the procedure set forth in Section 14581, to ensure that there are adequate funds in the fund to pay the refund values and other disbursements required by this division.~~

~~(e)~~

(c) This section does not apply to a refillable beverage container.

(Amended by Chapter 718, Statutes of 2010 (SB 855); effective October 19, 2010.)

14560.5. (a)(1) Except as provided in paragraph (2), the invoice or other form of accounting of the transaction submitted by a beverage distributor of beverages to a dealer shall separately identify the amount of any redemption payment imposed on beverage containers pursuant to Section 14560 and the

separate identification of the invoice or other form of accounting of the transaction shall not combine or include the gross wholesale price with the redemption payment but shall separately state the gross amount of the redemption payment for each type of container included in each delivery.

(2) The invoice or other form of accounting of the transaction submitted by any distributor of beer and malt beverages or wine or distilled spirit coolers to a dealer may separately identify the portion of the gross wholesale price attributable to any redemption payment imposed on beverage containers pursuant to Section 14560 and the separate identification of the invoice or other form of accounting of the transaction may separately state the gross amount of the redemption payment for each type of container included in each delivery. The invoice or other form of accounting of this transaction may separately identify the portion of the gross wholesale price attributable to the redemption payment.

(3) Notwithstanding Section 14541, the department shall randomly inspect beverage distributor invoices or other forms of accounting to ensure compliance with this subdivision. However, an unintentional error in addition or subtraction on an invoice or other form of accounting by a route driver of a distributor shall not be deemed a violation of this subdivision.

(4) For the purposes of this subdivision, the term, "type of container" includes the amount of the redemption payment on containers under 24 ounces and on containers 24 ounces or more.

(b) To the extent technically and economically feasible, a dealer may separately identify the amount of any redemption payment on the customer cash register receipt provided to the consumer, by the dealer, that is applied to the purchase of a beverage container.

(c)(1) A dealer shall separately identify the amount of any redemption payment imposed on a beverage container in all advertising of beverage products and on the shelf labels of the dealer's establishment. The separate identification shall be accomplished by stating one of the following:

(A) The price of the beverage product plus a descriptive term, as described in paragraph (2).

(B) The price of the beverage product plus the amount of the applicable redemption payment and a descriptive term, as described in paragraph (2).

(C) The price of the beverage product plus the amount of the applicable redemption payment, a descriptive term, as described in paragraph (2), and the total of these two amounts.

(2) For purposes of paragraph (1), the redemption payment shall be identified by one of the following descriptive terms: "California Redemption Value," "CA Redemption Value," "CRV," "California Cash Refund," "CA Cash Refund," or any other message specified in Section 14561.

(3) A dealer shall not include the redemption payment in the total price of a beverage container in any advertising or on the shelf of the dealer's establishment.

(4) This subdivision applies only to a dealer at a dealer location with a sales and storage area totaling more than 4,000 square feet.

(5) The penalties specified in Section 14591 and 14591.1 shall not be applied to a person who violates this subdivision.

(d) With regard to the sale of beer and other malt beverages or wine and distilled spirits cooler beverages, any amount of redemption payment imposed by this

division is subject to Section 25509 of the Business and Professions Code.

14561. (a) A beverage manufacturer shall clearly indicate on all beverage containers sold or offered for sale by that beverage manufacturer in this state the message "CA Redemption Value," "California Redemption Value," "CA Cash Refund," "California Cash Refund," or "CA CRV," by either printing or embossing the beverage container or by securely affixing a clear and prominent stamp, label, or other device to the beverage container.

(b) Any refillable beverage container sold or offered for sale is exempt from this section. However, any beverage manufacturer or container manufacturer may place upon, or affix to, a refillable beverage container, any message that the manufacturer determines to be appropriate relating to the refund value of the beverage container.

(c) A person shall not offer to sell, or sell to a consumer a beverage container subject to subdivision (a) that has not been labeled pursuant to this section, except for a refillable beverage container that is exempt from labeling pursuant to subdivision (b).

(d) The department may require that a beverage container intended for sale in this state be printed, embossed, stamped, labeled, or otherwise marked with a universal product code or similar machine-readable indicia.

(e) A beverage container labeled with the message specified in subdivision (a) shall have the minimum redemption payment established pursuant to Section 14560, which shall be paid by the distributor to the department pursuant to Section 14574.

14562. The Legislature hereby finds and declares that the minimum redemption payment established by this article is a regulatory fee collected for the purpose of assuring the return for recycling of a greater percentage of the beverage containers sold in this state, and is beneficial to the beverage industry by assuring the more reliable availability of raw materials. Accordingly, the payments of redemption payments to the department for deposit in the California Beverage Container Recycling Fund are not the "proceeds of taxes," as that term is used in subdivision (c) of Section 8 of Article XIII B of the California Constitution, and the disbursement or encumbrance of money in the fund is not subject to the limitations imposed by that article.

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CHAPTER 6. RETURNS

14570. Every dealer shall post a clear and conspicuous sign of at least 10 inches by 15 inches at each public entrance to the dealer's place of business, which specifies one of the following:

(a) The name and address, as provided by the department, of at least the certified recycling center, location, or locations, nearest to the dealer, which redeems all types of empty beverage containers at one location during at least 30 hours per week with a minimum of five hours of operation occurring during periods other than from Monday to Friday, from 9:00 a.m. to 5:00 p.m., and the toll-free telephone number established by the department for the purpose of disseminating information regarding beverage container recycling opportunities.

(b) One of the following procedures for redeeming beverage containers is available, pursuant to Section 14571.6:

(1) Beverage containers may be redeemed at all open cash registers within this place of business.

(2) Beverage containers may be redeemed at one specific location on the dealer's premises which is identified on the sign.

14571. (a) Except as otherwise provided in this chapter, there shall be at least one certified recycling center or location within every convenience zone that accepts and pays the refund value, if any, at one location for all types of empty beverage containers and is open for business during at least 30 hours per week with a minimum of five hours of operation occurring during periods other than from Monday to Friday, from 9:00 a.m. to 5:00 p.m.

(b)(1) Notwithstanding subdivision (a), the department may require a certified recycling center to operate 15 of its 30 hours of operation other than during 9 a.m. to 5 p.m.

(2) Notwithstanding subdivision (a) and paragraph (1), the department may certify a recycling center that will operate less than 30 hours per week, if all of the following conditions are met:

(A) The recycling center is in a rural region. For purposes of this subparagraph, "rural region" means a nonurban area identified by the department on an annual basis using the loan eligibility criteria of the Rural Housing Service of the United States Department of Agriculture, Rural Development Administration, or its successor agency. Those criteria include, but are not limited to, places, open country, cities, towns, or census designated places with populations that are less than 10,000 persons. The department may designate an area with a population of between 10,000 and 50,000 persons as a rural region, unless the area is identified as part of, or associated with, an urban area, as determined by the department on an individual basis.

(B) The recycling center agrees to post a sign indicating the location of the nearest recycling center that is open at least 30 hours per week and that will accept all material types.

(C) The needs of the community and the goals of this division will be best served by certification of the operation as a recycling center.

(c) Before establishing operating hours for a certified recycling center pursuant to subdivision (b), the department shall make a

determination that this action is necessary to further the goals of this division and that the proposed operating hours will not significantly decrease the ability of consumers to conveniently return beverage containers for the refund value to a certified recycling center redeeming all material types.

(d) For purposes of this section, if the recycling center is staffed and is not a reverse vending machine, a center is “open for business” if all of the following requirements are met:

(1) An employee of the certified recycling center or location is present during the hours of operation and available to the public to accept containers and to pay the refund values.

(2) In addition to the sign specified in subdivision (h), a sign having a minimum size of two feet by two feet is posted at the certified recycling center or location indicating that the center or location is open. Where allowed by local zoning requirements or where zoning restrictions apply, the sign shall be of the maximum allowable size.

(3) The prices paid, by weight or per container, are posted at the location.

(e) Except as provided in subdivision (f), for the purpose of this section, if the recycling center consists of reverse vending machines or other unmanned automated equipment, the center is “open for business” if the equipment is properly functioning, accepting all types of empty beverage containers at the recycling location, and paying posted refund values no less than the minimums required by this division.

(f) If a recycling center consists of reverse vending machines or other automated equipment, the recycling center is “open for business” if the equipment is properly functioning, and accepting all types of empty beverage containers at one

physical recycling location within the recycling location.

(g) Whenever a recycling center that is a reverse vending machine is not “open for business” during the 30 hours of operation required and posted pursuant to this section and Section 14570, the dealer that is hosting the reverse vending machine at its place of business shall redeem all empty beverage container types at all open cash registers or one designated location in the store, as specified on the sign required pursuant to subdivision (h).

(h) In addition to the sign specified in paragraph (2) of subdivision (d), each reverse vending machine shall be posted with a clear and conspicuous sign on or near the reverse vending machine which states that beverage containers may be redeemed by the host dealer if the machine is nonoperational at any time during the required 30 hours of operation, pursuant to subdivision (g). The department shall determine the size and location of the sign and the message required to be printed on the sign.

14571.1. On or before January 1 of each year, the department shall, on a statewide basis, designate all convenience zones as of that date, including convenience zones in underserved areas, and shall prepare a map or maps showing these convenience zones.

14571.2. The department shall continuously assist dealers and recyclers to establish certified recycling locations within each convenience zone. This assistance includes, but is not limited to, providing information to companies and organizations interested in operating recycling in the convenience zone; providing dealers with names of prospective recyclers for the convenience zone and providing recyclers with the names of dealers in need of a recycler for a convenience zone; providing dealers and recyclers with information on

grants, advertising funds, and other resources available; and providing recyclers with advice regarding appearance and image of the recycling center and the efficient handling and transportation of recycled beverage containers.

14571.3. (a) The department shall continuously assist any certified recycler to achieve greater service to the public in an economical and cost-effective manner. This assistance shall include, but not be limited to, advice on all of the following:

- (1) Methods to enhance public participation in recycling.
- (2) The most beneficial location, siting, and image of a recycling location.
- (3) Methods to reduce costs and optimize efficiencies of existing resources.

(b) The department shall conduct regular, unannounced inspections of certified recycling centers for the purpose of determining that the requirements of this division are satisfied. The department shall assess civil penalties pursuant to Section 14591.1 for violations at certified recycling centers.

14571.4. (a)(1) The department shall certify one operator to establish the Pacific Beach Mobile Recycling Program that incorporates all convenience zones in the Pacific Beach area of San Diego County.

(2) For the purposes of this section, “the Pacific Beach area of San Diego County” means the area designated in the Pacific Beach Community Plan.

(b) Notwithstanding Sections 14570 and 14571, all convenience zones within the Pacific Beach area of San Diego County shall be considered served if both of the following conditions are met:

(1) The recycling center operator meets all of the following conditions:

(A) The center is open for business at least once each week at a number of locations equal to the number of convenience zones in the Pacific Beach area of San Diego County as determined by the department annually, three of which are within existing convenience zones in the Pacific Beach area of San Diego County.

(B) The center is open for business at least eight hours per day at each location.

(C) The center agrees to accept, and pay the refund value for, all eligible beverage container types.

(D) The center is certified by the department for operation in the number of locations equal to the number of convenience zones in the Pacific Beach area of San Diego County, as determined by the department.

(2) All dealers within the Pacific Beach area of San Diego County post a clear and conspicuous sign of at least 10 inches by 15 inches at each public entrance to the dealer’s place of business, indicating the location, hours, and day of operation for each recycling location within the Pacific Beach area.

(c) A recycling center operator approved by the department, that meets the conditions prescribed in paragraphs (1) and (2) of subdivision (b), shall be designated a certified recycling center and shall be eligible to apply for handling fees pursuant to Section 14585 and to receive from processors the amounts specified in subdivision (a) of Section 14573.5 for refund values, administrative costs, and processing payments.

(d) If the department determines that it is necessary to adopt or revise regulations to implement this section, the regulations shall be adopted or revised as emergency regulations. The Office of Administrative

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Law shall consider these emergency regulations to be necessary for the immediate preservation of the public peace, health, and safety, and the general welfare for the purposes of Section 11349.6 of the Government Code. Notwithstanding the 120-day period provided for in subdivision (e) of Section 11346.1 of the Government Code, the emergency regulations shall be repealed 180 days from the effective date of the regulations.

14571.5. The department may, in a rural region, as identified pursuant to subparagraph (A) of paragraph (2) of subdivision (b) of Section 14571, upon petition by an interested person, do either of the following:

(a)(1) Increase a convenience zone to include the area within a three-mile radius of a supermarket, if the expanded convenience zone would then be served by a single existing certified recycling center or location.

(2) This subdivision applies only to a convenience zone that is otherwise not being served by a certified recycling center or location meeting the requirements of Section 14571 or is exempted by the department pursuant to Section 14571.8.

(b)(1) Designate a convenience zone pursuant to Section 14571.1 in an area where there is no supermarket, but with two or more dealers located within a one-mile radius of each other, and that meets all of the following criteria:

(A) The dealers in that area have combined gross annual sales of two million dollars (\$2,000,000) or more, as certified by the petitioner in an affidavit filed with the petition.

(B) The convenience zone encompasses a three-mile radius, with the center of the zone established at the dealer, located

closest to the existing recycling center specified in subparagraph (D).

(C) The convenience zone does not overlap any other existing convenience zone.

(D) The convenience zone is served by a single existing certified recycling center.

(2) The department shall identify the dealer locations only for the purpose of providing a reference point in the establishment of the convenience zone pursuant to this subdivision.

(3) If the existing recycling location in a convenience zone designated pursuant to this subdivision ceases operations, the convenience zone shall also cease to exist until a new recycling location is established, and the department is petitioned by an interested person to designate a convenience zone.

14571.6. In any convenience zone where no recycling location has been established which satisfies the requirements of Section 14571, and in any convenience zone which has exceeded the 60-day period for the establishment of a recycling center pursuant to Section 14571.7, all dealers within that zone shall, until a recycling location has been established in that zone, do one of the following:

(a) Submit to the department an affidavit form provided by the department stating that all of the following standards are being met by the dealer:

(1) The dealer redeems all empty beverage container types at all open cash registers or one designated location on the dealer's premises, during all hours that the dealer is open for business.

(2) The dealer has posted signs which meet the size and location requirements specified in subdivision (b) of Section

14570, and which conform to paragraph (2) of that subdivision.

(3) The dealer is delivering, or having delivered, all empty beverage containers received from the public to a certified recycling center or processor for recycling.

(b) Pay to the department for deposit in the fund the sum of one hundred dollars (\$100) per day until a recycling location is established or until the standards for redemption specified in subdivision (a) are met.

14571.7. (a) Except as provided in subdivision (b), in any convenience zone where a recycling location or locations were initially established, but where the location or locations cease to operate in accordance with Section 14571, the department shall notify all dealers within that convenience zone that a recycling location is required to be established within 60 days. If, within 30 days of the notification, a recycling location that satisfies the requirements of Section 14571 has not been established, the department shall notify all dealers within that zone, and one or more dealers within that zone shall establish, or cause to be established, a recycling location.

(b) In any convenience zone where a recycling location or locations were initially established, but where the location or locations cease to operate in accordance with Section 14571, the department shall determine, pursuant to Section 14571.8, if the convenience zone is eligible for an exemption. If the convenience zone meets all of the requirements for an exemption pursuant to 14571.8, the department shall grant one exemption. If the department determines that a convenience zone is not eligible for an exemption pursuant to subdivision (a) and Section 14571.8, the department shall notify all dealers within that convenience zone that a recycling location is required to be established within

60 days. If, within 30 days of the notification, a recycling location that satisfies the requirements of Section 14571 has not been established, the department shall notify all dealers within that zone, and one or more dealers within that zone shall establish, or cause to be established, a recycling location.

14571.8. (a) No lease entered into by a dealer after January 1, 1987, may contain a leasehold restriction that prohibits or results in the prohibition of the establishment of a recycling location.

(b) The director may grant an exemption to the requirements of Section 14571 for an individual convenience zone only after the department solicits public testimony on whether or not to provide an exemption from Section 14571. The solicitation process shall be designed by the department to ensure that operators of recycling centers, dealers, and members of the public in the jurisdiction affected by the proposed exemption are aware of the proposed exemption. After evaluation of the testimony and any field review conducted, the department shall base a decision to exempt a convenience zone on one, or any combination, of the following factors:

(1) The exemption will not significantly decrease the ability of consumers to conveniently return beverage containers for the refund value to a certified recycling center redeeming all material types.

(2) Except as provided in paragraph (5), the nearest certified recycling center is within a reasonable distance of the convenience zone being considered from exemption.

(3) The convenience zone is in the area of a curbside recycling program that meets the criteria specified in Section 14509.5.

(4) The requirements of Section 14571 cannot be met in a particular convenience

zone due to local zoning or the dealer's leasehold restrictions for leases in effect on January 1, 1987, and the local zoning or leasehold restrictions are not within the authority of the department and the dealer. However, any lease executed after January 1, 1987, shall meet the requirements specified in subdivision (a).

(5) The convenience zone has redeemed less than 60,000 containers per month for the prior 12 months and, notwithstanding paragraph (2), a certified recycling center is located within one mile of the convenience zone that is the subject of the exemption.

(c) The department shall review each convenience zone in which a certified recycling center was not located on January 1, 1996, to determine the eligibility of the convenience zone under the exemption criteria specified in subdivision (b).

(d) The total number of exemptions granted by the director under this section shall not exceed 35 percent of the total number of convenience zones identified pursuant to this section.

(e) The department may, on its own motion, or upon petition by any interested person, revoke a convenience zone exemption if either of the following occurs:

(1) The condition or conditions that caused the convenience zone to be exempt no longer exists, and the department determines that the criteria for an exemption specified in this section, are not presently applicable to the convenience zone.

(2) The department determines that the convenience zone exemption was granted due to an administrative error.

(f) If an exemption is revoked and a recycling center is not certified and operational in the convenience zone, the department shall, within 10 days of the date of the decision to revoke, serve all dealers in

the convenience zone with the notice specified in subdivision (a) of Section 14571.7.

(g) An exemption shall not be revoked when a recycling center becomes certified and operational within an exempt convenience zone unless either of the events specified in paragraphs (1) and (2) of subdivision (e) occurs.

14572. (a) Except as provided in subdivision (b), a certified recycling center shall accept from any consumer or dropoff or collection program any empty beverage container, and shall pay to the consumer or dropoff or collection program the refund value of the beverage container. The center may pay the refund value based on the weight of returned containers.

(b) Any recycling center or processor which was in existence on January 1, 1986, and which refused, as of January 1, 1986, to accept at a particular location a certain type of empty beverage container may continue to refuse to accept at the location the type or types of empty beverage containers that the recycling center or processor refused to accept as of January 1, 1986. Any certified recycling center which refuses, pursuant to this subdivision, to accept a certain type or types of empty beverage containers is not eligible to receive handling fees unless the center agrees to accept all types of empty beverage containers and is a supermarket site. This subdivision does not preclude the certified recycling center from receiving a handling fee for beverage containers redeemed at supermarket sites which do accept all types of containers.

(c) The department shall develop procedures by which recycling centers and processors which meet the criteria of subdivision (b) may recertify to change the material types accepted.

(d)(1) Only a certified recycling center may pay the refund value to consumers or dropoff or collection programs. No person shall pay a noncertified recycler for empty beverage containers an amount which exceeds the current scrap value for each container type, which shall be determined in the following manner:

(A) For a plastic or glass beverage container, the current scrap value shall be determined by the department.

(B) For an aluminum beverage container, the current scrap value shall be not greater than the amount paid to the processor for that aluminum beverage container, on the date the container was purchased, by the location of end use, as defined in the regulations of the department.

(2) No person may receive or retain, for empty beverage containers which come from out of state, any refund values, processing payments, or administrative fees for which a claim is made to the department against the fund.

(3) Paragraph (1) does not affect curbside programs under contract with cities or counties.

14572.5. A certified recycling center, other than a reverse vending machine, shall accept from any consumer or any dropoff or collection program and pay the applicable deposit for any refillable empty beer and other malt beverage container. The certified recycling center shall return, or cause to be returned, the refillable beer and other malt beverage container to the beer and other malt beverage distributor or any willing purchaser, who shall then pay the deposit to the center. The beer and other malt beverage distributor or other purchaser shall also negotiate a handling fee with the recycling center for the return of these containers.

14573. (a) The department shall pay to a processor, for every empty beverage container received by the processor from a certified recycling center, curbside program, or dropoff or collection program, upon presentation of a completed processor invoice accompanied by a shipping report from the supplier of the material, in the form adopted by the department, the sum of all of the following amounts:

(1) The refund value.

(2) Two and one-half percent of the refund value for administrative costs.

(3) The processing payment established pursuant to Section 14575.

(b) The department shall make the payment required in subdivision (a) within two working days of the date that the department is notified of the delivery or within the time determined by the department to be necessary and adequate. If the payment is not made by the Controller to the certified processor within 20 working days of receipt of the claims schedule, the Controller shall pay the processor interest at the current prime lending rate for any period in excess of these 20 working days.

14573.5. (a) Except as provided in Section 14573.6, a processor shall pay to a certified recycling center, dropoff or collection program, or curbside program, for all types of empty beverage containers, by type of beverage container, received by the processor from a recycling center, curbside program, or dropoff or collection program, upon receipt by the certified processor of a shipping report from the supplier of the material, in the form adopted by the regulations adopted by the department, the sum of all of the following amounts:

(1) The refund value.

(2) Three-fourths of 1 percent of the refund value for administrative costs.

(3) The processing payment established pursuant to Section 14575.

(b) The processor shall make the payment required in subdivision (a) within two working days of the date that the processor receives these empty beverage containers, or within the time which the department determines to be necessary and adequate. Under the procedures authorized by the department, the department may authorize a certified recycling center to cancel containers, and a certified processor may authorize a certified recycling center to cancel containers on behalf of the certified processor.

(c) If the department has set up an accounts receivable procedure or other procedure for seeking the payment of money improperly obtained by a certified recycling center from the fund, the department may reimburse the processor for its payments to that certified recycling center.

14573.51. (a) Notwithstanding any other provision of this division, recycling centers and processors shall not pay curbside programs more than the applicable statewide average curbside commingled rate unless the curbside program has received an individual commingled rate from the department pursuant to subdivision (b).

(b) The department may establish a procedure whereby the operators of curbside programs may apply for an individual commingled rate for any material or types with or without a statewide commingled rate, including, but not limited to, glass, aluminum, bimetal, or any of the individual plastic resin types or combination of resin types identified by resin identification codes under Section 18015. These procedures shall require, at a minimum, all of the following:

(1) The individual rate shall be valid for no more than one year from the date the individual rate is authorized.

(2) The methodology used by the operator of the curbside program to determine the commingled rate shall be approved by the department, in advance.

(c) Curbside programs that have acquired an individual commingled rate, pursuant to this section, shall not be surveyed by the department to determine the statewide average curbside commingled rate during the period the individual commingled rate is effective.

(d) The department may enter into a contract for the services required to implement the amendments to this section made by the act of the first half of the 2003-04 Regular Session of the Legislature amending this section. The department may not expend more than two hundred fifty thousand dollars (\$250,000) for each year of the contract. The contract shall be paid only from revenues derived from redemption payments and processing fees paid on plastic beverage containers displaying the resin identification code "3," "4," "5," "6," or "7" pursuant to Section 18015. If the department determines that insufficient funds will be available from these revenues, after refund values are paid to processors and the reduction is made in the processing fee pursuant to subdivision (f) of Section 14575 for these containers, the department may determine not to calculate a commingled rate pursuant to subdivision (b).

14573.6. No dropoff or collection program shall pay any refund value to the consumer, and a dropoff or collection program is not eligible to receive any sum paid pursuant to Section 14573 or 14573.5 for administrative costs.

14573.7. Notwithstanding Sections 14573 and 14573.5, the department may

require a recycling center, pursuant to a prepayment review taken pursuant to subdivision (a) of Section 14552, to submit consumer transaction logs and consumer transaction receipts as support documentation for shipping reports submitted to processors. The department may, pursuant to this section, authorize a processor to withhold refund value payments to a recycling center. The department may suspend the certification of a recycling center without a hearing if the recycling center fails to comply with the documental submittal requirements of this section, upon providing notice of these requirements. The recycling center which is the subject of the suspension may then request a hearing on the suspension, but the request for a hearing shall not stay the suspension. A hearing requested pursuant to this section shall be conducted in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code.

14574. (a)(1) A distributor of beverage containers shall pay to the department the redemption payment for every beverage container, other than a refillable beverage container, sold or transferred to a dealer, less 1.5 percent for the distributor's administrative costs.

~~(2) The payment made by a distributor shall be made not later than the last day of the third month following the sale. The distributor shall make the payment in the form and manner that the department prescribes.~~

(2) Between February 1, 2010, and June 30, 2012, inclusive, the payment made by a distributor shall be made not later than the last day of the second month following the sale. The distributor shall make the payment in the form and manner that the department prescribes.

(b)(1) Notwithstanding subdivision (a), if a distributor displays a pattern of operation in compliance with this division and the regulations adopted pursuant to this division, to the satisfaction of the department, the distributor may make a single annual payment of redemption payments, ~~if the distributor meets either of the following requirements:~~ distributor's projected redemption payment for a calendar year totals less than seventy-five thousand dollars (\$75,000).

~~(A) If the redemption payment and refund value is not increased pursuant to paragraph (3) of subdivision (a) of Section 14560, the distributor's projected redemption payment for a calendar year totals less than fifty thousand dollars (\$50,000).~~

~~(B) If the redemption payment and refund value is increased pursuant to paragraph (3) of subdivision (a) of Section 14560, the distributor's projected redemption payment for a calendar year totals less than seventy five thousand dollars (\$75,000).~~

(2) An annual redemption payment made pursuant to this subdivision is due and payable on or before February 1 for every beverage container sold or transferred by the distributor to a dealer in the previous calendar year.

(3) A distributor shall notify the department of its intent to make an annual redemption payment pursuant to this subdivision on or before January 31 of the calendar year for which the payment will be due.

(c) On or before January 10, 2012, the department shall submit to the relevant policy and budget committees of the Legislature an assessment of the effect of ending the bimonthly payment pursuant to

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paragraph (2) of subdivision (a) on the solvency of the fund. The assessment shall include data used to make the assessment, including sales, recycling, and other relevant information.

(d) This section shall become inoperative on July 1, 2012, and, as of January 1, 2013, is repealed, unless a later enacted statute, that becomes operative on or before January 1, 2013, deletes or extends the dates on which it becomes inoperative and is repealed.

(Amended by Chapter 5, Statutes of 2010 (AB 7 (X 8)); effective March 8, 2010.)

14574. (a)(1) A distributor of beverage containers shall pay to the department the redemption payment for every beverage container, other than a refillable beverage container, sold or transferred to a dealer, less 1.5 percent for the distributor's administrative costs.

(2) The payment made by a distributor shall be made not later than the last day of the third month following the sale. The distributor shall make the payment in the form and manner that the department prescribes.

(b)(1) Notwithstanding subdivision (a), if a distributor displays a pattern of operation in compliance with this division and the regulations adopted pursuant to this division, to the satisfaction of the department, the distributor may make a single annual payment of redemption payments, if the distributor's projected redemption payment for a calendar year totals less than seventy-five thousand dollars (\$75,000).

(2) An annual redemption payment made pursuant to this subdivision is due and payable on or before February 1 for every beverage container sold or transferred by the distributor to a dealer in the previous calendar year.

(3) A distributor shall notify the department of its intent to make an annual redemption payment pursuant to this subdivision on or before January 31 of the calendar year for which the payment will be due.

(b) This section shall become effective on July 1, 2012.

(Added by Chapter 5, Statutes of 2010 (AB 7 (X 8)); effective March 8, 2010.)

14575. (a) If any type of empty beverage container with a refund value established pursuant to Section 14560 has a scrap value less than the cost of recycling, the department shall, on January 1, 2000, and on or before January 1 annually thereafter, establish a processing fee and a processing payment for the container, by the type of the material of the container.

(b) The processing payment shall be at least equal to the difference between the scrap value offered to a statistically significant sample of recyclers by willing purchasers, and except for the initial calculation made pursuant to subdivision (d), the sum of both of the following:

(1) The actual cost for certified recycling centers, excluding centers receiving a handling fee, of receiving, handling, storing, transporting, and maintaining equipment for each container sold for recycling or, only if the container is not recyclable, the actual cost of disposal, calculated pursuant to subdivision (c). The department shall determine the statewide weighted average cost to recycle each beverage container type, which shall serve as the actual recycling costs for purposes of paragraph (2) of subdivision (c), by conducting a survey of the costs of a statistically significant sample of certified recycling centers, excluding those recycling centers receiving a handling fee, for receiving, handling, storing, transporting, and maintaining equipment.

(2) A reasonable financial return for recycling centers.

(c) The department shall base the processing payment pursuant to this section upon all of the following:

(1) Except as provided in paragraph (2), for calculating processing payments that will be in effect on and after January 1, 2004, the department shall determine the actual costs for certified recycling centers, every second year, pursuant to paragraph (1) of subdivision (b). The department shall adjust the recycling costs annually to reflect changes in the cost of living, as measured by the Bureau of Labor Statistics of the United States Department of Labor or a successor agency of the United States government.

(2) On and after January 1, 2010, the department shall use the most recently published, measured actual costs of recycling for a specific beverage material type if the department determines the number of beverage containers for that material type that is returned for recycling pursuant to Section 14551, based on the most recently published calendar year number of beverage containers returned for recycling, is less than 5 percent of the total number of beverage containers returned for recycling for all material types. The department shall determine the actual recycling cost to be used for calculating processing payments for those beverage containers in the following manner:

(A) The department shall adjust the costs of recycling that material type every second year by the percentage change in the most recently measured cost of recycling HDPE plastic beverage containers, as determined by the department. The department shall use the percentage change in costs of recycling HDPE plastic beverage containers for this purpose, even if HDPE plastic beverage containers are less than 5 percent of the total volume of returned beverage containers.

(B) The department shall adjust the recycling costs annually for that material type to reflect changes in the cost of living, as measured by the Bureau of Labor Statistics of the United States Department of Labor or a successor agency of the United States government.

(d) Except as specified in subdivision (e), the actual processing fee paid by a beverage manufacturer shall equal 65 percent of the processing payment calculated pursuant to subdivision (b).

(e) The department, consistent with Section 14581 and subject to the availability of funds, shall reduce the processing fee paid by beverage manufacturers by expending funds in each material processing fee account, in the following manner:

(1) On January 1, 2005, and annually thereafter, the processing fee shall equal the following amounts:

(A) Ten percent of the processing payment for a container type with a recycling rate equal to or greater than 75 percent.

(B) Eleven percent of the processing payment for a container type with a recycling rate equal to or greater than 65 percent, but less than 75 percent.

(C) Twelve percent of the processing payment for a container type with a recycling rate equal to or greater than 60 percent, but less than 65 percent.

(D) Thirteen percent of the processing payment for a container type with a recycling rate equal to or greater than 55 percent, but less than 60 percent.

(E) Fourteen percent of the processing payment for a container type with a recycling rate equal to or greater than 50 percent, but less than 55 percent.

(F) Fifteen percent of the processing payment for a container type with a

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recycling rate equal to or greater than 45 percent, but less than 50 percent.

(G) Eighteen percent of the processing payment for a container type with a recycling rate equal to or greater than 40 percent, but less than 45 percent.

(H) Twenty percent of the processing payment for a container type with a recycling rate equal to or greater than 30 percent, but less than 40 percent.

(I) Sixty-five percent of the processing payment for a container type with a recycling rate less than 30 percent.

(2) The department shall calculate the recycling rate for purposes of paragraph (1) based on the 12-month period ending on June 30 that directly precedes the date of the January 1 processing fee determination.

(f) Not more than once every three months, the department may make an adjustment in the amount of the processing payment established pursuant to this section notwithstanding any change in the amount of the processing fee established pursuant to this section, for any beverage container, if the department makes the following determinations:

(1) The statewide scrap value paid by processors for the material type for the most recent available 12-month period directly preceding the quarter in which the processing payment is to be adjusted is 5 percent more or 5 percent less than the average scrap value used as the basis for the processing payment currently in effect.

(2) Funds are available in the processing fee account for the material type.

(3) Adjusting the processing payment is necessary to further the objectives of this division.

(g)(1) Except as provided in paragraphs (2) and (3), every beverage manufacturer shall pay to the department the applicable

processing fee for each container sold or transferred to a distributor or dealer within 40 days of the sale in the form and in the manner which the department may prescribe.

(2)(A) Notwithstanding Section 14506, with respect to the payment of processing fees for beer and other malt beverages manufactured outside the state, the beverage manufacturer shall be deemed to be the person or entity named on the certificate of compliance issued pursuant to Section 23671 of the Business and Professions Code. If the department is unable to collect the processing fee from the person or entity named on the certificate of compliance, the department shall give written notice by certified mail, return receipt requested, to that person or entity. The notice shall state that the processing fee shall be remitted in full within 30 days of issuance of the notice or the person or entity shall not be permitted to offer that beverage brand for sale within the state. If the person or entity fails to remit the processing fee within 30 days of issuance of the notice, the department shall notify the Department of Alcoholic Beverage Control that the certificate holder has failed to comply, and the Department of Alcoholic Beverage Control shall prohibit the offering for sale of that beverage brand within the state.

(B) The department shall enter into a contract with the Department of Alcoholic Beverage Control, pursuant to Section 14536.5, concerning the implementation of this paragraph, which shall include a provision reimbursing the Department of Alcoholic Beverage Control for its costs incurred in implementing this paragraph.

(3)(A) Notwithstanding paragraph (1), if a beverage manufacturer displays a pattern of operation in compliance with this division and the regulations adopted pursuant to this division, to the satisfaction of the

department, the beverage manufacturer may make a single annual payment of processing fees, if the beverage manufacturer meets either of the following conditions:

(i) If the redemption payment and refund value is not increased pursuant to paragraph (3) of subdivision (a) of Section 14560, the beverage manufacturer's projected processing fees for a calendar year total less than ten thousand dollars (\$10,000).

(ii) If the redemption payment and refund value is increased pursuant to paragraph (3) of subdivision (a) of Section 14560, the beverage manufacturer's projected processing fees for a calendar year total less than fifteen thousand dollars (\$15,000).

(B) An annual processing fee payment made pursuant to this paragraph is due and payable on or before February 1 for every beverage container sold or transferred by the beverage manufacturer to a distributor or dealer in the previous calendar year.

(C) A beverage manufacturer shall notify the department of its intent to make an annual processing fee payment pursuant to this paragraph on or before January 31 of the calendar year for which the payment will be due.

(4) The department shall pay the processing payments on redeemed containers to processors, in the same manner as it pays refund values pursuant to Sections 14573 and 14573.5. The processor shall pay the recycling center the entire processing payment representing the actual costs and financial return incurred by the recycling center, as specified in subdivision (b).

(h) When assessing processing fees pursuant to subdivision (a), the department shall assess the processing fee on each container sold, as provided in subdivisions (d) and (e), by the type of material of the container, assuming that every container

sold will be redeemed for recycling, whether or not the container is actually recycled.

(i) The container manufacturer, or a designated agent, shall pay to, or credit, the account of the beverage manufacturer in an amount equal to the processing fee.

(j) If, at the end of any calendar year for which glass recycling rates equal or exceed 45 percent and sufficient surplus funds remain in the glass processing fee account to make the reduction pursuant to this subdivision or if, at the end of any calendar year for which PET recycling rates equal or exceed 45 percent and sufficient surplus funds remain in the PET processing fee account to make the reduction pursuant to this subdivision, the department shall use these surplus funds in the respective processing fee accounts in the following calendar year to reduce the amount of the processing fee that would otherwise be due from glass or PET beverage manufacturers pursuant to this subdivision.

(1) The department shall reduce the glass or PET processing fee amount pursuant to this subdivision in addition to any reduction for which the glass or PET beverage container qualifies under subdivision (e).

(2) The department shall determine the processing fee reduction by dividing two million dollars (\$2,000,000) from each processing fee account by an estimate of the number of containers sold or transferred to a distributor during the previous calendar year, based upon the latest available data.

14575.1. (a) Notwithstanding subdivision (b) of Section 14575, if a willing purchaser offers to purchase empty PET containers at a voluntary artificial scrap value that is equal to the processing fee reduced pursuant to subdivision (f) of Section 14575 when applied to all containers sold, no processing fee shall be imposed on PET containers pursuant to Section 14575.

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(b) If a willing purchaser offers to pay a voluntary artificial scrap value, the department shall, on a monthly basis, determine whether the sum of the voluntary artificial scrap value and payments made from the PET Processing Fee Account pursuant to subdivision (f) of Section 14575, are equal to, or more than, the recycling cost for empty PET containers determined pursuant to subdivision (d) of Section 14575.

(c) If the department determines that, for any monthly period, the sum of the voluntary artificial scrap value and payments made from the PET Processing Fee Account pursuant to subdivision (f) of Section 14575, is less than the recycling cost for empty PET containers, determined pursuant to Section 14575, the following requirements shall apply:

(1) The department shall immediately provide written notification of the deficiency for that monthly period and the amount of that deficiency to any willing purchaser.

(2) A willing purchaser shall correct the deficiency in the next monthly period by adjusting the voluntary artificial scrap value by an amount sufficient to equal the recycling cost for empty PET containers plus the previous monthly period's deficiency.

(3) If the deficiency and amount in arrears is not corrected within 30 days of

providing written notice to willing purchasers of empty PET containers, the department shall impose a processing fee pursuant to Section 14575 which includes any amount necessary, including any amount in arrears, to cover the cost of recycling empty PET containers.

(d) If the department determines that, for any monthly period, the sum of the voluntary artificial scrap value and payments made from the PET Processing Fee Account pursuant to subdivision (f) of Section 14575, is greater than the recycling cost for empty PET containers, the department shall do both of the following:

(1) Immediately provide written notification of the deviation for that monthly period and the amount of that deviation to any willing purchaser.

(2) Provide a credit equal to the amount of the deviation for any future monthly period wherein the voluntary artificial scrap value, and payments made from the PET Processing Fee Account, are less than the recycling cost of empty PET containers determined pursuant to subdivision (d) of Section 14575.

(e) Nothing in this section is intended to affect any litigation that was pending on January 1, 1996, in which the department is a party of record.

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14580. (a) Except as provided in subdivision (d), the department shall deposit all amounts paid as redemption payments by distributors pursuant to Section 14574, and all other revenues received into the California Beverage Container Recycling Fund, which is hereby created in the State Treasury. Notwithstanding Section 13340 of the Government Code, the money in the fund is hereby continuously appropriated to the department for expenditure without regard to fiscal year for the following purposes:

(1) The payment of refund values and administrative fees to processors pursuant to Section 14573.

(2) For a reserve for contingencies, which shall not be greater than an amount equal to 5 percent of the total amount paid to processors pursuant to Section 14573 during the preceding calendar year, plus the interest earned on that amount.

(b) The money in the fund may be expended by the department for the administration of this division only upon appropriation by the Legislature in the annual Budget Act.

(c) After setting aside funds estimated to be needed for expenditures authorized pursuant to this section, the department shall set aside funds on a quarterly basis for the purposes specified in Section 14581. Notwithstanding Section 13340 of the Government Code, that money is hereby continuously appropriated to the department, without regard to fiscal year, for the purposes specified in Section 14581.

(d) The department shall deposit all civil penalties or fines collected pursuant to this division into the Penalty Account, which is hereby created in the fund. The money in the Penalty Account may be expended by

the department only upon appropriation by the Legislature, for purposes of this division.

(e) The Legislature finds and declares that the maintenance of the fund is of the utmost importance to the state and that it is essential that any money in the fund be used solely for the purposes authorized in this division and should not be used, loaned, or transferred for any other purpose.

(Amended by Chapter 5, Statutes of 2010 (AB 7 (X 8)); effective March 8, 2010.)

14581. (a) Subject to the availability of funds, and pursuant to subdivision (c), the department shall expend the moneys set aside in the fund, pursuant to subdivision (c) of Section 14580 for the purposes of this section *in the following manner:*

(1) For each fiscal year commencing July 1, 2008, the department may expend the amount necessary to make the required handling fee payment pursuant to Section 14585.

(2) Fifteen million dollars (\$15,000,000) shall be expended annually for payments for curbside programs and neighborhood dropoff programs pursuant to Section 14549.6.

(3)(A) Fifteen million dollars (\$15,000,000), plus the proportional share of the cost-of-living adjustment, as provided in subdivision (b), shall be expended annually in the form of grants for beverage container litter reduction programs and recycling programs issued to either of the following:

(i) Certified community conservation corps that were in existence on September 30, 1999, or that are formed subsequent to that date, that are designated by a city or a city and county to perform litter abatement, recycling, and related activities, if the city or the city and county has a population, as

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determined by the most recent census, of more than 250,000 persons.

(ii) Community conservation corps that are designated by a county to perform litter abatement, recycling, and related activities, and are certified by the California Conservation Corps as having operated for a minimum of two years and as meeting all other criteria of Section 14507.5.

(B) Any grants provided pursuant to this paragraph shall not comprise more than 75 percent of the annual budget of a community conservation corps.

(C) For the 2009-10 fiscal year only, the eight million two hundred fifty thousand dollars (\$8,250,000) appropriated to the California Conservation Corps for certified local conservation corps by Item 3340-101-0133 of [Sec. 2.00 of](#) the 2009-10 Budget Act, as added by Section 166 of Chapter 1 of the Fourth Extraordinary Session of the Statutes of 2009, shall be in addition to the amounts expended pursuant to paragraph (3).

(4)(A) Ten million five hundred thousand dollars (\$10,500,000) may be expended annually for payments of five thousand dollars (\$5,000) to cities and ten thousand dollars (\$10,000) for payments to counties for beverage container recycling and litter cleanup activities, or the department may calculate the payments to counties and cities on a per capita basis, and may pay whichever amount is greater, for those activities.

(B) Eligible activities for the use of these funds may include, but are not necessarily limited to, support for new or existing curbside recycling programs, neighborhood dropoff recycling programs, public ~~education promoting~~ [education promoting](#) beverage container recycling, litter prevention, and cleanup, cooperative regional efforts among two or more cities or

counties, or both, or other beverage container recycling programs.

(C) These funds ~~may~~ [shall](#) not be used for activities unrelated to beverage container recycling or litter reduction.

(D) To receive these funds, a city, county, or city and county shall fill out and return a funding request form to the department. The form shall specify the beverage container recycling or litter reduction activities for which the funds will be used.

(E) The department shall annually prepare and distribute a funding request form to each city, county, or city and county. The form shall specify the amount of beverage container recycling and litter cleanup funds for which the jurisdiction is eligible. The form shall not exceed one double-sided page in length, and may be submitted electronically. If a city, county, or city and county does not return the funding request form within 90 days of receipt of the form from the department, the city, county, or city and county is not eligible to receive the funds for that funding cycle.

(F) For the purposes of this paragraph, per capita population shall be based on the population of the incorporated area of a city or city and county and the unincorporated area of a county. The department may withhold payment to any city, county, or city and county that has prohibited the siting of a supermarket site, caused a supermarket site to close its business, or adopted a land use policy that restricts or prohibits the siting of a supermarket site within its jurisdiction.

(5)(A) One million five hundred thousand dollars (\$1,500,000) may be expended annually in the form of grants for beverage container recycling and litter reduction programs.

(B) Notwithstanding subdivision (f), the department shall not expend funds pursuant to this paragraph for the 2010 and 2011 calendar years.

(6)(A) The department shall expend the amount necessary to pay the processing payment established pursuant to Section 14575. The department shall establish separate processing fee accounts in the fund for each beverage container material type for which a processing payment and processing fee are calculated pursuant to Section 14575, or for which a processing payment is calculated pursuant to Section 14575 and a voluntary artificial scrap value is calculated pursuant to Section 14575.1, into which account shall be deposited both of the following:

(i) All amounts paid as processing fees for each beverage container material type pursuant to Section 14575.

(ii) Funds equal to the difference between the amount in clause (i) and the amount of the processing payments established in subdivision (b) of Section 14575, and adjusted pursuant to paragraph (2) of subdivision (c) of, and subdivision (f) of, Section 14575, to reduce the processing fee to the level provided in subdivision (e) of Section 14575, or to reflect the agreement by a willing purchaser to pay a voluntary artificial scrap value pursuant to Section 14575.1.

(B) Notwithstanding Section 13340 of the Government Code, the moneys in each processing fee account are hereby continuously appropriated to the department for expenditure without regard to fiscal years, for purposes of making processing payments pursuant to Section 14575.

(C) Notwithstanding the other provisions of this section and Section 14575, for the 2010 and 2011 calendar years, the total amount that the department may expend to

reduce the amount of processing fees for each container type shall not exceed the total amount expended to reduce processing fees in the 2008 calendar year.

(7)(A) Up to five million dollars (\$5,000,000) may be annually expended by the department for the purposes of undertaking a statewide public education and information campaign aimed at promoting increased recycling of beverage containers.

(B) Notwithstanding subdivision (f), the department shall not expend funds pursuant to this paragraph for the 2010 and 2011 calendar years.

(8) Up to ten million dollars (\$10,000,000) may be expended annually by the department for quality incentive payments for empty glass beverage containers pursuant to Section 14549.1.

(9) Up to twenty million dollars (\$20,000,000) may be expended annually by the department, until January 1, 2012, to issue grants for recycling market development and expansion-related activities aimed at increasing the recycling of beverage containers. Notwithstanding subdivision (f), the department shall not expend any funds pursuant to this paragraph for the 2010 and 2011 calendar years. The activities that may be funded include, but are not limited to, the following:

(A) Research and development of collecting, sorting, processing, cleaning, or otherwise upgrading the market value of recycled beverage containers.

(B) Identification, development, and expansion of markets for recycled beverage containers.

(C) Research and development for products manufactured using recycled beverage containers.

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(D) Research and development to provide high-quality materials that are substantially free of contamination.

(E) Payments to California manufacturers who recycle beverage containers that are marked by resin type identification code "3," "4," "5," "6," or "7," pursuant to Section 18015.

(10) Up to ten million dollars (\$10,000,000) may be expended annually by the department for market development payments for empty plastic beverage containers pursuant to Section 14549.2, until January 1, 2012.

(11)(A) Up to twenty million dollars (\$20,000,000) may be expended from July 1, 2009, to January 1, 2012, inclusive, for either of the following:

(i) Grants for beverage container recycling and litter reduction programs that emphasize the greatest and most effective collection of beverage containers per dollar spent to ensure the program's performance and accountability.

(ii) Focused, regional community beverage container recycling and litter reduction programs that enable the department to more effectively organize the amount and type of resources needed for regional and statewide efforts to increase recycling.

(B) The department shall require, as a condition of receiving grant funds pursuant to subparagraph (A), each grant recipient to submit a final report including, but not limited to, the grant recipient's reported volumes of beverage containers recycled, where applicable.

(C) On or before July 1, 2014, the department shall publish an evaluation of all grants made pursuant to subparagraph (A). At a minimum, the evaluation shall summarize each final report submitted by

each grantee pursuant to subparagraph (B) and assess whether the grantee adequately met the scope and objectives outlined in the grant agreement.

(D) Notwithstanding subdivision (f), the department shall not expend funds pursuant to this paragraph for the 2010 and 2011 calendar years.

(b) The fifteen million dollars (\$15,000,000) that is set aside pursuant to paragraph (3) of subdivision (a) is a base amount that the department shall adjust annually to reflect any increases or decreases in the cost of living, as measured by the Department of Labor, or a successor agency, of the federal government.

~~(e)(1) The department shall review all funds on a quarterly basis and provide a status report on its Internet Web site to ensure that there are adequate funds to make the payments specified in this section and the processing fee reductions required pursuant to Section 14575.~~

~~(2) If~~

~~(c)(1) If~~ the department determines, pursuant to a review made pursuant to ~~paragraph (1)~~ Section 14556, that there may be inadequate funds to pay the payments required by this ~~section and the processing fee reductions required pursuant to Section 14575~~ division, the department shall immediately notify the appropriate policy and fiscal committees of the Legislature regarding the inadequacy.

~~(3)~~

~~(2)~~ On or before 180 days, but not less than ~~90~~ 80 days, after the notice is sent pursuant to paragraph ~~(2)~~ (1), the department may reduce or eliminate expenditures, or both, from the funds as necessary, according to the procedure set forth in subdivision (d).

(d) If the department determines that there are insufficient funds to make the payments specified pursuant to this section and Section 14575, the department shall reduce all payments proportionally.

(e) Prior to making an expenditure pursuant to paragraph (7) of subdivision (a), the department shall convene an advisory committee consisting of representatives of the beverage industry, beverage container manufacturers, environmental organizations, the recycling industry, nonprofit organizations, and retailers, to advise the department on the most cost-effective and efficient method of the expenditure of the funds for that education and information campaign.

(f) Subject to the availability of funds, the department shall retroactively pay in full any payments provided in this section that have been proportionally reduced during the period of January 1, 2010, through June 30, 2010.

(Amended by Chapter 718, Statutes of 2010 (SB 855); effective October 19, 2010.)

14582. The Recycling Infrastructure Loan Guarantee Account is hereby created as a revolving account in the California Beverage Container Recycling Fund, and the funds in that account are continuously appropriated to the department to issue loan guarantees for capital expenditures for new recycling infrastructure located in the state. The department may issue a loan guarantee from the account only if the department determines that the new recycling infrastructure adds recycling capacity, results in remanufacturing and reuse of beverage containers into new products, and complies with all applicable laws and regulations.

14584. (a) Operators of reverse vending machines or processors may apply to the California Pollution Control Financing Authority for financing pursuant to Section

44526 of the Health and Safety Code, as a means of obtaining capital for establishment of a convenience network. For purposes of Section 44508 of the Health and Safety Code, "project" includes the establishing of a recycling location pursuant to the division.

(b) Corporations, companies, or individuals may apply for loan and grant funds from the Energy Technologies Research, Development, and Demonstration Account specified in Section 25683 by applying to the State Energy Resources Conservation and Development Commission for the purpose of demonstrating equipment for enhancing recycling opportunities.

14585. (a) The department shall adopt guidelines and methods for paying handling fees to supermarket sites, nonprofit convenience zone recyclers, or rural region recyclers to provide an incentive for the redemption of empty beverage containers in convenience zones. The guidelines shall include, but not be limited to, all of the following:

(1) Handling fees shall be paid on a monthly basis, in the form and manner adopted by the department. The department shall require that claims for the handling fee be filed with the department not later than the first day of the second month following the month for which the handling fee is claimed as a condition of receiving any handling fee.

(2)(A) To be eligible for any handling fee, a supermarket site recycling center, nonprofit convenience zone recycler, or rural region recycler shall redeem not less than 60,000 beverage containers, during the calendar month in which the handling fee is claimed or have redeemed not less than an average of 60,000 beverage containers per month during the previous 12 months.

(B) Subparagraph (A) shall not apply on and after July 1, 2008.

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(3)(A) A beverage container with a capacity of 24 fluid ounces or more shall be considered as two beverage containers for purposes of determining the eligibility percentage, any handling fee calculations, and payments.

(B) Subparagraph (A) shall not apply on and after July 1, 2008.

(4) The department shall determine the number of eligible containers per site for which a handling fee will be paid in the following manner:

(A) Each eligible site's combined monthly volume of glass and plastic beverage containers shall be divided by the site's total monthly volume of all empty beverage container types.

(B) If the quotient determined pursuant to subparagraph (A) is equal to, or more than, 10 percent, the total monthly volume of the site shall be the maximum volume which is eligible for a handling fee for that month.

(C) If the quotient determined pursuant to subparagraph (A) is less than 10 percent, the department shall divide the volume of glass and plastic beverage containers by 10 percent. That quotient shall be the maximum volume that is eligible for a handling fee for that month.

(5)(A) From the effective date of the statute enacted by Assembly Bill 3056 of the 2005-06 Regular Session to June 30, 2008, inclusive, the department shall pay a handling fee of 1.8 cents (\$0.018) per eligible beverage container, as determined pursuant to paragraph (4).

(B) On and after July 1, 2008, the department shall pay a handling fee per eligible container in the amount determined pursuant to subdivision (f).

(6)(A) Notwithstanding paragraph (5), the total handling fee payment to a

supermarket site, nonprofit convenience zone recycler, or rural region recycler shall not exceed two thousand three hundred dollars (\$2,300) per month.

(B) Subparagraph (A) shall not apply on and after July 1, 2008.

(7) If the eligible volume in any given month would result in handling fee payments that exceed the allocation of funds for that month, as provided in subdivision (b), sites with higher eligible monthly volumes shall receive handling fees for their entire eligible monthly volume before sites with lower eligible monthly volumes receive any handling fees.

(8)(A) If a dealer where a supermarket site, nonprofit convenience zone recycler, or rural region recycler is located ceases operation for remodeling or for a change of ownership, the operator of that supermarket site nonprofit convenience zone recycler, or rural region recycler shall be eligible to apply for handling fees for that site for a period of three months following the date of the closure of the dealer.

(B) Every supermarket site operator, nonprofit convenience zone recycler, or rural region recycler shall promptly notify the department of the closure of the dealer where the supermarket site, nonprofit convenience zone recycler, or rural region recycler is located.

(C) Notwithstanding subparagraph (A), any operator who fails to provide notification to the department pursuant to subparagraph (B) shall not be eligible to apply for handling fees.

(b) The department may allocate the amount authorized for expenditure for the payment of handling fees pursuant to paragraph (1) of subdivision (a) of Section 14581 on a monthly basis and may carry over any unexpended monthly allocation to a subsequent month or months. However,

unexpended monthly allocations shall not be carried over to a subsequent fiscal year for the purpose of paying handling fees but may be carried over for any other purpose pursuant to Section 14581.

(c)(1) The department shall not make handling fee payments to more than one certified recycling center in a convenience zone. If a dealer is located in more than one convenience zone, the department shall offer a single handling fee payment to a supermarket site located at that dealer. This handling fee payment shall not be split between the affected zones. The department shall stop making handling fee payments if another recycling center certifies to operate within the convenience zone without receiving payments pursuant to this section, if the department monitors the performance of the other recycling center for 60 days and determines that the recycling center is in compliance with this division. Any recycling center that locates in a convenience zone, thereby causing a preexisting recycling center to become ineligible to receive handling fee payments, is ineligible to receive any handling fee payments in that convenience zone.

(2) The department shall offer a single handling fee payment to a rural region recycler located anywhere inside a convenience zone, if that convenience zone is not served by another certified recycling center and the rural region recycler does either of the following:

(A) Operates a minimum of 30 hours per week in one convenience zone.

(B) Serves two or more convenience zones, and meets all of the following criteria:

(i) Is the only certified recycler within each convenience zone.

(ii) Is open and operating at least eight hours per week in each convenience zone and is certified at each location.

(iii) Operates at least 30 hours per week in total for all convenience zones served.

(d) The department may require the operator of a supermarket site or rural region recycler receiving handling fees to maintain records for each location where beverage containers are redeemed, and may require the supermarket site or rural region recycler to take any other action necessary for the department to determine that the supermarket site or rural region recycler does not receive an excessive handling fee.

(e) The department may determine and utilize a standard container per pound rate, for each material type, for the purpose of calculating volumes and making handling fee payments.

(f)(1) On or before January 1, 2008, and every two years thereafter, the department shall conduct a survey pursuant to this subdivision of a statistically significant sample of certified recycling centers that receive handling fee payments to determine the actual cost incurred for the redemption of empty beverage containers by those certified recycling centers. The department shall conduct these cost surveys in conjunction with the cost surveys performed by the department pursuant to subdivision (b) of Section 14575 to determine processing payments and processing fees. The department shall include, in determining the actual costs, only those allowable costs contained in the regulations adopted pursuant to this division that are used by the department to conduct cost surveys pursuant to subdivision (b) of Section 14575.

(2) Using the information obtained pursuant to paragraph (1), the department

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shall then determine the statewide weighted average cost incurred for the redemption of empty beverage containers, per empty beverage container, at recycling centers that receive handling fees.

(3) On and after July 1, 2008, the department shall determine the amount of the handling fee to be paid for each empty beverage container by subtracting the amount of the statewide weighted average cost per container to redeem empty beverage containers by recycling centers that do not receive handling fees from the amount of the statewide weighted average cost per container determined pursuant to paragraph (2).

(4) The department shall adjust the statewide average cost determined pursuant to paragraph (2) for each beverage container annually to reflect changes in the cost of living, as measured by the Bureau of Labor Statistics of the United States Department of Labor or a successor agency of the United States government.

(5) The cost information collected pursuant to this section at recycling centers that receive handling fees shall not be used in the calculation of the processing payments determined pursuant to Section 14575.

14585.5. (a) The department shall not make handling fee payments to a supermarket site if the department determines that all empty beverage container types are not redeemed at the same physical location within the recycling location.

(b) A supermarket site that redeems all empty beverage container types at the same physical location within the recycling location, and issues script to consumers which is required to be redeemed at a nearby host business, is eligible to receive handling fee payments.

14586. This division does not create any guarantee of a continuing level of support, or other obligation on the part of the State of California, the department, or any agency thereof, to pay any specified amount to any local conservation organization, community conservation corps, or statewide nonprofit private agency.

14587. This division does not require or create any obligation that payments made pursuant to this division to any local conservation organization, community conservation corps, or statewide nonprofit private agency in any given fiscal year be made in any subsequent fiscal year at the same or greater level.

CHAPTER 7.5. PENALTIES FOR UNFAIR RECYCLING COMPETITION

14588. It is the intent of the Legislature that handling fees paid to supermarket site recycling centers pursuant to Section 14585 shall only be used to offset the unique costs of providing convenient recycling opportunities to consumers at supermarket sites, and that those fees may not be expended for the purpose of engaging in unfair and predatory competition in order to reduce recycling rates of other recycling centers certified pursuant to this division.

14588.1. (a) As used in this chapter, "unfair and predatory pricing" means the payment to consumers by a supermarket site, that receives handling fees for the redemption of beverage containers, in an amount that exceeds the sum of both of the following:

(1) The California refund value for that container.

(2)(A) If the supermarket site is not located in a rural region, the average scrap value paid per pound for that container type by specified certified recycling centers located within a five-mile radius of the supermarket site on the date of the alleged occurrence, the day before the alleged occurrence, and the day after the alleged occurrence.

(B) If the supermarket site is located in a rural region, the average scrap value paid per pound for that container type by specified certified recycling centers located within a 10-mile radius of the supermarket site on the date of the alleged occurrence, the day before the alleged occurrence, and the day after the alleged occurrence.

(b) In calculating the three-day average price paid by recyclers within the specified distance of a recycler alleged to have engaged in predatory pricing, as required by

subdivision (a), the department shall only survey those recyclers who did not receive handling fees in three or more of the 12 whole months immediately preceding the date of the allegation of predatory pricing.

(c) For purposes of this chapter, "rural region" means a nonurban area identified by the department on an annual basis using the loan eligibility criteria of the Rural Housing Service of the United States Department of Agriculture, Rural Development Administration, or its successor agency. Those criteria include, but are not limited to, places, open country, cities, towns, or census designated places with populations that are less than 10,000 persons. The department may designate an area with population of between 10,000 and 50,000 persons as a rural region, unless the area is identified as part of, or associated with, an urban area, as determined by the department on an individual basis.

14588.2. (a) To ensure that handling fees paid to a supermarket site are not used for the purpose of engaging in unfair and predatory pricing, and to otherwise further the intent of this chapter, the department shall follow all of the requirements of this section upon the complaint of either of the following:

(1) Any certified recycler located within five miles of the supermarket site alleged to have engaged in unfair and predatory pricing if not located in a rural region.

(2) Any certified recycler located within 10 miles of the supermarket site alleged to have engaged in unfair and predatory pricing if located in a rural region.

(b)(1) Within 50 days of receiving the complaint, the department shall complete an audit of the payments for the redemption of

CHAPTER 7.5. PENALTIES FOR UNFAIR RECYCLING COMPETITION

beverage containers being paid by the supermarket site, and by all other certified recycling centers as specified in Section 14588.1, for the purpose of determining whether the supermarket site is engaged in unfair and predatory pricing.

(2) The department shall withhold from public disclosure any proprietary information collected by the department in the course of the audit mandated by paragraph (1). The department shall exercise its discretion in determining what information is proprietary.

(c)(1) If the director determines there is probable cause that a supermarket site, against which a complaint has been made, has engaged in unfair and predatory pricing, the director shall, within 60 days of receiving the complaint, convene an informal hearing before the director, or the director's designee.

(2) At least 10 days before the hearing, the director shall forward the results of the audit to the complainant and respondent.

(3) At the hearing, the director, or the director's designee, shall review the audit conducted pursuant to subdivision (b) and any evidence presented by the complainant that a supermarket site has engaged in unfair and predatory pricing. The director, or the director's designee, shall also review any evidence presented by the respondent that the respondent has not engaged in unfair and predatory pricing.

(4) The respondent shall be given the opportunity to rebut the presumption of unfair and predatory pricing imposed by Section 14588.1 by demonstrating to the satisfaction of the director, or the director's designee, that the respondent did both of the following:

(A) The respondent made a good faith effort to determine the average scrap value paid per pound for that container type by

certified recycling centers located within a five-mile or 10-mile radius of the supermarket site, pursuant to subdivision (a) of Section 14588.1, within 30 days before the date of the alleged violation.

(B) The three-day average scrap value the respondent paid per pound for that container type was within 2.5 percent of the three-day average scrap value paid per pound determined by the department pursuant to subdivision (a).

(5) The director, or the director's designee, may dismiss a complaint made pursuant to subdivision (a) upon determining either of the following:

(A) The complaint is without basis.

(B) The complaint is repetitious of prior similar complaints against the same supermarket site for which the director or the director's designee has determined that no unfair and predatory pricing occurred.

(d) Within 20 days of the completion of the hearing, the director, or the director's designee, shall determine whether the supermarket site has engaged in unfair and predatory pricing. This determination shall be based upon the audit conducted pursuant to subdivision (b), and upon any clear and convincing evidence of unfair and predatory pricing presented at the hearing.

(e) During the time period from the date of the receipt of a complaint pursuant to subdivision (a), until the date the director makes a determination pursuant to subdivision (d), the supermarket site against which the allegation of unfair and predatory pricing is made shall not receive handling fees that were earned during the period commencing with the date of the alleged unfair and predatory pricing. However, nothing in this subdivision shall affect the payment of handling fees to a supermarket site that is found not to have engaged in unfair and predatory pricing pursuant to this

section, or to the activities of a supermarket site prior to the date of the alleged unfair and predatory pricing.

(f) If, after complying with the procedure established pursuant to this section, the director, or the director's designee, determines that a supermarket site has engaged in unfair and predatory pricing, the site is ineligible to receive handling fees as specified by this section.

(1) If the determination of unfair and predatory pricing is the first for the site, the site is ineligible to receive handling fees for six months from the date that the respondent is found to have engaged in unfair and predatory pricing.

(2) If the determination of unfair and predatory pricing is the second for the site, the site is ineligible to receive handling fees for one year from the date that the respondent is found to have engaged in unfair and predatory pricing.

(3) If the determination of unfair and predatory pricing is the third or more for the

site, the site is ineligible to receive handling fees for five years after that date that the respondent is found to have engaged in unfair and predatory pricing.

(g) The complainant or respondent may obtain a review of the determination made pursuant to this section by filing in the superior court a petition for a writ of mandate within 30 days following the issuance of the determination. Section 1094.5 of the Code of Civil Procedure shall govern judicial proceedings pursuant to this subdivision, except that the court shall exercise its independent judgment. If a petition for a writ of mandate is not filed within the time limits set forth in this subdivision, the determination made pursuant to this subdivision is not subject to review by any court or agency.

(h) If either party appeals the determination of the director, or the director's designee, pursuant to subdivision (g), and the department prevails, the department may recover any costs associated with its defense of the complaint.

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CHAPTER 8. SEVERABILITY AND ENFORCEMENT

14590. If any provision of this division or the application thereof to any person or circumstances is held invalid, that invalidity shall not affect other provisions or applications of the division which can be given effect without the invalid provision or application, and to this end the provisions of this division are severable.

14591. (a) Except as provided in subdivision (b), in addition to any other applicable civil or criminal penalties, any person convicted of a violation of this division is guilty of an infraction, which is punishable by a fine of one hundred dollars (\$100) for each initial separate violation and not more than one thousand dollars (\$1000) for each subsequent separate violation per day.

(b)(1) Every person who, with intent to defraud, takes any of the following actions is guilty of fraud:

(A) Submits a false or fraudulent claim for payment pursuant to Section 14573 or 14573.5.

(B) Fails to accurately report the number of beverage containers sold, as required by subdivision (b) of Section 14550.

(C) Fails to make payments as required by Section 14574.

(D) Redeems out-of-state containers, rejected containers, line breakage, or containers that have already been redeemed.

(E) Returns redeemed containers to the marketplace for redemption.

(F) Brings out-of-state containers, rejected containers, or line breakage to the marketplace for redemption.

(G) Submits a false or fraudulent claim for handling fee payments pursuant to Section 14585.

(2) If the money obtained or withheld pursuant to paragraph (1) exceeds nine hundred fifty dollars (\$950), the fraud is punishable by imprisonment in the county jail for not more than one year or by a fine not exceeding ten thousand dollars (\$10,000) or by both, or by imprisonment in the state prison for 16 months, two years, or three years, or by a fine not exceeding twenty-five thousand dollars (\$25,000) or twice the late or unmade payments plus interest, whichever is greater, or by both fine and imprisonment. If the money obtained or withheld pursuant to paragraph (1) equals, or is less than, nine hundred fifty dollars (\$950), the fraud is punishable by imprisonment in the county jail for not more than six months or by a fine not exceeding one thousand dollars (\$1000), or by both.

(c) For purposes of this section and Chapter 8.5 (commencing with Section 14595), "line breakage" and "rejected container" have the same meanings as defined in the regulations adopted or amended by the department pursuant to this division.

14591.1. (a)(1) The department may assess a civil penalty upon a person who violates this division in an amount greater than one thousand dollars (\$1,000) pursuant to this division and any regulations adopted pursuant to this division only after notice and hearing in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code.

(2) The department may assess a civil penalty upon a person who violates this division in an amount equal to, or less than, one thousand dollars (\$1,000), using a notice of violation process established by regulation and may use an informal hearing process pursuant to Article 10 (commencing

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with Section 11445.10) of Chapter 4.5 of Part 1 of Division 3 of Title 2 of the Government Code.

(3) Each violation of this division is a separate violation and each day of the violation is a separate violation. The department shall deposit all revenues from civil penalties in the Penalty Account specified in subdivision (d) of Section 14580.

(b) Any person who intentionally or negligently violates this division may be assessed a civil penalty by the department pursuant to subdivision (a) of up to five thousand dollars (\$5,000) for each separate violation, or for continuing violations, for each day that violation occurs.

(c) Any person who violates this division by an action not subject to subdivision (b) may be assessed a civil penalty by the department pursuant to subdivision (a) of up to one thousand dollars (\$1,000) for each separate violation, or for continuing violations, for each day that violation occurs.

(d) No person may be liable for a civil penalty imposed under subdivision (b) and for a civil penalty imposed under subdivision (c) for the same act or failure to act.

(e) In determining the amount of penalties to be imposed pursuant to this division, the department shall take into consideration the nature, circumstances, extent and gravity of the violation, the costs associated with bringing the action and, with respect to the violator, the ability to pay, the degree of culpability, compliance history, and any other matters that justice may require.

14591.2. (a) The department may take disciplinary action against any party responsible for directing, contributing to, participating in, or otherwise influencing the

operations of, a certified or registered facility or program. A responsible party includes, but is not limited to, the certificate holder, registrant, officer, director, or managing employee. Except as otherwise provided in this division, the department shall provide a notice and hearing in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code before taking any disciplinary action against a certificate holder.

(b) All of the following are grounds for disciplinary action, in the form determined by the department in accordance with subdivision (c):

(1) The responsible party engaged in fraud or deceit to obtain a certificate or registration.

(2) The responsible party engaged in dishonesty, incompetence, negligence or fraud in performing the functions and duties of a certificate holder or registrant.

(3) The responsible party violated this division or any regulation adopted pursuant to this division, including, but not limited to, any requirements concerning auditing, reporting, standards of operation, or being open for business.

(4) The responsible party is convicted of any crime of moral turpitude or fraud, any crime involving dishonesty, or any crime substantially related to the qualifications, functions, or duties of a certificate holder.

(c) The department may take disciplinary action pursuant to this section, by taking any one of, or any combination of, the following:

(1) Immediate revocation of the certificate or registration, or revocation of a certificate or registration as of a specific date in the future.

(2) Immediate suspension of the certificate or registration for a specified period of time, or suspension of the certificate or registration as of a specific date in the future. Notwithstanding subdivision (a), the department may impose a suspension of five days or less through an informal notice, if the action is subject to a stay on appeal, pending an informal hearing convened in accordance with Article 10 (commencing with Section 11445.10) of Chapter 4.5 of Part 1 of Division 3 of Title 2 of the Government Code.

(3) Imposition on the certificate or registration of any condition that the department determines would further the goals of this division.

(4) Issuance of a probationary certificate or registration with conditions determined by the department.

(5) Collection of amounts in restitution of any money improperly paid to the certificate holder or registrant from the fund.

(6) Imposition of civil penalties pursuant to Section 14591.1.

(d) The department may do any of the following in taking disciplinary action pursuant to this section:

(1) If a certificate holder or registrant holds certificates or is registered to operate at more than one site or to operate in more than one capacity at one location, such as an entity certified as both a processor and a recycling center, the department may simultaneously revoke, suspend, or impose conditions upon some, or all of, the certificates held by the responsible party.

(2) If the responsible party is an officer, director, partner, manager, employee, or the owner of a controlling ownership interest of another certificate holder or registrant, that other operator's certificate or registration may also be revoked suspended, or

conditioned by the department in the same proceeding, if the other certificate holder or registrant is given notice of that proceeding, or in a subsequent proceeding.

(3)(A) If, pursuant to a notice and a hearing conducted by the director or the director's designee in accordance with Article 10 (commencing with Section 11445.10) of Chapter 4.5 of Part 1 of Division 3 of Title 2 of the Government Code, the department determines that the continued operation of a certified or registered entity poses an immediate and significant threat to the fund, the department may order the immediate suspension of the certificate holder or registrant, pending revocation of the certificate or registration, or the issuance of a probationary certificate imposing reasonable terms and conditions. The department shall record the testimony at the hearing and, upon request, prepare a transcript. For purposes of this section, an immediate and significant threat to the fund means any of the following:

(i) A loss to the fund of at least ten thousand dollars (\$10,000) during the six-month period immediately preceding the order of suspension.

(ii) Missing or fraudulent records associated with a claim or claims totaling at least ten thousand dollars (\$10,000) during the six-month period immediately preceding the order of suspension.

(iii) A pattern of deceit, fraud, or intentional misconduct in carrying out the duties and responsibilities of a certificate holder during the six-month period immediately preceding the order of suspension. For purposes of this section, a pattern of deceit, fraud, or intentional misconduct in carrying out the duties of a certificate holder includes, but is not limited to, the destruction or concealment of any records six months immediately preceding the order of suspension.

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(iv) At least three claims submitted for ineligible material in violation of this division, including, but not limited to, a violation of Section 14595.5, during the six-month period immediately preceding the order of suspension.

(B) An order of suspension or probation may be issued to any or all certified or registered facilities or programs operated by a person or entity that the department determines to be culpable or responsible for the loss or conduct identified pursuant to subparagraph (A).

(C) The order of suspension or issuance of a probationary certificate imposing terms or conditions shall become effective upon written notice of the order to the certificate holder or registrant. Within 20 days after notice of the order of suspension, the department shall file an accusation seeking revocation of any or all certificates or registrations held by the certificate holder or registrant. The certificate holder or registrant may, upon receiving the notice of the order of suspension or probation, appeal the order by requesting a hearing in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code. A request for a hearing or appeal from an order of the department does not stay the action of the department for which the notice of the order is given. The department may combine hearings to appeal an order of suspension and a hearing for the proposed revocation of a certificate or registration into one proceeding.

(D) Nothing in this section shall prohibit the department from immediately revoking a probationary certificate pursuant to subdivision (b) of Section 14541 or from taking other disciplinary action pursuant to Section 14591.2.

14591.3. In any civil or administrative action brought pursuant to this division in

which the department prevails, the department may assess against the defendant or respondent any costs and fees, including attorneys' and experts' fees, and the cost of the investigation and hearing, which are incurred by the fund, whether paid or payable from the fund, and are a result of bringing the civil or administrative action against the defendant or respondent. In the same action, the defendant or respondent may claim from the department any costs and fees incurred in defending or responding to any action brought by the department in which the defendant or respondent prevails, upon a finding that the department's action was clearly frivolous or lacking in significant merit.

14591.4. (a) In addition to any other remedies, penalties, and disciplinary actions provided by this division or otherwise, the department may seek restitution of any money illegally paid to any person from the fund, plus interest at the rate earned on the Pooled Money Investment Account of the total amount.

(b) A certificate holder is liable to the department for restitution pursuant to paragraph (5) of subdivision (c) of Section 14591.2 for payments made by the department to the certificate holder that are based on improperly prepared or maintained documents, as specified in paragraph (7) of subdivision (b) of Section 14538 and paragraph (8) of subdivision (b) of Section 14539.

(c) If the department has a civil cause of action for restitution pursuant to subdivision (a) or (b), or if the department has a civil cause of action against a certificate holder or other responsible party for restitution under any other circumstance, the department may seek restitution in accordance with the following:

(1) For restitution of an amount of more than one thousand dollars (\$1,000), the

department shall proceed in a hearing in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code. The hearing may take place at the same time as a hearing to impose disciplinary action on a certificate holder.

(2) For restitution of an amount of one thousand dollars (\$1,000) or less, the department may use an informal hearing in accordance with Article 10 (commencing with Section 11445.10) of Chapter 4.5 of Part 1 of Division 3 of Title 2 of the Government Code.

(d) Notwithstanding subdivisions (b) and (c) of Section 14591.1, if the department collects amounts in full restitution for money paid, the department may impose a penalty of not more than one hundred dollars (\$100) for each separate violation, or for continuing violations, for each day that violation occurs.

14591.5. After the time for judicial review under Section 11523 of the Government Code has expired, the department may apply to the small claims court or superior court, depending on the jurisdictional amount and any other remedy sought, in the county where the penalties, restitution, or other remedy was imposed by the department, for a judgment to collect any unpaid civil penalties or restitution or to enforce any other remedy provided by this division. The application, which shall include a certified copy of the final agency order or decision, shall constitute a sufficient showing to warrant the issuance of the judgment. The court clerk shall enter the judgment immediately in conformity with the application. The judgment so entered shall have the same force and effect as, and shall be subject to all the provisions of law relating to, a judgment in a civil action, and may be enforced in the same manner as any

other judgment of the court. The court shall make enforcement of the judgment a priority.

14591.6. (a) When a person is engaged in recycling activity that violates this division, any regulation adopted pursuant to this division, or an order issued under this division, the department may issue an order to that person to cease and desist from that activity.

(b) If a request for a hearing is filed in writing within 10 days of the date of service of the order described in subdivision (a), a hearing shall be held in accordance with Article 10 (commencing with Section 11445.10) of Chapter 4.5 of Part 1 of Division 3 of Title 2 of the Government Code. The director or the director's designee shall determine whether to sustain or reverse the cease and desist order. If sustained, the order shall become effective and final upon the issuance and service of the order.

(c) If no written request for a hearing is filed within 10 days of the date of service of the order described in subdivision (a), or if a party requesting the hearing does not appear at the hearing, the order shall be deemed the final order of the department and is not subject to review by any court or agency. This order shall become effective and final after the expiration of the 10-day period within which a hearing may be requested.

(d) If a hearing is requested pursuant to subdivision (b) and the party requesting the hearing does not appear on the date scheduled, and fails to notify the department at least five days prior to the hearing date that the party will not appear, the department may recover from the party all costs and fees incurred by the department, including attorneys' and experts' fees, and any other costs associated with preparing for, or conducting, the hearing.

(e) Upon the failure of any person or persons to comply with any cease and desist order issued by the department, the Attorney General, upon request of the department, shall petition the superior court for the issuance of a preliminary or permanent injunction, or both, as may be appropriate, restraining the person from continuing the activity in violation of the cease and desist order.

(f) The court shall issue an order directing defendants to appear before the court at a certain time and place and show cause why the injunction should not be issued. The court may grant the prohibitory or mandatory relief that may be warranted.

14593. Notwithstanding subdivisions (b) and (c) of Section 14591.1, the department may assess a civil penalty of up to 15 percent of the amount due for payment, and interest at the rate earned by the Pooled Money Investment Account, on distributors and beverage manufacturers for underpayment or late payment of the redemption payments for containers to the fund. The department may examine the accounts and records of distributors and beverage manufacturers that pay or should pay a redemption payment. No penalty shall be assessed until 30 days after the department has notified the distributor or manufacturer of the penalty assessment, and the amount due for payment and interest has not been paid.

14594. (a) Notwithstanding subdivisions (b) and (c) of Section 14591.1, the

department may assess a civil penalty of up to 15 percent of the amount due for payment, and interest at the rate earned by the Pooled Money Investment Account, on a beverage manufacturer that fails to pay a processing fee required pursuant to Section 14575. The department may examine the accounts and records of a beverage manufacturer that pays or should pay a processing fee. No penalty shall be assessed until 30 days after the department has notified the manufacturer of the penalty assessment, and the amount due for payment and interest has not been paid.

(b) If the department determines that an audit of a beverage manufacturer shows that there has been an underpayment of a processing fee, the department may examine the records concerning beverage container sales of a container manufacturer that supplied the beverage containers to the beverage manufacturer.

14594.5. The department may assess upon any person, entity, or operation which redeems, attempts to redeem, or aids in the redemption of, empty beverage containers that have already been redeemed, a civil penalty of up to ten thousand dollars (\$10,000) per transaction, or an amount equal to three times the damage or potential damage, whichever is greater, plus costs as provided in Section 14591.3, pursuant to notice and hearing in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code.

CHAPTER 8.5. REPORTING REQUIREMENTS AND PAYMENT PROHIBITIONS RELATED TO OUT-OF-STATE AND OTHER INELIGIBLE CONTAINERS

14595. The Legislature finds and declares that the redemption of beverage container material imported from out of state, previously redeemed containers, rejected containers, and line breakage presents a significant threat to the integrity of the beverage container recycling program and fund. It is therefore the intent of the Legislature that no refund value or other recycling program payments be paid to any person for this material. It is further the intent of the Legislature that any person participating in conduct intended to defraud the state's beverage container recycling program shall be held accountable for that conduct.

14595.4. For purposes of this chapter, the following definitions shall apply:

(a) "Person" means any individual, corporation, operation, or entity, whether or not certified or registered pursuant to this division.

(b) "Refund value" means, in addition to the definition in Section 14524, any payment by a certified recycler for beverage container material that is at least 15 percent more than the statewide average scrap value for that material type, as determined by the department for the month in which the payment was made, unless the department determines that a reasonable basis exists for that payment.

14595.5. (a)(1) No person shall pay, claim, or receive any refund value, processing payment, handling fee, or administrative fee for any of the following:

(A) Beverage container material that the person knew, or should have known, was imported from out of state.

(B) A previously redeemed container, rejected container, line breakage, or other ineligible material.

(2) No person shall, with intent to defraud, do any of the following:

(A) Redeem or attempt to redeem an out-of-state container, rejected container, line breakage, previously redeemed container, or other ineligible material.

(B) Return a previously redeemed container to the marketplace for redemption.

(C) Bring an out-of-state container, rejected container, line breakage, or other ineligible material to the marketplace for redemption.

(D) Receive, store, transport, distribute, or otherwise facilitate or aid in the redemption of a previously redeemed container, out-of-state container, rejected container, line breakage, or other ineligible material.

(b) For purposes of implementing subdivision (a), the department shall take all reasonable steps to exclude beverage container material imported from out of state, previously redeemed containers, rejected containers, and line breakage, when conducting surveys to determine a commingled rate pursuant to Section 14549.5.

14596. (a) Any person importing more than 100 pounds of aluminum, bimetal, or plastic beverage container material, or more than 1,000 pounds of glass beverage container material, into the state, shall report the material to the department and provide the department with an opportunity for inspection, in accordance with the regulations adopted by the department.

CHAPTER 8.5. REPORTING REQUIREMENTS AND PAYMENT PROHIBITIONS RELATED TO OUT-OF-STATE AND OTHER INELIGIBLE CONTAINERS

(b) The department may impose civil penalties pursuant to Section 14591.1 or take disciplinary action pursuant to Section 14591.2 for a violation of this section.

14597. (a) No person shall falsify documents required pursuant to this division or pursuant to regulations adopted by the department. The falsification of these documents is evidence of intent to defraud and, for purposes of subdivision (b) of Section 14591.1, constitutes intentional misconduct. The department may also take disciplinary action pursuant to Section 14591.2 against a person who engages in falsification including, but not limited to, revocation of any certificate or registration.

(b) No person shall submit, or cause to be submitted, a fraudulent claim pursuant to this division. For purposes of this subdivision, a fraudulent claim is a claim based in whole or in part on false information or falsified documents. Any person who submits a fraudulent claim is subject to the assessment of penalties pursuant to subdivision (b) of Section 14591.1. The department may take action for full restitution for a fraudulent

claim, pursuant to Section 14591.4, and may also take disciplinary action pursuant to Section 14591.2 including, but not limited to, revocation of any certificate or registration.

14599. The department may adopt emergency regulations to implement this chapter. Any emergency regulations, if adopted, shall be adopted in accordance with Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, and for the purposes of that chapter, including Section 11349.6 of the Government Code, the adoption of these regulations is an emergency and shall be considered by the Office of Administrative Law as necessary for the immediate preservation of the public peace, health and safety, and general welfare. Notwithstanding Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code, any emergency regulations adopted pursuant to this section shall be filed with, but not repealed by, the Office of Administrative Law, and shall remain in effect until revised by the director.

PUBLIC RESOURCES CODE
DIVISION 12.7
PLASTIC WASTE

(Division 12.7 was added by Chapter 838 (AB 3299), Statutes of 1988; effective January 1, 1989)
AS AMENDED THROUGH 1/1/2011

CHAPTER 1. LEGISLATIVE FINDINGS

18000. The Legislature finds and declares the following:

(a) Facilitating the recycling of plastics is in the best interests of the state.

(b) This division is intended to require all plastic products sold in California on and after January 1, 1992, to have a molded label indicating the plastic resin used to produce the product.

CHAPTER 2. CONTAINERS AND PACKAGING

18010. “Rigid plastic container” means any formed or molded article comprised predominantly of plastic resin and having a relatively inflexible finite shape or form intended primarily as a single service container with a capacity of eight ounces or more and less than five gallons.

18011. “Rigid plastic bottle” means any rigid plastic container with a neck that is smaller than the container body with a capacity of 16 ounces or more and less than five gallons.

18012. “Label” means a code label described in Section 18015 molded into the bottom of the plastic product.

18015. (a) All rigid plastic bottles and rigid plastic containers sold in California on and after January 1, 1992, shall be labeled with a code which indicates the resin used to produce the rigid plastic bottle or rigid plastic container. Rigid plastic bottles or rigid plastic containers with labels and basecaps of a different material shall be coded by their basic material. The code shall consist of a number placed inside a triangle, and letters placed below the triangle. The triangle shall be equilateral, formed by three arrows with the apex of each point of the triangle at the midpoint of each arrow, rounded with a short radius. The pointer (arrowhead) of each arrow shall be at the midpoint of each side of the triangle with a short gap separating the pointer from the base of the adjacent arrow.

The triangle, formed by the three arrows curved at their midpoints shall depict a clockwise path around the code number. The numbers and letters used shall be as follows:

1 =PETE (polyethylene terephthalate)

2 =HDPE (high density polyethylene)

3 =V (vinyl)

4 =LDPE (low density polyethylene)

5 =PP (polypropylene)

6 =PS (polystyrene)

7 =OTHER (includes multilayer)

(b) A “7” shall appear below the resin abbreviation when the bottle or container is composed of more than one layer of that resin.

(c) On and after January 1, 1989, the Division of Recycling of the Department of Conservation shall maintain a list of abbreviations used on labels pursuant to subdivision (a) and shall provide a copy of that list to any person upon request.

18016. On and after January 1, 1992, it is unlawful to manufacture for use in this state any rigid plastic container which is not labeled in accordance with Section 18015. A violation of this section is a crime punishable by a fine of one thousand dollars (\$1,000).

PUBLIC RESOURCES CODE
DIVISION 12.9
FIBERGLASS RECYCLED CONTENT ACT OF 1991

(Division 12.9 was added by Chapter 706 (AB 1340), Statutes of 1991; effective January 1, 1992)
AS AMENDED THROUGH 1/1/2011

CHAPTER 1. FINDINGS AND DEFINITIONS

19500. The Legislature finds and declares all of the following:

(a) Recycling of glass sold in the state benefits the state through reduction in the need for solid waste landfills, more efficient use of energy in manufacturing, and development of an economy more efficient in its use of secondary materials.

(b) Because of the expansion of recycling collection programs in the state, there is a need to aggressively develop new markets for scrap glass.

(c) The use of scrap glass in the manufacture of fiberglass products sold in California will contribute significantly to developing markets for recycled glass.

(d) The use of cullet in fiberglass manufacturing presents no significant technical or financial barriers to industry or consumers, if the cullet meets minimum quality specifications.

(e) In order to enhance the availability and efficiency of recycling opportunities, it is in the best interest of the health and safety of the people of the state to make alternative

markets for recycled glass economically feasible.

19501. This division shall be known and may be cited as the Fiberglass Recycled Content Act of 1991.

19502. For purposes of this division, the following definitions shall apply:

(a) "Cullet" means postconsumer glass from food, drink, or beverage containers, or any other glass not generated by fiberglass manufacturing.

(b) "Department" means the Department of Conservation.

(c) "Fiberglass manufacturer" means a person who uses glass in the commercial manufacture of building insulation fiberglass for wholesale or retail sale in the state.

(d) "Building insulation" means a fiberglass batt, blanket, loose fill or spray-in-place material primarily designed and used to resist heat flow, that is installed in roofs, ceilings, walls, and floors of buildings.

CHAPTER 2. FIBERGLASS RECYCLED CONTENT PROGRAM

19510. Except as provided in Section 19511, every manufacturer shall ensure that the annual tonnage of fiberglass manufactured or sold in the state by that manufacturer on and after January 1, 1992, other than fiberglass in inventory manufactured for sale before January 1, 1992, shall contain at least 10 percent cullet.

19511. The percentage of fiberglass sold which is made of cullet shall be calculated in tons used on an annual basis. Unless the department determines that an increase in the percentage of cullet would pose an unreasonable technical burden on the fiberglass manufacturer that exceeds the benefits to recycling the cullet, each fiberglass manufacturer shall increase the percentage of cullet in fiberglass in accordance with the following requirements:

(a) On and after January 1, 1994, until December 31, 1994, the percentage of cullet shall be 20 percent.

(b) On and after January 1, 1995, the percentage of cullet shall be 30 percent.

19512. On or before January 1, 1994, the department shall request comments from at least two fiberglass manufacturers, two cullet processors, and any other interested parties on the feasibility of increasing the percentage of cullet in fiberglass to 30 percent. On or before July 1, 1994, the department shall hold a public hearing, on the record, with representatives from the fiberglass industry, cullet processors, and other interested parties to determine the feasibility of increasing cullet content in fiberglass manufacturing.

CHAPTER 3. CULLET SPECIFICATIONS FOR FIBERGLASS MANUFACTURING

19515. The quality specifications provided in this chapter are the minimum quality specifications which cullet is required to meet for purposes of the exemption specified in Section 19522.

19515.5. Chemical Composition

<i>Oxides</i>	<i>Percentage Weight</i>	<i>Tolerance (+ or - Percentage Range)</i>
Silicon Dioxide	66-75	1.00
Aluminum Oxide	0-7	0.50
Calcium Oxide	5-15	0.50
Magnesium Oxide	0-5	0.50
Sodium Oxide	8-18	0.50
Potassium Oxide	0-4	0.50
Iron Oxide	less than 0.5	0.05
Chromium Oxide	less than 0.1	0.02
Sulfur Trioxide	less than 0.2	0.02
All other oxides	less than 0.1	0.02
Organic Carbon	less than 0.1	0.02
Moisture Content (No caking with free-flowing fiberglass)	less than 0.5	0.05
Loss on Ignition	less than 1.0	0.10

19516. Contaminants

<i>Other Inorganic Material</i>	<i>Percentage Weight</i>
+12 Mesh	None
+20 Mesh	less than 0.1
-20 Mesh	less than 0.2
Magnetic Materials	less than 0.1
Nonmagnetic Materials	None

CHAPTER 3. CULLET SPECIFICATIONS FOR FIBERGLASS MANUFACTURING

19517. Physical Composition

Particle Size: Cullet shall be one of two types below depending upon the requirements of the fiberglass manufacturer.

<i>Screen Size</i>	<i>Coarse Cullet</i>	<i>Fine Cullet</i>
+1/4"	0%	0%
+12 Mesh	25% Minimum	0.5% Maximum
-200 Mesh	15% Maximum	15.0% Maximum
<i>Color Distribution</i>		
<i>Type</i>	<i>Nominal Percentage Weight</i>	<i>Tolerance (+ or - Percentage Range)</i>
Flint	0-100	+ or - 3.0
Green	1-100	+ or - 3.0
Amber	less than 25	+ or - 3.0

19518. The department may change minimum quality specifications based upon the fiberglass industries' ability to use cullet with higher levels of contamination.

19519. A fiberglass manufacturer shall comply with all applicable state and federal laws, regulations, and permits concerning the environment, health, or safety when using cullet in fiberglass manufacturing.

CHAPTER 4. CERTIFICATION OF USE

19520. Each fiberglass manufacturer shall, on or before March 1 of each year, submit a report to the department certifying the number of tons of cullet used for the manufacture of fiberglass during the preceding calendar year and the number of tons of fiberglass sold in the state during the preceding calendar year.

19521. Every fiberglass manufacturer who submits glass cullet content usage certification pursuant to Section 19520 may be subject to an audit by the department to ensure that the cullet was used.

19522. If a manufacturer of fiberglass is unable to obtain sufficient amounts of cullet within any certification period, the manufacturer shall certify this fact to the department and provide the department with the specific reason for failing to use cullet,

including verification of a best faith effort to use the cullet, and evidence that the cullet failed to meet minimum quality specifications pursuant to Chapter 3 (commencing with Section 19515) and, therefore, presented a significant barrier to meeting the requirements of Chapter 2 (commencing with Section 19510).

19523. For the purposes of implementing and enforcing these provisions, the department shall develop and maintain a list which identifies all fiberglass manufacturers. The department shall also make available to fiberglass manufacturers names and addresses of all recyclers and processors of cullet certified pursuant to Division 12.1 (commencing with Section 14500).

CHAPTER 5. ENFORCEMENT

19530. If any person provides a fiberglass manufacturer with false or misleading information concerning the recycled content of glass cullet, the department, within 30 days of making this determination, shall refer the false or misleading certificate to the Attorney General for prosecution for fraud.

19531. If any fiberglass manufacturer provides the department with a false or misleading certificate concerning the percentage of glass cullet used pursuant to this division pursuant to Section 19520, the department, within 30 days of making this determination, shall refer the false or misleading certificate to the Attorney General for prosecution for fraud.

19532. If any fiberglass manufacturer provides the department with a false or misleading certificate concerning why the fiberglass manufacturer was unable to meet the content requirements due to technical infeasibility pursuant to Section 19522, the department, within 30 days of making this determination, shall refer the false or misleading certificate to the Attorney General for prosecution for fraud.

19533. Information on glass cullet prices or other prices obtained by the department in the course of an audit is proprietary information and the department shall not

make this information available to the general public.

19534. This division does not prevent a person from selling or using fiberglass made of 100 percent virgin content, as long as the fiberglass manufacturer meets the content requirements of Chapter 2 (commencing with Section 19510).

19535. (a) Any person who violates Chapter 2 (commencing with Section 19510) or this section is guilty of an infraction punishable by a fine of not more than one thousand dollars (\$1,000).

(b) In addition to subdivision (a), any person who violates this division may be assessed a civil penalty by the department of not more than one thousand dollars (\$1,000) for each violation, pursuant to a notice and a hearing conducted in accordance with Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code. Any civil penalties and fines received pursuant to this section shall be deposited in the Fiberglass Recycled Content Account, which is hereby established in the California Beverage Container Recycling Fund, and the funds in that account may be expended by the department for the administration of this division upon appropriation by the Legislature.

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Handout 3
Relevant Regulations

California Code of Regulations

Title 14 – Natural Resources Division 2 – Department of Conservation Chapter 5 – Division of Recycling Subchapter 12 – DOR Requirements

Article 1. DOR Determinations and Calculations

§2900. Determinations.

The Division shall make, and give notice of, the following determinations. For purposes of this section, notice shall be deemed complete upon the date of the postmark or date of deposit in the U.S. mail, whichever is earlier. Notices shall be mailed to the last known address of the intended recipient.

(a) Statistics.

(1) Determination. The Division shall determine the following statistics:

(A) Containers per pound. The average number of empty beverage containers per pound, by material type. This number is used to calculate the quantity of beverage containers for certain records, reports, and payments required pursuant to this chapter.

(B) Commingled rate. The average percentage of empty beverage containers in a commingled load of containers, by material type. The Division may determine more than one commingled rate. The Division shall also determine the geographic area within which each commingled rate shall apply. This rate shall be used to calculate the quantity of empty beverage containers for certain records, reports, and payments required pursuant to this chapter.

(2) Notice. Except for the initial determination of the above statistics after which the Division shall provide notice of not less than 10 days prior to their effective date or dates, the Division shall provide notice of the initial determination and any changes to the above statistics no less than 30 days prior to their effective date or dates, as follows:

(A) Recipients. Notice of any such determination shall be provided to persons certified pursuant to this subchapter 2 of these regulations, and to any persons requesting such notice in writing.

(B) Contents. The notice shall state the relevant statistics themselves and their effective date.

(b) Notice of redemption payment or refund value. The Division shall provide notice of any change pursuant to Section 14560 of the Act to the redemption payment or refund value per container, by material type, as follows.

(1) Timing: Notice shall be given no less than 30 days prior to the effective date of the change.

(2) Recipients: Notice shall be mailed to the last known addresses of the following parties:

(A) Persons certified pursuant to subchapter 2 of these regulations.

(B) Distributors having submitted a report to the Division within the previous 6 months.

(C) Persons requesting such notice in writing.

(3) Contents: The notice shall state the changed redemption payment and/or refund value by material type, and its effective date.

NOTE

Authority cited: Sections 14530.5(b) and 14536, Public Resources Code. Reference: Sections 14551, 14553, 14560, and 14581, Public Resources Code.

§2920. Containers per Pound Rate.

The method used to calculate the average number of empty beverage containers per pound, by material type, shall include sampling procedures which consider, at a minimum, the following factors:

- (a) Weight by separately aggregated size categories of containers (same size) in their original manufactured and unfilled state.
- (b) Weight by variously mixed aggregated size of containers (different sizes) in their original manufactured and unfilled state.
- (c) Weight by separately aggregated size categories of containers (same size) in their post-filled state.
- (d) Weight by variously mixed aggregated size of containers (different sizes) in their post-filled state.
- (e) Weight by individually mixed aggregated size of container loads in their post-filled state as presented by consumers at recycling centers (selected statewide on a random basis).
- (f) Volume of sales at wholesale and retail levels in various regions of the state.

NOTE

Authority cited: Sections 14530.5(b) and 14536, Public Resources Code. Reference: Sections 14552 and 14572, Public Resources Code.

§2930. Commingled Rate.

The method used to calculate the commingled rate per pound, by material type, shall include sampling procedures which consider, at a minimum, the following factors:

- (a) Weight and analysis of randomly mixed pre-filled empty beverage containers and other pre-filled containers of the same size in the original manufactured and unfilled state.
- (b) Weight and analysis of individual loads of empty beverage containers and other containers in their post-filled state as presented by consumers at recycling centers (selected statewide on a random basis), excluding reverse vending machines.
- (c) Weight and analysis of loads of empty beverage containers and other containers in their post-filled state redeemed or returned by consumers to reverse vending machines (selected statewide on a random basis).
- (d) Weight and analysis of loads presented to processors by curbside programs, community service programs and dropoff or collection programs.

NOTE

Authority cited: Sections 14530.5(b) and 14536, Public Resources Code. Reference: Sections 14506.7, 14549.5, 14552 and 14572, Public Resources Code.

Article 2. Processing Fees and Processing Payments

§2945. Confidentiality of Information.

- (a) The Division shall disclose only aggregated survey information for three or more firms to the public.
- (b) Individual recycling center, processor, or scrap purchaser survey data exempt from public disclosure includes: trade secrets; financial statements; investment data; proprietary information relating to specific sales, purchases, revenues or expenses; or other information as permitted by section 6255 of the Public Records Act (Government Code section 6255).
- (c) Upon receipt of a written request for records pertaining to information obtained by the Division pursuant to this chapter, the Division shall determine whether the requested information may be exempt from disclosure. The Division shall notify the requesting party of its determination within 10 days of the receipt of the written request as required by the Public Records Act (Government Code section 6256). If the Division determines that the information is not exempt from disclosure, it shall promptly provide it to the requesting party in accordance with the procedures of the Public Records Act.

NOTE

Authority cited: Section 14530.5(b) and (c), Public Resources Code. Reference: Sections 14518.5, 14551(b) and 14575(a), (b) and (d), Public Resources Code; and Sections 6250-6267, Government Code.

§2950. Eligibility.

- (a) Programs and operations eligible to receive processing payments include:
 - (1) recycling centers certified pursuant to these regulations,
 - (2) curbside programs which hold a valid identification number issued by the Division,
 - (3) dropoff or collection programs certified pursuant to these regulations,
 - (4) community service programs certified pursuant to these regulations.

NOTE

Authority cited: Section 14530.5(b), Public Resources Code. Reference: Sections 14518.5, 14573, 14573.5, and 14575(a), (b) and (d), Public Resources Code.

§2955. Scrap Value Calculation.

- (a) The Division shall survey processors to determine statewide weighted average scrap values paid for each beverage container material type (in the case of plastic, for each resin code type) on a monthly basis.
- (b) The Division shall calculate the statewide weighted average scrap value using a statistically significant survey of the processors pursuant to paragraph (a).
- (c) The statewide weighted average scrap value shall be equal to the quotient of the total net payment by the sampled processors to nonaffiliated recyclers divided by the total volume of beverage container material types purchased by the sampled processors from nonaffiliated recyclers, excluding beverage container material types processors receive in a form mixed with other beverage container material types and/or material types not covered by the Act.
- (d) The scrap values reported in (c) above will then be used to determine a per container statewide weighted average scrap value for each container type.
- (e) The Division may periodically sample and review processors' individual scrap purchases to verify the accuracy of the aggregated weights and aggregated net payments reported on the monthly Scrap Value Purchases Survey Form DOR - SV (10/00). The review may include examination of the records maintained by a sample of the selling entities.
- (f) If, through this review, the Division determines that either or both of the sampled weights and sampled net payments reported by a processor differ by more than ten percent (.10) from those recorded by the sellers, the Division shall adjust the reported aggregate weights or aggregate net payments or both to reflect the discovered difference.

NOTE

Authority cited: Sections 14530.5(b), 14536 and 14536.1, Public Resources Code. Reference: Sections 14504, 14515.5, 14518.5, 14519.5, 14526, 14538(b) (8), 14539(a) (9), 14575 and 18015, Public Resources Code.

§2960. Allowable Costs for Recycling Centers.

(a) On or after January 1, 2004, and every second year thereafter, the Division shall survey a statistical sample of recycling centers to determine statewide average allowable costs per container type.

(b) Allowable costs for calculation of the processing fee and processing payment shall include the actual costs of receiving, handling, processing, and storing and transporting postfilled beverage containers. Allowable costs also include maintaining equipment necessary for the above activities. More specifically these costs shall include, but not be limited to:

- (1) labor,
- (2) property taxes,
- (3) depreciation,
- (4) utilities,
- (5) supplies,
- (6) fuel,
- (7) insurance,
- (8) interest,
- (9) general business overhead exclusive of administrative costs,
- (10) facilities and equipment rent or lease,
- (11) maintenance,
- (12) transportation,
- (13) disposal costs.

(c) The scrap price paid to the consumer by the recycling center shall not be included in allowable costs.

NOTE

Authority cited: Section 14530.5(b), Public Resources Code. Reference: Sections 14518.5, 14526, 14573.5 and 14575(a), (b), (c) and (k), Public Resources Code.

§2965. Allowable Costs for Processors.

(a) Allowable costs for calculation of the processing fee shall include the actual costs of receiving, handling, processing, storing, and maintaining equipment, necessary for accepting, canceling, and readying postfilled beverage containers prior to shipment to scrap purchasers. More specifically, these costs shall include, but not be limited to:

- (1) labor,
- (2) property taxes,
- (3) depreciation,
- (4) utilities,
- (5) supplies,
- (6) fuel,
- (7) insurance,
- (8) interest,
- (9) general business overhead exclusive of administrative costs,
- (10) facilities and equipment rent or lease,
- (11) maintenance,
- (12) disposal costs pursuant to (c) below,
- (13) transportation.

(b) The scrap price paid to recycling centers by processors shall not be included in allowable costs.

(c) The Division shall calculate a statewide average disposal cost per container for each beverage container type if the scrap value of a container type is negative as determined in section 2955(c) of these regulations.

(1) When 200% of the disposal cost is less than the absolute value of scrap value pursuant to section 2955 of these regulations, the Division shall use disposal cost, not scrap value, in the calculation of processing fees and processing payments.

(2) When 200% of the disposal cost is greater than or equal to the absolute value of scrap value pursuant to section 2955 of these regulations, the Division shall use only scrap value in the calculation of processing fees and processing payments.

(3) If the scrap price is zero, the Division shall use disposal cost, not scrap value in the calculation of processing fees and processing payments.

NOTE

Authority cited: Section 14530.5(b), Public Resources Code. Reference: Sections 14501(d) and (h), 14518.5, 14526, 14573.5 and 14575(a), (b), (c) and (k), Public Resources Code.

§2970. Allocation of Allowable Costs.

(a) The Division shall determine allowable costs per container pursuant to sections 2960 and 2965 of this subchapter that can be directly allocated to each beverage container type. (For example: depreciation and labor expenses for operating an aluminum can crusher shall be directly allocated to the allowable costs of aluminum beverage containers.)

(b) Allowable costs pursuant to sections 2960 and 2965 of this subchapter that cannot be directly allocated shall be allocated using the direct labor cost percentages for each container type as determined in the allowable cost surveys pursuant to sections 2960 and 2965 of this subchapter.

NOTE

Authority cited: Section 14530.5(b), Public Resources Code. Reference: Sections 14518.5 and 14575(a) and (b), Public Resources Code.

§2975. Reasonable Financial Return Calculation.

The statewide average reasonable financial return for recycling centers shall be equal to the statewide average allowable costs calculated in section 2960 of this subchapter, multiplied by the average return on costs for the scrap and waste materials industry as determined from data contained in the most recent Dun and Bradstreet Standard Three Year Norm Report (Published by Dun and Bradstreet Credit Services).

NOTE

Authority cited: Section 14530.5(b), Public Resources Code. Reference: Sections 14501(f) and (g), 14518.5 and 14575(a) and (b), Public Resources Code.

§2980. Processing Payments.

On and after January 1, 2000, the processor shall pay the operators of curbside programs, dropoff or collection programs, community service programs, and certified recycling centers, the entirety of the processing payment multiplied by the number of containers accepted from the operator by the processor.

NOTE

Authority cited: Section 14530.5(b), Public Resources Code. Reference: Sections 14518.5, 14573.5 and 14575(a), (b) and (h) (3), Public Resources Code.

§2985. Notification of Changes.

(a) When the Division adopts a revised, terminated or newly established processing fee and processing payment pursuant to Public Resources Code Section 14575, the Division shall mail written notification within fifteen (15) days of adoption, and at least fifteen (15) days prior to the effective date of the proposed action(s), to all interested persons.

(b) The Division shall mail written notification to certified processors, who participated in the scrap value survey, of the average monthly scrap value for each container material type pursuant to Section 2955 of the regulations. This notification will be sent within sixty (60) days of the end of the reporting month.

NOTE

Authority cited: Section 14530.5(b) and (c), Public Resources Code. Reference: Sections 14518.5 and 14575(a), (b) and (f) (1), Public Resources Code.

California Code of Regulations

Title 14 – Natural Resources

Division 2 – Department of Conservation

Chapter 5 – Division of Recycling

Subchapter 2 – General Requirements

Article 5. Administrative Actions

§2125. Inspection Authority.

- (a) An applicant, certified operator, or curbside program shall provide access to the operator's facility or program to staff authorized by the Division for any one or all of the following purposes:
- (1) To determine compliance with the Division's regulations and with the provisions of the Act, or
 - (2) To determine the accuracy of the information provided in the application for certification, or
 - (3) To determine the accuracy of the information provided in the application for curbside registration, or
 - (4) For the investigation of complaints related to compliance with the Division's regulations and with the provisions of the Act, or
 - (5) To obtain allowable cost survey data required for the Division to carry out its responsibilities pursuant to sections 14575 and 14585 of the Act, or
 - (6) To inspect all records, required by section 2420(h), upon which the scrap value surveys are based.
- (b) Failure to submit to inspections described in subsection (a) above shall result in either:
- (1) Denial of an application if the application is pending, or
 - (2) Revocation of a certification, or registration, or
 - (3) Suspension of a certification, or registration.
 - (4) Imposition of civil penalties pursuant to Section 14591.1 of the Act.

Authority cited: Section 14530.5(b) and 14536(b), Public Resources Code. Reference: Sections 14537, 14538, 14539, 14540, 14549.1, 14575 and 14585, Public Resources Code.

California Code of Regulations

Subchapter 6 – Recycling Centers

Article 2. Handling Fees

§2518. Calculations and Payments.

(a) The Division shall determine handling fee payments for a recycling center meeting the requirements of Section 14585 of the Act and Section 2516, above, based on data contained in the Handling Fee Application Form (Form DR-14 (1/00)) by performing the following calculations:

(1) The reported redemption weights shall be converted to number of empty beverage containers using the Division's statewide average containers-per-pound rate for each material type, and pursuant to Subsection 14585(e) of the Act.

(2) The total number of empty beverage containers for the calendar month shall be calculated by summing the number of empty aluminum, glass, plastic and bimetal beverage containers. If the total number of empty beverage containers is less than the minimum number required by Section 14585(a)(2)(A) of the Act, the recycling center is not eligible for handling fees for that calendar month.

(3) The Division shall determine the number of empty beverage containers eligible for handling fees pursuant to Subsection 14585(a)(4) of the Act.

(4) On and after July 1, 2008, the Department shall pay a handling fee per eligible beverage container as determined by the handling fee cost survey required by Section 14585 (f) of the Act.

(b) Prior to release of handling fees for each month during which a recycling center is eligible, the Division may determine that such fees should be withheld for any of the following reasons:

(1) The Division has prevailed against the recycler in a civil or administrative action and money is owed to the Division as a result of the action.

(2) The Division determines, based on information contained in the shipping reports filed pursuant to Section 2530 of Article 3 of Subchapter 6, that the recycler has received handling fees for materials which were not redeemed for refund value and such discrepancies between reported redemption weights and shipping weights are more than two and one-half percent.

Authority cited: Section 14530.5, 14536 and 14552(e), Public Resources Code. Reference: Section 14504, 14526.6 and 14585, Public Resources Code.

California Code of Regulations

Subchapter 12 – DOR Requirements

Article 3. Handling Fee Payments

§2990. Allowable Costs For Handling Fee Recycling Centers.

(a) On or before January 1, 2008, and every second year thereafter, the Division shall survey a statistical sample of recycling centers receiving handling fees to determine the average allowable costs per empty beverage container redeemed.

(b) Allowable costs for calculation of the handling fee shall include the actual costs of receiving, handling, processing, and storing and transporting postfilled beverage containers. Allowable costs also include maintaining equipment necessary for the above activities. More specifically these costs shall include, but not be limited to:

- (1) labor,
- (2) property taxes,
- (3) depreciation,
- (4) utilities,
- (5) supplies,
- (6) fuel,
- (7) insurance,
- (8) interest,
- (9) general business overhead exclusive of administrative costs,
- (10) facilities and equipment rent or lease,
- (11) maintenance,
- (12) transportation,
- (13) disposal costs.

(c) The scrap price paid to the consumer by the recycling center shall not be included in allowable costs.

Authority: Section 14530.5(b) and 14536(b), Public Resources Code. Reference: Sections 14513.4, 14526.6, 14581, and 14585, Public Resources Code.

§2995. Allocation of Allowable Costs For Handling Fee Sites.

(a) The Division shall determine allowable costs per container pursuant to section 2990 of this subchapter that can be directly allocated to each beverage container type. (For example: depreciation and labor expenses for operating an aluminum can crusher shall be directly allocated to the allowable costs of aluminum beverage containers.)

(b) Allowable costs pursuant to section 2990 of this subchapter that cannot be directly allocated shall be allocated using the direct labor cost percentages for each container type as determined in the allowable handling fee cost surveys pursuant to section 2990 of this subchapter.

Authority cited: Section 14530.5(b) and 14536(b), Public Resources Code. Reference: Sections 14513.4, 14526.6, 14581, and 14585, Public Resources Code.

§2997. Notification of Handling Fee Changes.

When the Division adopts a revised, terminated or newly established handling fee pursuant to Public Resources Code Section 14585, the Division shall provide written notification within fifteen (15) days of adoption, and at least fifteen (15) days prior to the effective date of the proposed action(s), to all interested persons.

Authority cited: Section 14530.5(b) and (c) and 14536(b), Public Resources Code. Reference: Sections 14513.4, 14581 and 14585, Public Resources Code.

Relevant Regulations



Handout 1
**Financial Statements:
The Starting Point in the
Study of Accounting**

FINANCIAL STATEMENTS: THE STARTING POINT IN THE STUDY OF ACCOUNTING

The preparation of financial statements is not the first step in the accounting process, but it is a convenient point to begin the study of accounting. The financial statements are the means of conveying to management and to interested outsiders a concise picture of the profitability and financial position of the business. Since these financial statements are in a sense the end product of the accounting process, the student who acquires a clear understanding of the content and meaning of financial statements will be in an excellent position to appreciate the purpose of the earlier steps of recording and classifying business transactions.

The two most widely used financial statements are the *balance sheet* and the *income statement*.¹ Together, these two statements (perhaps a page each in length) summarize all the information contained in the hundreds or thousands of pages comprising the detailed accounting records of a business. In this introductory chapter and in Chapter 2, we shall explore the nature of the balance sheet, or statement of financial position, as it is sometimes called. Once we have become familiar with the form and arrangement of the balance sheet and with the meaning of technical terms such as *assets, liabilities, and owner's equity*, it will be as easy to read and understand a report on the financial position of a business as it is for an architect to read the blueprint of a proposed building. (We shall discuss the income statement in Chapter 3.)

The balance sheet

The purpose of a balance sheet is to show the financial position of a business at *a particular date*. Every business prepares a balance sheet at the end of the year, and most companies prepare one at the end of each month. A balance sheet consists of a listing of the assets and liabilities of a business and of the owner's equity. The following balance sheet portrays the financial position of the Westside Cleaning Company at December 3.)

<i>Westside Cleaning Company</i>																																		
<i>Balance Sheet</i>																																		
<i>December 31, 19__</i>																																		
	<i>Assets</i>		<i>Liabilities & Owner's Equity</i>																															
<i>Balance Sheet shows financial position at a specific date</i>	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Cash</td> <td style="width: 20%; text-align: right;">\$19,500</td> </tr> <tr> <td>Accounts receivable.....</td> <td style="text-align: right;">9,000</td> </tr> <tr> <td>Supplies.....</td> <td style="text-align: right;">500</td> </tr> <tr> <td>Land</td> <td style="text-align: right;">21,000</td> </tr> <tr> <td>Building</td> <td style="text-align: right;">44,500</td> </tr> <tr> <td>Cleaning equipment</td> <td style="text-align: right;">13,000</td> </tr> <tr> <td>Delivery equipment.....</td> <td style="text-align: right;">7,500</td> </tr> <tr> <td>Total assets</td> <td style="text-align: right;"><u>\$115,000</u></td> </tr> </table>	Cash	\$19,500	Accounts receivable.....	9,000	Supplies.....	500	Land	21,000	Building	44,500	Cleaning equipment	13,000	Delivery equipment.....	7,500	Total assets	<u>\$115,000</u>	<table style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2">Liabilities:</td> </tr> <tr> <td style="width: 80%;">Notes payable.....</td> <td style="width: 20%; text-align: right;">\$22,000</td> </tr> <tr> <td>Accounts payable.....</td> <td style="text-align: right;">16,000</td> </tr> <tr> <td>salaries payable.....</td> <td style="text-align: right;">2,000</td> </tr> <tr> <td>Total liabilities</td> <td style="text-align: right;"><u>\$40,000</u></td> </tr> <tr> <td colspan="2">Owners equity:</td> </tr> <tr> <td>Joe Crane, capital.....</td> <td style="text-align: right;">75,000</td> </tr> <tr> <td>Total liabilities & owner's equity</td> <td style="text-align: right;"><u>\$115,000</u></td> </tr> </table>	Liabilities:		Notes payable.....	\$22,000	Accounts payable.....	16,000	salaries payable.....	2,000	Total liabilities	<u>\$40,000</u>	Owners equity:		Joe Crane, capital.....	75,000	Total liabilities & owner's equity	<u>\$115,000</u>
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Note that the balance sheet sets forth in its heading three items: (1) the name of the business, (2) the name of the financial statement "Balance Sheet," and (3) the date of the balance sheet. Below the heading is the body of the balance sheet, which consists of three distinct sections: assets, liabilities, and owner's equity. The remainder of this chapter is largely devoted to making clear the nature of these three sections.

Another point to note about the form of a balance sheet is that cash is always the first asset listed; it is followed by receivables, supplies, and any other assets that will soon be converted into cash or consumed in operations. Following these items are the more permanent assets, such as land, buildings, and equipment.

The liabilities of a business are always listed before the owner's equity. Each liability (such as notes payable, accounts payable, and salaries payable) should be listed separately, followed by a total figure for liabilities.

The business entity The illustrated balance sheet refers only to the financial affairs of the business entity known as Westside Cleaning Company and not to the personal financial affairs of the owner, Joe Crane. Crane may have

¹ A third financial statement, called a *statement of changes a financial position*, will be discussed later.

a personal bank account, a home, a car, a cattle ranch, and other property, but since these personal belongings are not a part of the cleaning business, they are not included in the balance sheet of this business unit.

In brief, ***a business entity is an economic unit which enters into business transactions that must be recorded, summarized, and reported. The entity is regarded as separate from its owner or owners;*** the entity owns its own property and has its own debts. Consequently, for each business entity, there should be a separate set of accounting records. A balance sheet and an income statement are intended to portray the financial position and the operating results of a single business entity. If the owner intermingles his or her personal affairs with the transactions of the business, the resulting financial statements will be misleading and will fail to describe the business fairly.

Assets

Assets are economic resources which are owned by a business and are expected to benefit future operations. Assets may have definite physical form such as buildings, machinery, or merchandise. On the other hand, some assets exist not in physical or tangible form, but in the form of valuable legal claims or rights; examples are amounts due from customers, investments in government bonds, and patent rights.

One of the most basic and at the same time most controversial problems in accounting is determining the dollar values for the various assets of a business.

The cost principle Assets such as land, buildings, merchandise, and equipment are typical of the many economic resources that will be used in producing income for the business. The prevailing accounting view is that such assets should be recorded at their cost. When we say that an asset is shown in the balance sheet at its ***historical cost***, we mean the dollar amount originally paid to acquire the asset; this amount may be very different from what we would have to pay today to replace it. We have already described ***transactions*** as business events which can be measured in money and must be recorded in the accounting records. The price established in a transaction for the purchase of property or services is the cost to be recorded by the buyer. Thus, the “accounting value” or “valuation” of an asset means the cost of the asset to the entity owning it. For example, let us assume that a business buys a tract of land for use as a building site, paying \$40,000 in cash. The amount to be entered in the accounting records as the value of the asset will be the cost of \$40,000. If we assume a booming real estate market, a fair estimate of the sales value of the land 10 years later might be \$100,000. Although the market price or economic value of the land has risen greatly, the accounting value as shown in the accounting records and on the balance sheet would continue unchanged at the cost of \$40,000. This policy of accounting for assets at their cost is often referred to as the ***cost principle*** of accounting.

In reading a balance sheet, it is important to bear in mind that the dollar amounts listed do not indicate the prices at which the assets could be sold, nor the prices at which they could be replaced. One useful generalization to be drawn from this discussion is that a balance sheet does not show “how much a business is worth.”

The going-concern assumption It is appropriate to ask ***why*** accountants do not change the recorded values of assets to correspond with changing market prices for these properties. One reason is that the land and building used to house the business are acquired for ***use*** and not for personal use; in fact, these assets cannot be sold without disrupting the business. The balance sheet of a business is prepared on the assumption that the business is a continuing enterprise, a “going concern.” Consequently, the present estimated prices at which the land and buildings could be sold are of less importance than if these properties were intended for sale.

The objectivity principle Another reason for using cost rather than current market values in accounting for assets is the need for a definite, factual basis for valuation. The cost for land, buildings, and many other assets purchased for cash can be rather definitely determined. Accountants use the term ***objective*** to describe asset valuations that are factual and can be verified by independent experts. For example, if land is shown on the balance sheet at cost, any CPA who performed an audit of the business would be able to find objective evidence that the land was actually valued at the cost incurred in acquiring it. Estimated market values, on the other hand, for assets such as buildings and specialized machinery are not factual and objective. Market values are constantly changing and estimates of the prices assets could be sold for are largely a matter of personal opinion. Of course at the date an asset is acquired, the cost and market value are usually the same because the

buyer would not pay more than the asset was worth and the seller would not take less than current market value. The bargaining process which results in the sale of an asset serves to establish both the current market value of the property and the cost to the buyer. With the passage of time, however, the current market value of assets is likely to differ considerably from the cost recorded in the owner's accounting records.

Accounting for inflation Severe worldwide inflation in recent years has raised serious doubts as to the adequacy of the conventional cost basis in accounting for assets. When inflation becomes very severe, historical cost values for assets simply lose their relevance as a basis for making business decisions. Proposals for adjusting recorded dollar amounts to reflect changes in the value of the dollar, as shown by a price index, have been considered for many years. However, stronger interest is being shown at present in balance sheets which would show assets at *current appraised values or replacement costs* rather than at historical cost. The British government has experimented extensively with the revision of corporate accounting to reflect inflation. The British approach proposes that year-end balance sheets show assets at their current value rather than at historical or original cost. Many companies in the Netherlands are now using some form of current-value accounting. In the United States, the Financial Accounting Standards Board requires that large corporations disclose the *current replacement cost* of certain assets as *supplementary information* to conventional cost based financial statements.

Accounting concepts are not as exact and unchanging as many persons assume. To serve the needs of a fast-changing economy, accounting concepts and methods must also undergo continuous evolutionary change. As of today, however, the cost basis of valuing assets is still the generally accepted method.

The problem of valuation of assets is one of the most complex in the entire field of accounting. It is merely being introduced at this point; in later chapters we shall explore carefully some of the valuation principles applicable to the major types of assets.

Liabilities

Liabilities are debts. All business concerns have liabilities; even the largest and most successful companies find it convenient to purchase merchandise and supplies on credit rather than to pay cash at the time of each purchase. The liability arising from the purchase of goods or services on credit is called an *account payable*, and the person or company to whom the account payable is owed is called a *creditor*.

A business concern frequently finds it desirable to borrow money as a means of supplementing the funds invested by the owner, thus enabling the business to expand more rapidly. The borrowed funds may, for example, be used to buy merchandise which can be sold at a profit to the firm's customers. Or, the borrowed money might be used to buy new and more efficient machinery, thus enabling the company to turn out a larger volume of products at lower cost. When a business borrows money for any reason, a liability is incurred and the lender becomes a creditor of the business. The form of the liability when money is borrowed is usually a *note payable*, a formal written promise to pay a certain amount of money, plus interest, at a definite future time. An *account payable*, as contrasted with a *note payable*, does not involve the issuance of a formal written promise to the creditor, and it does not call for payment of interest. When a business has both notes payable and accounts payable, the two types of liabilities are shown separately in the balance sheet. The sequence in which these two liabilities are listed is not important, although notes payable are usually shown as the first item among the liabilities. A figure showing the total of the liabilities may also be inserted, as shown by the illustrated balance sheet on page 15.

The creditors have claims against the assets of the business, usually against any particular asset but against the assets in general. The claims of creditors are liabilities of the business and have priority over the claims of owners. Creditors are entitled to be paid in full even if such payment should exhaust the assets of the business, leaving nothing for the owner. The issue of valuation, which poses so many difficulties in accounting for assets, is a much smaller problem in the case of liabilities, because the amounts of most liabilities are specified by contract.

Owner's equity

The owner's equity in a business represents the resources invested by the owner; it is equal to the total assets minus the liabilities. The equity of the owner is a residual claim because the claims of the creditors legally come first. If you are the owner of a business, you are entitled to whatever remains after the claims of the creditors are fully satisfied.

For example:

<i>The Westside Cleaning Company has tow assets of.....</i>	<i>\$115,000</i>
<i>And total liabilities amounting to</i>	<i>40,000</i>
<i>Therefore, tire owner's equity must equal</i>	<u><u><i>\$75,000</i></u></u>

Suppose that The Westside Cleaning Company borrows \$3,000 from a bank. After recording the additional asset of \$3,000 in cash and recording the new liability of \$3,000 owed to the bank, we would have the following:

<i>The Westside Cleaning Company now has tow assets of</i>	<i>\$118,000</i>
<i>And total liabilities are now.....</i>	<i>43,000</i>
<i>Therefore, tire owner's equity still is equal to.....</i>	<u><u><i>\$75,000</i></u></u>

It is apparent that the total assets of the business were increased by the act of borrowing money from a bank, but the increase in assets was exactly offset by an increase in liabilities, and the owner's equity remained unchanged. The owner's equity in a business *is not increased* by borrowing from banks or other creditors.

Increases in owner's equity If you begin a small business of your own, you will probably invest cash and possibly some other assets to get the business started. Later, as the business makes payments for rent, office equipment, advertising, salaries to employees, and other items, you may find it necessary to supply additional cash to the business. Hopefully, before long, the business will become self-sustaining. Whenever, as owner of the business, you transfer cash or other personally owned assets to the business entity, your ownership equity will increase. In summary, the owner's equity in a business comes from two sources:

- 1 Investment by the owner
- 2 Earnings from profitable operation of the business

Only the first of these two sources of owner's equity is considered in this chapter. The second source, an increase in owner's equity through earnings of the business, will be discussed in Chapter 3.

Decreases in owner's equity If you are the owner of a single proprietorship, you have the right to withdraw cash or other assets from the business at any time. Since you are strongly interested in seeing the business succeed, you will probably not make withdrawals that would handicap the business entity in operating efficiently. Once the business achieves momentum and financial strength, you may choose to make substantial withdrawals. Withdrawals are most often made by writing a check drawn on the company's bank account and payable to the owner. However, other types of withdrawals also occur, such as taking office equipment out of the business for personal use by the owner, or by causing cash belonging to the business to be used to pay a personal debt of the owner. Every withdrawal by the owner reduces the total assets of the business and reduces the owner's equity. In summary, decreases in the owner's equity in a business are caused in two ways:

- 1 Withdrawals of cash or other assets by the owner
- 2 Losses from unprofitable operation of the business

Only the first of these two causes of decrease in owner's equity is emphasized in this chapter. The second cause, a decrease in owner's equity through operating at a loss, will be considered in Chapter 3.

The accounting equation

One of the fundamental characteristics of every balance sheet is that the total figure for assets always equals the total figure for liabilities and owner's equity. This agreement or balance of total assets with the total of liabilities plus owner's equity is one reason for calling this statement of financial position a *balance sheet*. But

why do total assets equal the total of liabilities and owner's equity? The answer can be given in one short paragraph as follows.

The dollar totals on the two sides of the balance sheet are always equal because these two sides are merely two views of the same business resources. The listing of assets shows us *what resources* the business owns; the listing of liabilities and owner's equity tells us *who supplied these resources* to the business and how much each group supplied. Everything that a business owns has been supplied to it by the creditors or by the owner. Therefore, the total claims of the creditors plus the claim of the owner equal the total assets of the business.

The equality of assets on the one hand and of the claims of the creditors and the owner on the other hand is expressed in the equation:

*Fundamental
accounting equation*

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

$$\$115,000 = \$40,000 + \$75,000$$

The amounts listed in the equation were taken from the balance sheet illustrated on page 15. A balance sheet is simply a detailed statement of this equation. To illustrate this relationship, compare the balance sheet of the Westside Cleaning Company with the above equation.

To emphasize that the equity of the owner is a residual element, secondary to the claims of creditors, it is often helpful to transpose the terms of the equation, as follows:

*Alternative form
of equation*

$$\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$$

$$\$115,000 - \$40,000 = \$75,000$$

Every business transaction, no matter how simple or how complex, can be expressed in terms of its effect on the accounting equation. A thorough understanding of the equation and some practice in using it are essential to the student of accounting.

Regardless of whether a business grows or contracts, this equality between the assets and the claims against the assets is always maintained. Any increase in the amount of total assets is necessarily accompanied by an equal increase on the other side of the equation, that is, by an increase in either the liabilities or the owner's equity. Any decrease in total assets is necessarily accompanied by a corresponding decrease in liabilities or owner's equity. The continuing equality of the two sides of the balance sheet can best be illustrated by taking a brand-new business as an example and observing the effects of various transactions upon its balance sheet.

Effects of business transactions upon the balance sheet

Assume that James Roberts, a licensed real estate broker, decided to start a real estate business of his own, to be known as Roberts Real Estate Company. The planned operations of the new business call for obtaining listings of houses being offered for sale by owners, advertising these houses, and showing them to prospective buyers. The listing agreement signed with each owner provides that Roberts Real Estate Company shall receive at the time of sale a commission equal to 6% of the sales price of the property.

The new business was begun on September 1, when Roberts deposited \$60,000 in a bank account in the name of the business, Roberts Real Estate Company. The initial balance sheet of the new business then appeared as follows:

*Beginning
balance sheet of
a new business*

ROBERTS REAL ESTATE COMPANY
Balance Sheet
September 1, 19__

	Assets		Owner's Equity
Cash	\$60,000		James Roberts, capital.....
			\$60,000

Observe that the equity of the owner in the assets is designated on the balance sheet by the caption, James Roberts, capital. The word *capital* is the traditional accounting term used in describing the equity of the proprietor in the assets of the business.

Purchase of an asset for cash The next transaction entered into by Roberts Real Estate Company was the purchase of land suitable as a site for an office. The price for the land was \$21,000 and payment was made in cash on September 3. The effect of this transaction on the balance sheet was twofold: first, cash was decreased by the amount paid out; and second, a new asset, Land, was acquired. After this exchange of cash for land, the balance sheet appeared as follows:

Balance sheet
totals unchanged
by purchase of
land for cash

ROBERTS REAL ESTATE COMPANY			
Balance Sheet			
September 3, 19__			
Assets		Owner's Equity	
Cash	\$39,000	James Roberts, capital	\$60,000
Land	21,000		
Total assets	\$60,000	Total owner's equity	\$60,000

Purchase of an asset and incurring of a liability On September 5 an opportunity arose to buy from OK Company a complete office building which had to be moved to permit the construction of a freeway. A price of \$36,000 as agreed upon, which included the cost of moving the building and installing it upon the Roberts Company's lot. As the building was in excellent condition and would have cost approximately \$80,000 to build, Roberts considered this a very fortunate purchase.

The terms provided for an immediate cash payment of \$15,000 and payment of the balance of \$21,000 within 90 days. Cash was decreased \$15,000, but a new asset, Building, was recorded at cost in the amount of \$36,000. Total assets were thus increased by \$21,000 but the total of liabilities and owner's equity was also increased as a result of recording the \$21,000 account payable as a liability. After this transaction had been recorded, the balance sheet appeared as shown below. Remember that cash is always the first asset listed in a balance sheet.

Totals increased
equally by
purchase on
credit

ROBERTS REAL ESTATE COMPANY			
Balance Sheet			
September 5, 19__			
Assets		Owner's Equity	
Cash	\$24,000	Liabilities:	
Land	21,000	Accounts payable	\$21,000
Building	36,000	Owner's equity:	
		James Roberts, capital	60,000
Total assets	\$81,000	Total liabilities & owner's equity	\$81,000

Note that the building appears in the balance sheet at \$36,000, its cost to Roberts Real Estate Company. The estimate of \$80,000 as the probable cost to construct such a building is irrelevant. Even if someone should offer to buy the building from the Roberts Company for \$80,000 or more, this offer, if refused, would have no bearing on the balance sheet. Accounting records are intended to provide a historical record of *costs actually incurred*; therefore, the \$36,000 price at which the building was purchased is the amount to be recorded.

Sale of an asset After the office building had been moved to the Roberts Company's lot, Roberts decided that the lot was much larger than was needed. The adjoining business, Carter's Drugstore, wanted more room for a parking area so, on September 10, Roberts Company sold the unused part of the lot to Carter's Drugstore for a price of \$6,000. Since the sales price was computed at the same amount per foot as Roberts Company had paid for the land, there was neither a profit nor a loss on the sale. No down payment was required but it was agreed that the full price would be paid within three months. By this transaction a new asset, Accounts Receivable, was acquired, but the asset Land was decreased by the same amount; consequently, there was no change in the amount of total assets. After this transaction, the balance sheet appeared as follows:

No change in
totals by sale of
land at cost

ROBERTS REAL ESTATE COMPANY
Balance Sheet
September 10, 19__

Assets		Owner's Equity	
Cash	\$24,000	Liabilities:	
Accounts receivable	6,000	Accounts payable	\$21,000
Land	15,000	Owner's equity:	
Building	36,000	James Roberts, capital	60,000
Total assets	<u>\$81,000</u>	Total liabilities & owner's equity	<u>\$81,000</u>

In the illustration thus far, Roberts Real Estate Company has an account receivable from only one debtor, and an account payable to only one creditor. As the business grows, the number of debtors and creditors will increase, but the Accounts Receivable and Accounts Payable designations will continue to be used. The additional records necessary to show the amount receivable from each individual debtor and the amount owing to each individual creditor will be explained in Chapter 7.

Purchase of an asset on credit A complete set of office furniture and equipment was purchased on credit from General Equipment, Inc., on September 14 for \$5,400. As the result of this transaction the business owned a new asset, Office Equipment, but it had also incurred a new liability in the form of Account: Payable. The increase in total assets was exactly offset by the increase in liabilities. After this transaction the balance sheet appeared as follows:

Totals increased
by acquiring
asset on credit

ROBERTS REAL ESTATE COMPANY
Balance Sheet
September 14, 19__

Assets		Owner's Equity	
Cash	\$24,000	Liabilities:	
Accounts receivable	6,000	Accounts payable	\$26,400
Land	15,000	Owner's equity:	
Building	36,000	James Roberts, capital	60,000
Office equipment	5,400		
Total assets	<u>\$86,400</u>	Total liabilities & owner's equity	<u>\$86,400</u>

Collection of an account receivable On September 20, cash of \$1,500 was received as partial settlement of the account receivable from Carter's Drugstore. This transaction caused cash to increase and the accounts receivable to decrease by an equal amount. In essence, this transaction was merely the exchange of one asset for another of equal value. Consequently, there was no change in the amount of total assets. After this transaction, the balance sheet appeared as follows:

Totals unchanged
by collection of
an account
receivable

ROBERTS REAL ESTATE COMPANY
Balance Sheet
September 20, 19__

Assets		Owner's Equity	
Cash	\$25,500	Liabilities:	
Accounts receivable	4,500	Accounts payable	\$26,400
Land	15,000	Owner's equity:	
Building	36,000	James Roberts, capital	60,000
Office equipment	5,400		
Total assets	<u>\$86,400</u>	Total liabilities & owner's equity	<u>\$86,400</u>

Payment of a liability On September 30 Roberts Real Estate Company paid \$3,000 in cash to General Equipment, Inc. This payment caused a decrease in cash and an equal decrease in liabilities. Therefore the totals of assets and equities were still in balance. After this transaction, the balance sheet appeared as follows:

Totals decreased
by paying a
liability

ROBERTS REAL ESTATE COMPANY			
Balance Sheet			
September 30, 19__			
Assets		Owner's Equity	
<i>Cash</i>	\$22,500	<i>Liabilities:</i>	
<i>Accounts receivable</i>	4,500	<i>Accounts payable</i>	\$23,400
<i>Land</i>	15,000	<i>Owner's equity:</i>	
<i>Building</i>	36,000	<i>James Roberts, capital</i>	60,000
<i>Office equipment</i>	5,400		
Total assets	\$83,400	Total liabilities & owner's equity	\$83,400

The transactions which have been illustrated for the month of September were merely preliminary to the formal opening for business of Roberts Real Estate Company on October 1. Since we have assumed that the business earned no commissions and incurred no expenses during September, the owner's equity at September 30 is shown in the above balance sheet at \$60,000, unchanged from the original investment by Roberts on September 1. September was a month devoted exclusively to organizing the business and not to regular operations. In succeeding chapters we shall continue the example of Roberts Real Estate Company by illustrating operating transactions and considering how the net income of the business is determined.

Effect of business transactions upon the accounting equation

A balance sheet is merely a detailed expression of the accounting equation, Assets = Liabilities + Owner's Equity. To emphasize the relationship between the accounting equation and the balance sheet, let us now repeat the September transactions of Roberts Real Estate Company to show the effect of each transaction upon the accounting equation. Briefly restated, the seven transactions were as follows:

- Sept. 1 Began the business by depositing \$60,000 in a company bank account.
- 3 Purchased land for \$21,000 cash.
- 5 Purchased a building for \$36,000, paying \$15,000 cash and incurring a liability of \$21,000.
- 10 Sold part of the land at a price equal to cost of \$6,000, collectible within three months.
- 14 Purchased office equipment on credit for \$5,400.
- 20 Received \$1,500 cash as partial collection of the \$6,000 account receivable.
- 30 Paid \$3,000 on accounts payable.

In the table below, each transaction is identified by date; its effect on the accounting equation and also the new balance of each item are shown. Each of the lines labeled Balances contains the same items as the balance sheet previously illustrated for the particular date. The final line in the table corresponds to the amounts in the balance sheet at the end of September. Note that the equality of the two sides of the equation was maintained throughout the recording of the transactions.

	Assets					=	Liabilities	+	Owner's Equity			
	Cash	+	Accounts Receivable	+	Land	+	Building	+	Offices Equipment	Accounts Payable	+	James Roberts, capital
Sept 1	+\$60,000											
Sept. 3	-21,000			+521,000								
Balances	\$39,000			\$21,000								\$60,000
Sept 5	-15,000					+\$36,000				+521,000		
Balances	\$24,000			\$21,000		\$36,000				521,000		\$60,000

Sept. 10		<u>+56,000</u>	<u>-6,000</u>				
Balances	\$24,000	56,000	\$15,000	\$36,000		\$21,000	\$60,000
Sept 14					<u>+\$5,400</u>	<u>+5,400</u>	
Balances	\$24,000	56,000	515,000	\$36,000	\$5,400	\$26,400	\$60,000
Sept 20	<u>+1,500</u>	<u>-1,500</u>					
Balances	\$25,500	\$4,500	515,000	536,000	55,400	\$26,400	\$60,000
Sept 30	<u>-3,000</u>					<u>-3,000</u>	
Balances	<u>\$22,500</u>	<u>54,500</u>	<u>\$15,000</u>	<u>\$36,000</u>	<u>\$5,400</u>	<u>\$23,400</u>	<u>\$60,000</u>

USE OF FINANCIAL STATEMENTS BY OUTSIDERS

Through careful study of financial statements, it is possible for the outsider with training in accounting to obtain a fairly complete understanding of the financial position of the business and to become aware of significant changes that have occurred since the date of the preceding balance sheet. Bear in mind, however, that financial statements have limitations. As stated earlier, only those factors which can be reduced to monetary terms appear in the balance sheet. Let us consider for a moment some important business factors which are not set for in financial statements. Perhaps a new competing store has just opened for business across the street; the prospect for intensified competition in the future will not be described in the balance sheet- As another example, the health, experience, and managerial skills of the key people in the management group may be extremely important to the success of a business, but these qualities cannot be measured and expressed in dollars in the balance sheet. Efforts to develop methods of accounting for the human resources of an organization presently constitute an important area of accounting research.

Bankers and other creditors

Bankers who have loaned money to a business concern or who are considering making such a loan will be vitally interested in the balance sheet of the business. By studying the amount and kinds of assets in relation to the amount and payment dates of the liabilities, a banker can form an opinion as to the ability of the business to pay its debts promptly. The banker gives particular attention to the amount of cash and of other assets (such as accounts receivable) which will soon be converted into cash and then compares the amount of these assets with the amount of liabilities falling due in the near future. The banker is also interested in the amount of the owner's equity, as this ownership capital serves as a protecting buffer between the banker and any losses which may befall the business. Bankers are seldom, if ever, willing to make a loan unless the balance sheet and other information concerning the prospective borrower offer reasonable assurance that the loan can and will be repaid promptly at the maturity date.

Another important group making constant use of balance sheets consists of the credit managers of manufacturing and wholesaling firms, who must decide whether prospective customers are to be allowed to buy merchandise on credit. The credit manager, like the banker, studies the balance sheets of customers and prospective customers for the purpose of appraising their debt-paying ability. Credit agencies such as Dun & Bradstreet, Inc., make a business of obtaining financial statements from virtually all business concerns and appraising their debt-paying ability. The conclusions reached by these credit agencies are available to business concerns willing to pay for credit reports about prospective customers.

Owners

The financial statements of corporations listed on the stock exchanges are eagerly awaited by millions of stockholders. A favorable set of financial statements may cause the market price of the company's stock to rise dramatically; an unfavorable set of financial statements may cause the "bottom to fall out" of the market

price. Current dependable financial statements are one of the essential ingredients for successful investment in securities. Of course, financial statements are equally important in single proprietorships and partnerships. The financial statements tell the owners just how successful their business has been and summarize in concise form its present financial position.

Others interested in financial information

In addition to owners, managers, bankers, and merchandise creditors, other groups making use of accounting data include governmental agencies, employees, investors, and writers for business periodicals. Some very large corporations have more than a million stockholders; these giant corporations send copies of their annual financial statements to each of these many owners. In recent years there has been a definite trend toward wider distribution of financial statements to all interested persons, in contrast to the attitude of a few decades ago when many companies regarded their financial statements as a confidential matter. This trend reflects an increasing awareness of the impact of corporate activities on all aspects of our lives and of the need for greater disclosure of information about the activities of business corporations.

The purpose of this discussion is to show the extent to which a modern industrial society depends upon accounting. Even more important, however, is a clear understanding at the outset of your study that accounting does not exist just for the sake of keeping a record or in order to fill out income tax returns and various other regulatory reports. These are but auxiliary functions. If you gain an understanding of accounting concepts, you will have acquired an analytical skill essential to the field of professional management. ***The prime and vital purpose of accounting is to aid decision makers in choosing among alternative courses of action.***

KEY TERMS INTRODUCED IN CHAPTER 1

Accounting equation Assets equal liabilities plus owner's equity. $A=L+OE$.

Accounting system A financial information system which includes accounting forms, records, instruction manuals, flow charts, programs, and reports to fit the particular needs of the business.

Accounts payable Amounts which a company owes its creditors for goods and services purchased on credit.

Accounts receivable Amounts which a company expects to collect from its customers for goods and services sold to them on credit.

American Institute of Certified Public Accountants (AICPA) The national professional association of certified public accountants (CPAs). Carries on extensive research and is influential in improving accounting standards and practices.

Assets Economic resources (things of value) owned by a business which are expected to benefit future operations.

Audit report A report issued by a CPA expressing an independent professional opinion on the fairness and reliability of the financial statements of a business.

Auditing The principal activity of a CPA. Consists of an independent examination of the accounting records and other evidence relating to a business to support the expression of an impartial expert opinion about the reliability of the financial statements.

Balance sheet A financial statement which shows the financial position of a business entity by summarizing the assets, liabilities, and owner's equity at a specific date.

Business entity An economic unit that enters into business transactions that must be recorded, summarized, and reported. The entity is regarded as *separate from its owner or owners*.

Certificate in Management Accounting (CMA) A designation granted to persons who have demonstrated competence in management accounting by passing an examination and meeting educational and experience requirements.

Certified public accountants (CPAs) Independent professional accountants licensed by a state to offer auditing and accounting services to clients for a fee.

Controller The chief accounting officer of a business.

Corporation A business organized as a separate legal entity and chartered by a state, with ownership divided into transferable shares of capital stock.

Cost accounting A specialized field of accounting concerned with determining and controlling the cost of particular products or processes.

Cost principle A widely used policy of accounting for assets at their original cost to the business.

CPA certificate A license to practice public accounting granted by a state on the basis of educational requirements, a rigorous examination, and (in most states) evidence of practical experience.

Creditor The person or company to whom a liability is owed.

Financial Accounting Standards Board (FASB) An independent group which conducts research in accounting and issues authoritative statements as to proper reporting of financial information.

Financial statements Reports which summarize the financial position and operating results of a business (balance sheet and income statement).

Generally accepted accounting principles The accounting concepts, measurement techniques, and standards of presentation used in financial statements. Examples include the cost principle, the going-concern assumption, and the objectivity principle.

Going-concern assumption An assumption by accountants that a business will continue to operate indefinitely unless specific evidence to the contrary exists, as, for example, impending bankruptcy.

Internal control All measures used by a business to guard against errors, waste, and fraud; to assure the reliability of accounting data; and to promote compliance with all company policies.

Internal Revenue Service A governmental agency charged with responsibility for collecting federal income taxes from individuals and corporations.

Liabilities Debts or obligations of a business. The claims of creditors against the assets of a business.

Notes payable Liabilities evidenced by a formal written promise to pay a certain amount of money plus interest at a future date. Usually arise from borrowing.

Owner's equity The excess of assets over liabilities. The amount of an owner's net investment in a business plus profits from successful operations which have been retained in the business.

Partnership A business owned by two or more persons voluntarily as partners.

Securities and Exchange Commission (SEC) A government agency which reviews the financial statements and other reports of corporations which offer securities for sale to the public. Works closely with the FASB and the AICPA to improve financial reporting practices.

Single proprietorship An unincorporated business owned by one person.

Solvency Having enough money to pay debts as they fall due.

Tax accounting The determination of taxable income, preparation of federal and state income tax returns, and planning of operations along lines that will hold tax payments to the legal minimum.

Transactions Business events which can be measured in money and which are entered in the accounting records.

Withdrawals by owner Amounts of cash or other assets removed from the business by the owner. Cause a decrease in owner's equity.

DEMONSTRATION PROBLEM FOR YOUR REVIEW

An alphabetical list of the various items showing the financial condition of Wilson Company at September 30 appears below. Although the figure for the owner's equity is not given, it can be determined when all the items are arranged in the form of a balance sheet.

Accounts payable	\$18,100	Land	\$24,000
Accounts receivable	16,400	Notes payable	35,000
Building	39,200	Notes receivable	1,400
Cash	8,500	Office equipment	4,800
Delivery truck	3,000	Ralph Wilson, capital	?

On October 1, the following transactions occurred:

- (1) Accounts payable of \$8,000 were paid.
- (2) The owner, Ralph Wilson, invested an additional \$5,000 cash in the business.
- (3) Office equipment was purchased at a cost of \$1,000 to be paid for within 10



Handout 2
Measuring Business Income

MEASURING BUSINESS INCOME

The earning of net income, or profits, is a major goal of almost every business enterprise, large or small. Profit is the *increase in the owner's equity resulting from operation of the business*. The opposite of profit, a decrease in owner's equity from operation of the business, is termed a loss. If you were to organize a small business of your own, you would do so with the hope and expectation that the business would operate at a profit, thereby increasing your ownership equity in the business. From the standpoint of the individual firm, profitable operation is essential if the firm is to succeed, or even to survive.

Operating profitably usually leads to an increase in total assets as well as in owner's equity. From the fundamental accounting equation ($A = L + OE$), we know that any transaction which changes total assets must also change either total liabilities or owner's equity. For example, borrowing money from a bank increases both total assets and total liabilities. Operating profitably increases owner's equity and this increase is usually accompanied by an increase in total assets. It is possible that the increase in owner's equity from profitable operations could be accompanied by a decrease in liabilities, but in the great majority of cases, operating profitably increases total assets along with the increase in owner's equity.

Profits may be retained in the business to finance expansion, or they may be withdrawn by the owner or owners. Some of the largest corporations have become large by retaining their profits in the business and using these profits for purposes of growth. Retained profits may be used, for example, to acquire new plant and equipment, to carry on research leading to new and better products, and to extend sales operations into new territories.

Profits' public image versus economic function

In recent years, business profits have become a controversial issue. Critics often call corporate profits "excessive" and charge that profits are a major cause of rising prices. Such charges have received considerable publicity, and as a result many people have come to believe that business profits are something harmful to society. Actually, business profits perform a vital economic function in our economy, and a satisfactory level of business profits is generally associated with high employment, an improving standard of living, and an expanding national economy.

In a free market economy, profits assist in the efficient allocation of resources. When the demand for a particular product is much greater than the supply, the price consumers will pay for the product tends to rise. As the price rises, investors are attracted to that industry by the opportunity to earn greater than normal profits. The inflow of capital into the industry results in greater productive capacity, and supply of the product increases to meet demand.

Corporate profits may be viewed as the "return" to stockholders for having invested their resources in a particular company. When creditors lend money to a company, they expect to earn a reasonable rate of interest. When employees invest their time and labor, they expect to earn a reasonable wage. It is equally logical that stockholders, who supply financial resources to a business, should expect to earn a satisfactory return on their investment.

If business profits were reduced to insignificant levels, prices probably would rise rather than fall. Investors would stop providing capital to those industries in which profit opportunities were unsatisfactory. The resulting capital shortages would leave businesses unable to produce enough goods, causing production shortages, higher prices, and unemployment. Thus, a satisfactory level of business profits is essential to maintaining high levels of production and to financing economic growth.

When competition is restricted, profits may become “excessive.” Excessive profits, just as excessive wages or excessive materials costs, can be harmful to the economy. Profits are excessive when they become unreasonably large in relation to the amounts of money invested and the degree of risk being taken by the owners of a business. The risk taken by owners of a business is the chance that future losses may decrease or even wipe out their investment. Once we have completed our study of how business profits are measured, we shall discuss some ways of appraising their adequacy.

Net income

Since the drive for profits underlies the very existence of business organizations, it follows that a most important function of an accounting system is to provide information about the profitability of a business. Before we can measure the profits of a business, we need to establish a sharp, clear meaning for *profits*. Economists define profits as the amount by which an entity becomes *better off* during a period of time. Unfortunately, how much “better off” an entity has become may be largely a matter of personal opinion and cannot be measured *objectively* enough to provide a useful definition for accountants.

For this reason, accountants traditionally have looked to actual business transactions to provide objective evidence that a business has been profitable or unprofitable. For example, if a business buys an item for \$60 and promptly sells it for \$100 cash, we have objective evidence that the business has earned a profit of \$40. This policy of relying upon the objective evidence of completed transactions served accountants very well until the advent of continued severe inflation began to distort accounting measurements. We shall consider in later chapters some of the methods accountants are developing to compensate for the effects of inflation upon the income statement and balance sheet. Because the word *profits* has been used with various meanings by business managers and economists, accountants prefer to use the alternative term *net income*, and to define this term very carefully. *Net income is the excess of the price of goods sold and services rendered over the cost of goods and services used up during a given time period.* At this point, we shall adopt the technical accounting term *net income* in preference to the less precise term *profits*.

To determine net income, it is necessary to measure for a given time period (1) the price of goods sold and services rendered and (2) the cost of goods and services used up. The technical accounting terms for these items comprising net income are *revenue and expenses*. Therefore, we may state that *net income equals revenue minus expenses*. To understand why this is true and how the measurements are made, let us begin with the meaning of revenue.

Revenue

Revenue is the price of goods sold and services rendered to customers. When a business renders services to its customers or delivers merchandise to them, it either receives immediate payment in cash or acquires an account receivable which will be collected and thereby become cash within a short time. The revenue for a given period is equal to the inflow of cash and receivables from sales made in that period. For any single transaction, the amount of revenue is a measurement of the asset values received from the customer.

Revenue causes an increase in owner’s equity. The inflow of cash and receivables from customers increases the total assets of the company. On the other side of the accounting equation, the liabilities do not change, but the owner’s equity is increased to match the increase in total assets. Thus revenue is the *gross* increase in owner’s equity resulting from business activities. Bear in mind, however, that not every increase in owner’s equity comes from revenue. As illustrated in Chapter 1, the owner’s equity is also increased by the investment of assets in the business by the owner.

Various terms are used to describe different types of revenue; for example, the revenue earned by a real estate broker may be called *Commissions Earned*; for a theater or stadium the term *Admissions Revenue* is

appropriate; in the professional practice of lawyers, physicians, and CPAs, the revenue is called *Fees Earned*; and companies selling merchandise generally use the term *Sales* to describe their principal revenue account.

Realization or recognition of revenue Revenue is recognized and entered in the accounting records at the time services are rendered to a customer or when goods sold to a customer are delivered. The amount of revenue is equal to the cash received plus the accounts receivable acquired from customers buying on credit. Thus the *point of sale* is the time to recognize revenue, regardless of whether the customer pays cash or promises to pay later.

To illustrate the recognition of revenue, let us assume that a business begins operations in March and makes sales of merchandise or services to its customers in March as follows: sales for cash, \$25,000; sales on credit (to be collected in April), \$15,000. The revenue for March is \$40,000, an amount equal to the *cash received and to be received* from March sales. When the accounts receivable of \$15,000 are collected during April, they must not be counted a second time in measuring revenue for April. The act of collection causes an increase in the asset, Cash, and a corresponding decrease in the asset, Accounts Receivable. The amount of total assets remains unchanged, and, of course, there is no change in liabilities or owner's equity.

Another example of a cash receipt that does not represent revenue comes from borrowing. A business may obtain cash by borrowing from a bank. This increase in cash is offset by an increase in liabilities in the form of a note payable to the bank. The owner's equity is not affected by the borrowing transaction.

Expenses

Expenses are the cost of the goods and services used up in the process of obtaining revenue. Examples include salaries for employees, charges for newspaper advertising and for telephone service, and the wearing out (depreciation) of the building and office equipment. All these items are necessary to attract and serve customers and thereby to obtain revenue. Expenses are sometimes referred to as the "cost of doing business," that is, the cost of the various activities necessary to carry on a business. Since expenses are the cost of goods and services used up, they are also called *expired costs*.

Expenses cause the owner's equity to decrease. Revenue may be regarded as the positive factor in producing net income, expenses as the negative factor. The relationship between expenses and revenue is a significant one; the expenses of a given month or other time period are incurred in order to generate revenue in that same period. The salaries earned by sales employees waiting on customers during July are applicable to July revenue and should be treated as July expenses, even though these salaries may not actually be paid to the employees until sometime in August.

As previously explained, revenue and cash receipts are not one and the same thing; similarly, expenses and cash payments are not identical. Examples of cash payments which are not expenses of the current period include the purchase of an office building for cash, the purchase of merchandise for later sale to customers, the repayment of a bank loan, and withdrawals of cash from the business by the owner. In deciding whether a given transaction should be regarded as an expense of the current period, it is often helpful to pose the following questions:

- 1 Was the alleged "expense" incurred in order to produce revenue in the current period?
- 2 Does the item in question reduce the owner's equity?

If the answer to both questions is yes, the transaction does represent an expense.

Withdrawals by the owner

The owner of an unincorporated business (James Roberts, in our continuing example) invests money in the enterprise and devotes all or part of his time to its affairs in the hope that the business will earn a profit. The

owner does not earn interest on the money invested nor a salary for personal services. His incentive, rather than interest or salary, is the increase in owner's equity that will result if the business earns a net income.

An owner of an unincorporated business usually makes withdrawals of cash from time to time for personal use. These withdrawals are in anticipation of profits and are not regarded as an expense of the business. The withdrawal of cash by the owner is like an expense in one respect; it reduces the owner's equity. However, expenses are incurred for the purpose of generating revenue, and a withdrawal of cash by the owner does not have this purpose. From time to time the owner may also make additional investments in the business. The investment of cash and the withdrawal of cash by the owner may be thought of as exact opposites: the investment does not represent revenue; the withdrawal does not represent an expense. Investments and withdrawals of cash affect only balance sheet accounts and are not reported in the income statement.

Since a withdrawal of cash reduces the owner's equity, it *could be* recorded by debiting the owner's capital account (James Roberts, Capital, in our example). However, a clearer record is created if a separate *drawing account* (James Roberts, Drawing) is debited to record all amounts withdrawn. The drawing account is also known as a *personal account*.

Debits to the owner's drawing account are required for any of the following transactions:

- 1 Withdrawals of cash.
- 2 Withdrawals of other assets. The owner of a clothing store, for example, may withdraw merchandise for his or her personal use. The amount of the debit to the drawing account would be for the cost of the goods which were withdrawn.
- 3 Payment of the owner's personal bills out of company funds.

The disposition of the drawing account when financial statements are prepared will be illustrated later in this chapter.



Handout 8
**Long-Lived Assets
and Depreciation**

CHAPTER 8

Long-Lived Assets and Depreciation

LEARNING OBJECTIVES

After studying this chapter, you should be able to

1. Define and explain depreciation and show how it relates to income measurement, income taxes, and cash balances
2. Define, compute, and compare some typical depreciation methods
3. Contrast the accounting for repairs, maintenance, and improvements
4. Demonstrate how gains and losses on sales of fixed assets are computed and presented in financial statements
5. Define and explain depletion and amortization
6. Define *intangible* assets and explain how to account for them for both shareholder purposes and income tax purposes

Cost of goods sold and depreciation expense are the two most widely encountered and debated items on an income statement. Chapter 7 emphasized FIFO, LIFO, and other ways of computing cost of goods sold. This chapter emphasizes various ways of computing depreciation as well as similar items like depletion and amortization.

This chapter considers some major assets, such as land, buildings, equipment, natural resources, and patents. These resources are often described as **long-lived assets** because they are held for an extended time. A distinguishing feature of these assets is their underlying purpose: to facilitate the production and sale of goods or services to customers. That is, these assets by themselves are not available for sale in the ordinary course of business. Thus a delivery truck is a long-lived asset for nearly all companies; of course, a truck dealer would regard trucks as merchandise inventory.

GENERAL PERSPECTIVE

With the exception of land, the acquisition costs of all long-lived assets are typically charged to expense over a period of years in some systematic way. As Exhibit 8-1 shows, such expenses are called depreciation, depletion, or amortization, depending on the asset in question.

The word **amortization** is probably the most general in the sense that it means the systematic reduction of a lump-sum amount. Therefore there is nothing inherently wrong with using a single word such as *amortization* to describe the application of the *same fundamental* idea to various types of long-lived assets. However, it is customary to use three words, as shown in Exhibit 8-1.

How do you compute the acquisition cost of long-lived assets? How do you account for useful lives? Residual values? Gains or losses on disposition? Intervening changes in original estimates? This chapter explores these fundamental questions.

EXHIBIT 8-1 Summary of Accounting for Long-Lived Assets

BALANCE SHEET	INCOME STATEMENT
Land	—
Buildings and equipment	Depreciation
Natural resources	Depletion
Intangible assets (for example, franchises or patents)	Amortization/ Impairment testing

The major long-lived assets are often divided into tangible and intangible categories. Examples of tangible assets are land, natural resources, buildings, and equipment. Tangible assets are physical items that can be seen and touched. In contrast, intangible assets are rights or economic benefits that are not physical in nature. Examples are franchises, patents, trademarks, copyrights, and goodwill.

Tangible assets are often called fixed assets for brevity, but plant assets is more descriptive. Corporate annual reports generally use the following nomenclature, which is taken from the annual report of the American Telephone and Telegraph Company (AT&T):

AT&T COMPANY

Property, Plant, and Equipment:

(in millions)	AT JANUARY 1,	
	1988	1987
Lard and improvements	\$512	\$499
Buildings and improvements	6,502	6,199
Machinery, electronic and other equipment	32,532	33,190
Total property, plant, and equipment	39,546	39,886
Less: Accumulated depreciation	18,685	18,810
Property, plant, and equipment—net	\$20,861	\$21,078

LAND

Shareholders' reports often contain summarized data, as shown by AT&T. However, in the accounting records, accumulated depreciation and amortization are kept in great detail for various categories of plant and equipment.

The acquisition cost of all long-lived assets is their cash-equivalent purchase price, including incidental costs.

The cost of land includes charges to the purchaser for the cost of land surveys, legal fees, title fees, realtors' commissions, transfer taxes, and even the demolition costs of old structures that might be torn down to get the land ready for its intended use.

Land such as plant sites or building sites is ordinarily accounted for as a separate item. Under historical-cost accounting, land is carried indefinitely at its original cost. As a result, if land is held for many years of persistent inflation, its carrying amount is likely to be far below its current realizable value.

Should land acquired and held since 1932 be placed on a 1990 balance sheet at cost expressed in 1932 dollars? Accountants do exactly that. For example, Weyerhaeuser lists 5.9 million acres of land at \$125 million (only \$21 per acre). Many critics of accounting point to such extreme examples as illustrations of why the basic historical-cost framework of accounting deserves drastic overhauling. They claim that some type of accounting for inflation should be mandatory. This worrisome problem of inflation is discussed in Chapter 16.

BUILDINGS AND EQUIPMENT

■ Acquisition Cost

The cost of buildings, plant, and equipment should include all costs of acquisition and preparation for use. Consider the following example for some used packaging equipment:

Invoice price, gross	\$100,000
Deduct 2% cash discount for payment within 30 days	<u>2,000</u>
Invoice price, net	\$ 98,000
State sales tax at 8% of \$98,000	7,800
Transportation costs	3,000
Installation costs	8,000
Repair costs prior to use -	<u>7,000</u>
Total acquisition cost	<u>\$123,840</u>

The \$123,840 would be the total *capitalized cost* added to the Equipment account. A cost is described as being **capitalized** when it is added to an asset account, as distinguished from being "expensed" immediately. Note that ordinary repair costs are expensed if incurred *after* the equipment is placed in use.

Generally accepted accounting principles usually regard interest cost as an expense. However, FASB *Statement No. 34* specifies that interest on expenditures during an extended construction period should be added to the acquisition cost of the fixed asset under construction. Suppose a \$2 million plant was constructed over two years. If no construction payments were made before the plant was completed, no interest would be capitalized. However, suppose \$1 million was paid at the end of the first year, and \$1 million at completion. Assume the interest rate on recent borrowing was 12%. Interest of \$1,000,000 x .12 = \$120,000 would be part of the capitalized cost of the plant.

■ Basket Purchases

Frequently, more than one type of long-lived asset is acquired for a single overall outlay. For instance, suppose land and a building were acquired for \$1 million. The acquisition of two or more types of assets for a lump-sum cost is sometimes called a **basket purchase**. How much of the \$1 million should be allocated to each? Invariably, the cost is allocated in proportion to some estimate of their relative sales values as separate items. For example, an appraiser or a tax assessor might indicate that the market value of the land is \$480,000 and of the building is \$720,000. The cost would be allocated as follows:

	(1) MARKET VALUE	(2) WEIGHTING	(3) TOTAL COST TO ALLOCATE	(2) X (3) ALLOCATED COSTS
Land	\$480,000	480/1,200 (or 40%)	\$1,000,000	\$400,000
Building	<u>720,000</u>	720/1,200 (or 60%)	1,000,000	<u>600,000</u>
Total	<u>\$1,200,000</u>			<u>\$1,000,000</u>

This problem of allocating a basket purchase cost to the individual assets is often extremely important.¹ Why? Because the useful lives of various assets differ. Consequently, the reported income might be affected considerably. The higher the cost allocated to land, the lower the cost of the depreciable assets, the lower the depreciation expense, and the higher the subsequent reported income. In our example, suppose the building bore an \$800,000 cost instead of the \$600,000 cost above. Then straight-line depreciation based on a twenty-year useful life and zero residual value could be \$800,000/20 or \$40,000, instead of \$600,000/20, or \$30,000.

However, if managers want to reduce their income tax outflows in earlier years, they would tend to take advantage of any doubts (within the bounds of the law) about relative market values by loading as much cost as possible on depreciable assets rather than on land.

■ Depreciation in General

¹ The allocation of a lump-sum cost of a sports team, which includes player contracts, has been the subject of litigation between taxpayers and the Internal Revenue Service. Buyers want to allocate as much of the cost to player contracts as possible. Such contracts may be depreciated (amortized) for income tax purposes, but the sports franchise itself may not. (See problem 8-66 for an example.)

Equipment and similar long-lived assets are initially recorded at cost. The major difficulties of measurement center on the choice of a pattern of depreciation that is, the allocation of the original cost to the particular periods that benefit from the use of the assets.

In particular, note that accountants regard depreciation as a process of *allocating the acquisition cost* to the particular periods or products that are related to the use of the assets. Depreciation is frequently misunderstood. It is not a process of *valuation*. In everyday use, we might say that an auto depreciates in value, meaning a decrease in its current market value. But to an accountant, depreciation is *not* a technique for approximating current values such as replacement costs or resale values. It is simply *cost allocation*.

The amount of the acquisition cost to be allocated over the total useful life of the asset as deprecation is the **depreciable value**. It is the difference between the total acquisition cost and the predicted residual value. The **residual value** is the amount received from disposal of a long-lived asset at the end of its useful life. Synonyms for residual value are **terminal value**, **disposal value**, **salvage value**, and **scrap value**.

The depreciation allocation to each year may be made on the basis of either time or service. The prediction of useful life, which is a crucial factor in determining the yearly amount of depreciation, is influenced by predictions of physical wear and tear. However, the useful lives are almost always more heavily affected by economic and technological factors than by when equipment may physically wear out.

The following symbols and amounts will be used to compare various depreciation patterns:

	AMOUNTS FOR ILLUSTRATION
Let	
C =total acquisition cost on December 31, 19X7	\$41,000
R =residual value	1,000
n = estimated useful life	4 years
D =amount of depreciation (or amortization) per unit of n	

■ **Straight-Line Depreciation**

Straight-line depreciation spreads the depreciable value evenly over the useful life of an asset. It is by far the most popular method for corporate reporting to shareholders. It is used by almost 95% of major companies for at least part of their fixed assets, and over 66% use it exclusively.

Exhibit 8-2 shows how the asset would be displayed in the balance sheet if a straight-line method of depreciation were used. The annual depreciation expense that would appear on the income statement would be:

$$D = \frac{\text{Acquisition cost} - \text{Residual value}}{\text{Years of useful life}}$$

$$\frac{C - R}{n}$$

$$\frac{\$41,000 - 51,000}{4} = \$10,000 \text{ per year}$$

EXHIBIT 8-2
Straight-Line Depreciation Schedule*

	BALANCES AT END OF YEAR			
	1	2	3	4

Plant and equipment (at original acquisition cost)	41,000	\$41,000	\$41,000	\$41,000
Less: Accumulated depreciation (the portion of original cost that has already been charged to operations as expense)	10,000	20,000	30,000	40,000
Net book value (the portion of original cost that will be charged to future operations as expense)	\$31,000	521,000	\$11,000	\$1,000

* Other patterns of depreciation are discussed later in this chapter.

The listing of depreciation amounts for each year of an asset's useful life is called a depreciation schedule.

■ Depreciation Based on Units

When physical wear and tear is the dominating influence on the useful life of the asset, depreciation may be based on units of service or units of production rather than on the units of time (years) so commonly used. Depreciation based on units of service is called unit depreciation. Suppose the asset in our example were a large truck that would be kept for a useful life of two hundred thousand miles. Depreciation would then be computed on a mileage basis:

$$D = \frac{C - R}{n}$$

$$\frac{\$41,000 - \$1,000}{200,000 \text{ miles}}$$

$$\$20 \text{ per mile}$$

For some assets, such as transportation equipment, this depreciation pattern may have more logical appeal than the straight-line method. However, the unit depreciation method is not widely used, probably for two major reasons:

1. Straight-line depreciation frequently produces approximately the same yearly depreciation amounts.
2. Straight-line depreciation entails less data-collection costs. The entire depreciation schedule can be set at the time of acquisition, and detailed records of units of service are not necessary.

The most commonly encountered example of unit depreciation relates to the use of mining equipment. Instead of writing such costs off on a time basis, the equipment costs are depreciated at a rate per ton of minerals extracted.

■ Double-Declining-Balance Depreciation

Any pattern of depreciation that writes off depreciable costs more quickly than the ordinary straight-line method based on expected useful life is called accelerated depreciation.² The most popular form of accelerated depreciation is the double-declining-balance (DDB) method. DDB is computed as follows:

1. Compute a rate (*ignoring the residual value*) by dividing 100% by the years of useful life. This is the straight-line rate. Then double the rate.³ In our example, the straight-line rate is $100\% \div 4 \text{ years} = 25\%$. The DDB rate would be $2 \times 25\%$, or 50%.
2. To compute the depreciation for any year, multiply the beginning book value for the year by the DDB rate.

The DDB method can be illustrated as follows:

$$\begin{aligned} \text{DDB rate} &= 2(100\% \div n) \\ \text{DDB rate, 4-year life} &= 2(100\% \div 4) = 50\% \\ \text{DDB depreciation} &= \text{DDB rate} \times \text{Beginning book value} \end{aligned}$$

² Between 20% and 25% of major U.S. companies use accelerated depreciation for part of their fixed assets in reporting to shareholders.

³ Double-declining-balance requires doubling the rate. Other declining-balance methods use other multiples. For instance, 150% declining-balance requires the straight-line rate to be multiplied by 1.5.

For year 1:	$D = .50$	$(\$41,000 - \$20,500)$		} Cumulative total= \$35,875
For year 2:	$D = .50$	$(\$41,000 - \$20,500)$		
	$= .50$	$(\$20,500) = \$10,250$		
For year 3:	$D = .50$	$[\$41,000 - (\$20,500 + \$10,250)]$		
	$= .50$	$(\$10,250) = \$5,125$		
For year 4:	$D = .50$	$[\$41,000 - (\$20,500 + \$10,250 + \$5,125)]$		
	$= .50$	$(\$5,125) = \$2,563$		

In this example, by coincidence the depreciation amount for each year happens to be half the preceding year's depreciation. However, this is a special case; it happens only with a four-year life. As the equations show, the basic approach is to apply the depreciation rate to the beginning book value.

■ Sum-of-the-Years'-Digits Depreciation

Another method of accelerated depreciation is the **sum-of-the-years'-digits (SYD)** method. DuPont and Holly Sugar are among the few companies currently using SYD for reporting to stockholders. Sum of the digits is the total of the numbers representing the years of life; for example, assuming a four-year life, $1 + 2 + 3 + 4 = 10$. This sum becomes the denominator⁴ in a key fraction as follows:

$$\begin{aligned} \text{SYD depreciation} &= \text{Fraction} \times \text{Depreciable amount} \\ &= \frac{\text{Number of remaining years of life}}{\text{Sum of digits}} (C - R) \end{aligned}$$

$$\begin{aligned} \text{For year 1: } D &= \frac{4}{1 + 2 + 3 + 4} (\$41,000 - \$1,000) \\ &= 4/10 (\$40,000) = \$16,000 \\ \text{For year 2: } D &= 3/10 (\$40,000) = \$12,000 \\ \text{For year 3: } D &= 2/10 (\$40,000) = \$8,000 \\ \text{For year 4: } D &= 1/10 (\$40,000) = \$4,000 \end{aligned}$$

SYD became popular mainly because of its use in tax reporting. Until 1954 U.S. companies used straight-line depreciation for their reports to shareholders and to the Internal Revenue Service (IRS). In 1954, the IRS began to allow accelerated depreciation, either SYD or DDB, for tax reporting. Even though companies were permitted to use different depreciation methods for reporting to shareholders and to income tax authorities, some companies used the same depreciation methods for reporting to all interested parties. Since 1980, when tax laws changed and SYD was no longer permitted for tax purposes, its use for reporting to shareholders has gradually declined.

■ Comparing Depreciation Methods

Exhibit 8-3 compares the results of these three popular depreciation methods. Note that the DDB method will not write off the full depreciable cost of \$40,000. When DDB is used for tax reporting, American income tax regulations permit the taxpayer to change to the straight-line method part way through the asset's depreciable life. Straight-line depreciation over the remaining useful life is applied to the remaining depreciable value, thereby fully writing off the depreciable value. The change comes when the next year's straight-line depreciation first exceeds the amount in the original DDB schedule.

Consider the DDB section of Exhibit 8-3, for example. The taxpayer could switch to the straight-line method at the beginning of the fourth year. The total accumulated depreciation for the first three years is \$35,875. Because the maximum depreciation allowed for this asset over its four-year life is \$40,000, the taxpayer would deduct $\$40,000 - \$35,875$, or $\$4,125$, in the fourth year (rather than the \$2,563 shown in Exhibit 8-3). In this way, the taxpayer obtains the complete depreciation deduction allowable.

Because different depreciation methods can be used for tax and shareholder reporting, it is important to recognize which reporting is at issue. The following table gives a summary:

⁴ A general formula for the denominator is $S = n(n + 1)/2$ where S = sum of the digits and n = useful life: $S = 4(4+1)/2 = 10$

WHEN ASSETS ACQUIRED	REPORTS TO SHAREHOLDERS	REPORTS TO INTERNAL REVENUE SERVICE
Before 1954	Straight-line	Straight-line
1954 to date:		
Most companies	Straight-line	Accelerated
Some companies (such as DuPont and Motorola)	Accelerated	Accelerated

Even for shareholder reporting alone, companies do not necessarily use the same depreciation policies for all types of depreciable assets. For example, consider the 1988 annual report of Kobe Steel, Ltd., a major Japanese company: "Buildings and structures in all locations and machinery and equipment located in Kakogawa Works, Kobe Works, Takasago Works, Mooka Plant and Chofu Plant are depreciated on the straight-line method and all other machinery and equipment are depreciated on the declining balance method over estimated useful lives."

EXHIBIT 8-3**Depreciation: Three Popular Methods****(Assume equipment costs \$41,000, four-year life, predicted residual value of \$1,000)**

	ACCELERATED DEPRECIATION					
	Straight-Line ^a		Sum-of-Years'- Digits(SYD) ^b		Declining Balance at Twice the Straight-Line Rate (DDB) ^c	
	Annual Depreciation	Book Value	Annual Depreciation	Book Value	Annual Depreciation	Book Value
At acquisition		\$41,000		\$41,000		\$41,000
Year						
1	\$10,000	31,000	\$16,000	25,000	52,500	20,500
2	10,000	21,000	12,000	13,000	10,250	10,250
3	10,000	11,000	8,000	5,000	5,125	5,125
4	10,000	1,000	4,000	1,000	2,563	2,562
Total	<u>\$40,000</u>		<u>\$40,000</u>		<u>\$38,438</u>	

a Depreciation is the same each year, 25% of (\$41,000 - \$1,000).

b Sum of digits is 1 + 2 + 3 + 4 = 10. Then 4/10 x \$40,000; 3/10 x \$40,000, etc.

c $100\% \div 4 = 25\%$. The double rate is 50%. Then 50% of \$41,000; 50% of (\$41,000 - \$20,500); 50% of [\$41,000 - (\$20,500 + \$10,250)]; etc. Unmodified, this method will never fully depreciate the in the later years of an asset's life, companies typically switch to a straight-line method. See the text for a fuller explanation existing book value. Therefore, in the later years of an asset's life, companies typically switch to a straight-line method. See the text for a fuller explanation.

■ Modified Accelerated Cost Recovery System (MACRS)

Tax laws have greatly influenced depreciation methods. The tax laws pertaining to depreciation changed twice during the 1980s. For most fixed assets placed in service after December 31, 1980, and before December 31, 1986, the tax regulations require use of the Accelerated Cost Recovery System (ACRS). Assets acquired after December 31, 1966, use the Modified Accelerated Cost Recovery System (MACRS). Both ACRS and MACRS have assigned shorter useful lives to the assets than previously. In essence, for most assets MACRS approximates (a) *double-declining-balance* depreciation⁵ (b) applied over *shorter lives*. In combination a and b provide greater acceleration of depreciation than was allowed before 1981. (Taxpayers have the option of using straight-line depreciation.) For the most part, these shorter lives are not used for reporting to shareholders. See Chapter 13 for a fuller explanation.

The key word in depreciation schedules that differ from straight-line based on expected useful service life is *accelerated*. For example, whether declining balance depreciation is 200%, 175%, or 150% of the straight-line rate, in the early years of an asset's service life there will be higher depreciation than with the straight-

⁵ Some categories of assets use a 150% declining-balance method, and residential rental Property and nonresidential real estate are depreciated using the straight-line method.

line method. Moreover, the use of a shorter useful life is also a form of accelerated depreciation. Carried to its extreme, an accelerated depreciation method would call for immediate total write-off in the year of acquisition.

INCOME TAX REPORTING AND SHAREHOLDER REPORTING

■ Purposes and Income Taxes

Throughout this discussion of long-lived assets, please distinguish between reporting to stockholders and reporting to the income tax authorities. Reports to stockholders must abide by “generally accepted accounting principles (GAAP).” In contrast, reports to income tax authorities must abide by the income tax rules and regulations. These rules comply with GAAP in many respects, but they frequently diverge. Therefore there is nothing immoral or unethical about “keeping two sets of records.” In fact, it is necessary.

Keep in mind that the income tax laws are patchworks that are often designed to give taxpayers special incentives for making investments. For example, tax authorities in some countries have permitted taxpayers to write off the full cost of new equipment as expense in the year acquired. Although such a total write-off may be permitted for income tax purposes, it is not permitted for shareholder-reporting purposes.

Major differences between GAAP and the U.S. tax laws are found in accounting for amortization and depreciation. For example, consider how the accounting for perpetual franchises, trademarks, and goodwill differs. Their acquisition costs must be amortized for shareholder reporting. However, the Internal Revenue Service will not allow amortization because such assets are deemed to have indefinite useful lives. Tax reporting and shareholder reporting are *required* to differ.

■ Straight-Line or Accelerated Depreciation

The vast bulk of companies use straight-line depreciation for reporting to shareholders. Practical reasons for adopting straight-line depreciation are simplicity, convenience, and the reporting of higher earnings in early years than would be reported under accelerated depreciation. Managers tend not to choose accounting methods that hurt reported earnings in the early years of long-lived assets.

An additional reason given in support of straight-line depreciation is the assumption that depreciation is a function of time rather than of use. Therefore the “service potential” of the asset is assumed to decline by an equal amount each period; the total cost of the services consumed in any period is the same regardless of actual use. Further, suppose the benefit from using an asset is the same each period. The matching principle would require that the cost be spread equally to all periods.

For income-tax-reporting purposes, most corporations use accelerated depreciation. Why? To postpone payments of income taxes. Most of the same companies simultaneously use straight-line depreciation for shareholder reporting. Chapter 13 discusses the accounting problems that arise from such simultaneous reporting.

A few companies also use some form of accelerated depreciation for reporting to shareholders. For example, Texas Instruments Corporation states that “substantially all depreciation is computed by either the declining balance method. . . or the sum-of-the-years'-digits method.” Among the reasons for using accelerated depreciation is conservatism. A more persuasive reason is that fixed assets are bundles of services or economic benefits that are used at a faster rate in early years. For example, suppose repair and maintenance expenses increase as an asset ages. If the service obtained is the same each year, the total cost should not increase across time. In essence, the asset is more responsible for the services in early years, and repairs and maintenance are relatively more responsible in later years. Hence depreciation expense should be higher in earlier years and lower in later years.

For simplicity, unless stated otherwise, throughout this chapter we assume that the company uses the same accounting for both income tax reporting and shareholder reporting.

DEPRECIATION AND GENERATION OF CASH

■ Misunderstood Relationships

Depreciation is widely misunderstood. Depreciation is simply an allocation of the original cost of an asset to the periods in which the asset is used, nothing more and nothing less. Accumulated depreciation is a summation of the amounts of the original cost already written off to expense in prior periods. Thus accumulated depreciation is not a pile of cash waiting to be used to replace the assets.

For example, suppose a \$40,000 machine is acquired early in 19X1 and is expected to be used through the end of 19X5, at which time the residual value will be zero. Each year, some of the services of the machine are used; depreciation expense recognizes this use. By the end of 19X5, the accumulated depreciation will be \$40,000 because the entire original cost will have been charged as depreciation expense. Charging depreciation does nothing to set aside cash for replacement of the machine; it simply measures the consumption of some of the services of an asset. Accumulated depreciation shows the total amount consumed.

A major objective of this chapter is to pinpoint the relationships between depreciation expense, income tax expense, cash, and accumulated depreciation. Too often, these relationships are confused. For example, the business press frequently contains misleading quotations such as ". . . we're looking for financing \$3.75 billion. Of that, about 60% will be recovered in depreciation and amortization." As another example, consider a *Business Week* news report concerning an airline company: "And with a hefty boost from depreciation and the sale of \$6 million worth of property, its cash balance rose by \$10 million in the years first quarter." Also consider Forbes: "Now, by dragging out their depreciation schedules, firms may run the risk of repeating the errors of the automobile and steel industries, which found themselves hard pressed to replace assets because of years of underdepreciation."

■ Depreciation Is Not Cash

Suppose Acme Service Company began business with cash and common stock equity of \$100,000. On the same day, equipment was acquired for \$40,000 cash. The equipment had an expected four-year life and zero predicted residual value. The first year's operations generated cash sales of \$103,000 and cash operating expenses of \$53,000. These relationships are depicted in Exhibit 8-4, using straight-line depreciation in Panel I and accelerated depreciation in Panel II. The form of accelerated depreciation assumed here is double-declining-balance. DDB depreciation for the first year is $2 \times 25\% \times \$40,000 = \$20,000$, compared with straight-line depreciation of $\frac{1}{4} \times \$40,000 = \$10,000$.

EXHIBIT 8-4
ACME SERVICE COMPANY
Analysis of Transactions (in thousands of dollars)

		A			=	L	+	SE	
		Cash	+ Equipment	- Accumulated Depreciation	=	Liabilities	+	Paid-in Capital	+ Retained Income
Panel I.	STRAIGHT-LINE DEPRECIATION								
	Initial Investment	+100					+100		
	Acquisition	-40	+40						
	Cash sales	+103							+103 Sales
	Cash operating expenses	-53		-10					-53 Expense
	Depredation, year 1						+100		-10 Expense
	Bal. Dec. 31 before taxes	+110	+40	-10					
	Income taxes (40% of 40)	-16							-16 Expense
	Bal. Dec. 31 after taxes	+94	+40	-10			+100		+24
Panel II.	ACCELERATED DEPRECIATION								
	Initial Investment	+100					+100		
	Acquisition	-40	+40						
	Cash sales	+103							+103 Sales
	Cash operating expenses	-53		-20					-53 Expense
	Depredation, year 1								Expense
	Bal. Dec. 31 before taxes	+110	+40	-20			+100		+30
	Income taxes (40% of 30)	-12							-12 Expense
	Bal. Dec. 31 after taxes	+98	+40	-20			+100		+18

Focus first on the December 31 balances before taxes in Exhibit 8-4. A comparison of the before-tax amounts stresses the role of depreciation expense most vividly. At the end of the year, the cash balance before taxes is \$110,000, regardless of the deprecation method used. Changes in the deprecation method affect only the accumulated depreciation and retained earnings accounts. The before-tax ending cash balances are completely unaffected. The same conclusions can be drawn from the before-tax balance sheet shown in the top half of Exhibit 8-5.

Consider next the effect of deprecation on the before-tax income statement. The relevant amounts are in the last column of Exhibit 8-4, but the first two columns of Exhibit 8-6 present the same numbers in a more useful format. The cash provided by operations before income taxes is \$50,000, regardless of the deprecation method used. Pretax income under straight-line differs from that under accelerated depreciation only because of differences in the noncash depreciation expense. Examine the diagram in Exhibit 8-7. Only sales and cash operating expenses affect cash. Each extra dollar of deprecation reduces pretax income by a dollar but leaves the increase in cash unaffected.

Suppose deprecation were \$40,000. Before reading on, compute the pretax income and increase in cash. You should have obtained pretax income of only \$10,000. However, the increase in cash remains at \$50,000, the sum of the pretax income and the deprecation expense.

EXHIBIT 8-5
ACME SERVICE COMPANY
Balance Sheet
December 31, 19X1 (in thousands)

ASSETS	STRAIGHT-LINE DEPRECIATION	ACCELERATED DEPRECIATION	STOCKHOLDER' EQUITY	STRAIGHT-LINE DEPRECIATION	ACCELERATED DEPRECIATION
BEFORE TAXES					
Cash		\$110	\$110		
Equipment	\$40	\$40	Paid-in capital		
Deduct:				\$100	\$100
Accumulated depreciation	10	30	Retained income	40	30
Total	<u>10</u>	<u>30</u>	Total	<u>\$140</u>	<u>\$130</u>
AFTER TAXES					
Cash		\$94	\$98		
Equipment	\$40	\$40	Paid-in capital		
Deduct:				\$100	\$100
Accumulated depreciation	10	30	Retained income	24	18
Total	<u>10</u>	<u>30</u>	Total	<u>\$124</u>	<u>\$118</u>

Exhibit 8-6
ACME SERVICE COMPANY
Income Statement
Ended December 31, 19X1 (in thousands)

	Before Taxes		After Taxes	
	STRAIGHT-LINE DEPRECIATION	ACCELERATED DEPRECIATION	STRAIGHT-LINE DEPRECIATION	ACCELERATED DEPRECIATION
Sales	\$103	\$103	\$103	\$103
Cash operating expenses	53	53	53	53
Cash provided by operations before income taxes	50	50	50	50
Depreciation expense	10	20	10	20
Pretax income	40	30	40	30
Income tax expense (40%)	—	—	16	12
Net income	<u>\$40</u>	<u>\$30</u>	<u>\$24</u>	<u>\$18</u>
Supplementary analysis:				
Cash provided by operations before income tax	\$50	\$50	\$50	\$50
Income tax expense	—	—	16	12
Cash provided by operations*	<u>\$50</u>	<u>\$50</u>	<u>\$34</u>	<u>\$38</u>

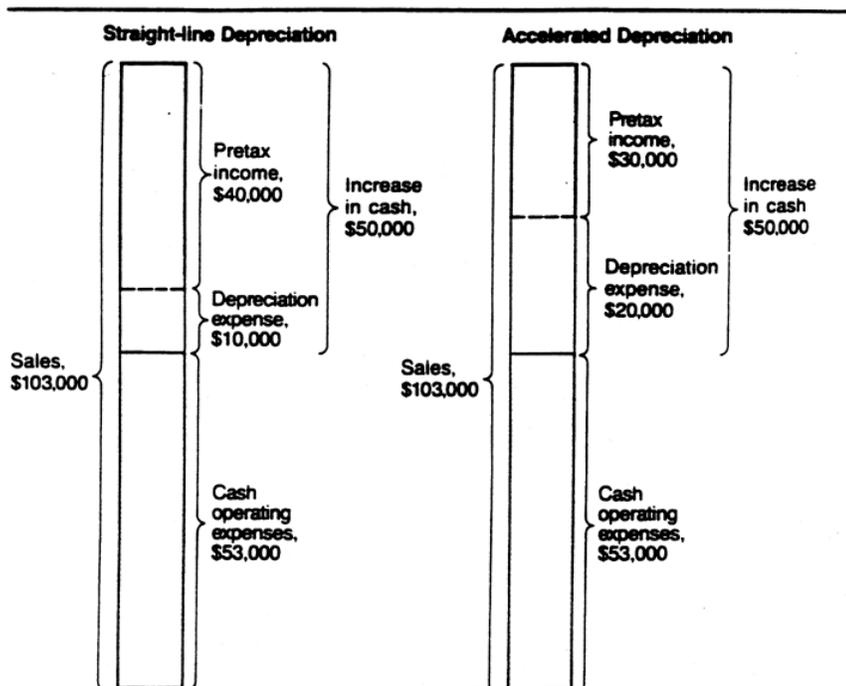
* Sometimes called cash flow from operations or just cash flow. But it is usually simply called cash provided by operations, which is typically defined as cash collected on sales (a) less all operating expenses requiring cash and (b) less income taxes.

■ Effects on Income Taxes

Now consider the after-tax portions of Exhibits 8-4, 8-5, and 8-6. Depreciation is a deductible noncash expense for income tax purposes. Hence the higher the depreciation allowed to be deducted in any given year, the lower the taxable income, and therefore the lower the cash disbursement for income taxes. In short, if depreciation expense is higher, more cash is conserved and kept for use in the business. From the first column of Exhibit 8-4 or the last two columns of Exhibit 8-6, you can see that Acme would pay \$16,000 of income taxes using straight-line depreciation but only \$12,000 using accelerated depreciation. Therefore, compared with the straight-line method, the accelerated method results in a higher cash balance *after* income tax (\$98,000 instead of \$94,000). At a 40% income tax rate, a \$10,000 higher depreciation expense postpones \$4,000 of income taxes.

Some strange results occur here. The reported net income is *lower* under accelerated than under straight-line depreciation, but the cash balance is *higher*. Thus, suppose managers were forced to choose one depreciation method for all purposes. Managers who are concerned about reported net income to shareholders may prefer straight-line to accelerated depreciation. This dilemma is not faced by managers in the United States, where straight-line depreciation is often used for shareholder purposes while accelerated depreciation is used for income tax purposes. You may recall from Chapter 7 that companies using the LIFO inventory method for tax purposes are also required to use LIFO for reporting to shareholders. Such is NOT the case with depreciation, where methods for tax and shareholder reporting are allowed to differ. See Chapter 13 for additional explanation.

EXHIBIT 8-7
Depreciation, Pretax Income, and Cash



Each extra dollar of depreciation reduces pretax income by a dollar but leaves the increase in cash unchanged. If depreciation were \$40,000, pretax income would be only \$10,000, but the increase in cash would remain at \$50,000.

Governments throughout the world have increasingly tolerated a wide variety of depreciation methods "to provide more cash for industrial expansion. The business press and financial analysts' reports are peppered with such phrasing as "cash provided by depreciation" or "funds generated by depreciation". Accountants quarrel with such phrasing because depreciation by itself is *not* a source of cash.

There is only one source of cash from operations: the cash provided through *sales to customers*. As our example shows, the effect of more depreciation on cash is *indirect*; it reduces income taxes by 40% of the extra depreciation of \$10,000, or \$4,000. Therefore accelerated depreciation keeps more cash in the business for a longer span of time because of the postponement of cash disbursements for income taxes.

Examine the account for accumulated depreciation. *No cash is there*. It is a deduction from an asset, regardless of whether income tax rates are zero, 20%, or 90%.

CHANGES IN DEPRECIATION ESTIMATES

Predictions of useful lives and residual values are invariably not accurate. If the inaccuracies are material, how should the affected accounts be adjusted? Consider the example of the \$41,000 asset with a \$1,000 residual value. Use the straight-line method. Suppose it is the beginning of Year 3. The firm's economists and engineers have altered their expectations; the asset's new expected useful life is five instead of four years. Moreover, the new expected residual value is \$3,000 instead of \$1,000:

	EXPECTATIONS	
	Original	Revised
Cost	\$41,000	\$41,000
Useful life	4 years	5 years
Residual value	\$1,000	\$3,000
Straight-line depreciation per year		
Old, \$40,000:4	\$10,000	
New, as computed below		\$6,000

These modifications to predictions are "changes in accounting estimates." They must be accounted for "prospectively" rather than "retroactively" in the sense that the records through Year 2 would not be adjusted. Instead the *remaining* depreciable amount would be written off over the new *remaining* useful life:

New book value at end of Year 2: \$41,000 - 2 (\$10,000) =	\$21,000
Revised residual value	3,000
Revised depreciable amount	<u>\$18,000</u>
Divide by remaining useful life in years, ÷ 3	
New straight-line depreciation per year	<u>= \$6,000</u>

Critics of the foregoing "prospective" method assert that it misstates the yearly depreciation throughout the entire life of the asset. That is, depreciation in early years is overstated and in later years is understated. This can be illustrated by comparing the prospective method in our example with the retroactive method (which uses perfect hindsight):

YEAR	PROSPECTIVE METHOD	RETROACTIVE METHOD
1	\$10,000	\$7,600
2	10,000	7,600
3	6,000	7,600
4	6,000	7,600
5	6,000	7,600
	<u>\$38,000</u>	<u>\$38,000</u>

* $(\$41,000 - \$3,000) \div 5 = \$7,600$.

Applying the retroactive method would entail restating the accounts of prior periods, a procedure that many accountants oppose mainly on the grounds that the past accounting was as accurate as possible given the knowledge then existing. Although the retroactive way of adjusting the accounts has much logical appeal, Accounting Principles Board Opinion No. 20 stated: "A change in estimate should not be accounted for by restating amounts reported in financial statements of prior periods."

DEPRECIATION FOR PARTS OF A YEAR

Assets are rarely acquired exactly at the start of a year or a month. To economize on recordkeeping, various simplifying assumptions are made about depreciation within the year. Each assumption must be reasonable and be consistently applied.⁶

For interim reporting, yearly depreciation is usually spread uniformly within a given fiscal year (an equal amount for each month), regardless of whether straight-line or accelerated depreciation is used to compute the total amount for the year. Moreover, depreciation for an asset acquired during a month is usually provided for the full month or not at all (depending on specific accounting policies, which vary among companies). For instance, suppose our \$41,000 asset had been acquired on October 14, 19X1, and SYD depreciation was used. As Exhibit 8-3 (page 326) shows, the depreciation for Year 1 would be \$16,000 and for Year 2 would be \$12,000.

Assume that the company's fiscal year and calendar year are the same and that depreciation is to be included for the full month of October. The depreciation schedule could appear as follows (in thousands of dollars):

ASSET YEAR	DEPRECIATION FOR 12-MONTH PERIODS	ALLOCATION TO EACH CALENDAR YEAR				
		19X1	19X2	19X3	19X4	19X5
1	4/10(40) = 16	4*	12 ^t			
2	3/10(40) = 12		3*	9 ^t		
3	2/10(40) = 8			2*	6 ^t	
4	1/10(40) = 4				1*	3 ^t
10	40	4	15	11	7	3

*3/12 of column 2 (for example, 19X1: 16 ÷ 12 months = \$1.33% per month; 3 months, \$1.33% x 3 = \$4).

^t9/12 of column 2 (for example, 19X2: 16 ÷ 12 months = \$1.33% per month; 9 months, \$1.33% x 9 = \$12).

The monthly statements in October, November, and December, 19X1, would each have depreciation expense of $\$4,000 \div 3 = \$1,333$. In turn, the monthly statements of 19X2 would each have depreciation expense of $\$15,000 \div 12 = \$1,250$.

EXPENSES VERSUS EXPENDITURES**■ Types of Expenditures**

This section explores the accounting for expenditures. **Expenditures** are defined by accountants as the purchases of goods or services, whether for cash or credit. **Capital expenditures** are those expected to benefit more than the current accounting year. **Revenue expenditures** are those deemed to have a useful life no longer than the current accounting year. Capital expenditures generally add new fixed assets or increase the capacity, efficiency, useful life, or economy of operation of an existing fixed asset.

The terminology here is a good example of entrenched usage that does not provide particularly accurate descriptions of the classification intended. For example, a capital expenditure might better be called an *asset* expenditure. Similarly, a revenue expenditure might better be called an *expense* expenditure.

Every expenditure eventually becomes an expense. Revenue expenditures are matched with current revenues and therefore become expenses in the current period. Capital expenditures benefit future revenues. They are charged as expenses over future periods.

⁶ For example, one of two methods might be used to determine when certain specified assets are placed in service:

1. *Half-year convention*. Treat all assets placed in service during the year as if they had been placed in service at the year's midpoint.

2. *Modified half-year convention*. Treat each asset placed in service during the first half of a tax year as if it had been placed in service on the first day of that tax year. Treat each asset placed in service during the last half of the tax year as if it had been placed in service on the first day of the *following* tax year.

Sometimes the distinction between capital and revenue expenditures is subjective. Auditors from both the public accounting firms and the income tax authorities regularly investigate whether a given outlay is a capital expenditure or a revenue expenditure. That is, is a particular outlay for the engine repair or part properly classified as an asset or an expense? The public accountant (who tends to prefer conservatism) is usually on the alert for any tendencies to understate current expenses through the unjustified charging of a repair to an asset account. In contrast, the income tax auditor is looking for the unjustified charging to an expense account (which provides an immediate income tax deduction).

Wherever doubt exists, there is a general tendency in practice to charge an expense rather than an asset account for repairs, parts, and similar items. First, many of these outlays are minor, so the cost-benefit test of recordkeeping (the concept of materiality) justifies such action. For instance, many companies have a policy of charging to expense all outlays that are less than a specified minimum such as \$100, \$500, or \$1,000. Second, there is the temptation of an immediate deduction for income tax purposes (if, indeed, the deductions are allowable as reasonable expenses).

■ Repairs and Maintenance

Repairs and maintenance costs are necessary if a fixed asset is to continue in a specified operating condition. The costs of repairs and maintenance are usually compiled in the same account and are labeled as revenue expenditures because they are regarded as expenses of the current period.

Repairs are sometimes distinguished from maintenance as follows. Repairs include the occasional costs of restoring a fixed asset to its ordinary operating condition after breakdowns, accidents, or damage. Maintenance includes the routine recurring costs of oiling, polishing, painting, and adjusting.

Obviously, distinctions between repairs and maintenance are sometimes hard to draw. For example, is an engine tune-up a repair expense or a maintenance expense? Nobody loses much sleep over such matters, so one account typically contains both repairs and maintenance.

■ Capital Improvements

An **improvement** (sometimes called a **betterment** or a **capital improvement**) is a capital expenditure that is intended to add to the future benefits from an existing fixed asset. How? By decreasing its operating cost, increasing its rate of output, or prolonging its useful life. An improvement differs from repairs and maintenance because the latter help ensure a specified level of benefits but do not enlarge the expected future benefits.

Examples of capital improvements or betterments include the rehabilitation of an apartment house that will allow increased rents and the rebuilding of a packaging machine that increases its speed or extends its useful life.

In Exhibit S-2 (page 322), suppose that at the start of Year 3 a major overhaul costing \$7,000 occurred. If this is judged to extend the useful life from four to five years, the required accounting would be:

1. Increase the book value of the asset (now \$41,000 - \$20,000 = \$21,000) by \$7,000 this is usually done by adding the \$7,000 to Equipment.⁷
2. Assume straight-line depreciation. Revise the deprecation schedule so that the new unexpired cost is spread over the remaining three years, as follows:

⁷ A few accountants prefer to debit Accumulated Depreciation instead of Equipment. The theory is that a portion of past depreciation is being "reversed" or "made good" by the improvement or betterment. In any event, the effect of the improvement is to increase the net book value of the equipment and increase subsequent deprecation in identical amounts, regardless of whether the debit is made to Equipment or to Accumulated Depreciation. The major justification for debiting Accumulated Depreciation is that old machine parts have been replaced, but their original cost cannot be isolated.

	ORIGINAL DEPRECIATION SCHEDULE		REVISED DEPRECIATION SCHEDULE	
	Year	Amount	Year	Amount
	1	\$10,000	1	\$10,000
	2	10,000	2	10,000
	3	10,000	3	9,000*
	4	10,000	4	9,000
			5	9,000
Accumulated depreciation		<u>*40,000^t</u>		<u>\$47,000^t</u>

* New depreciable amount is $(\$41,000 - \$20,000 + \$7,000) - \$1,000$ residual value = \$27,000. New depreciation expense is \$27,000 divided by remaining useful life of 3 years, or \$9,000 per year.

^t Recapitulation:

	NET BOOK VALUE	
	Original	Revised
Original outlay	\$41,000	\$41,000
Major overhaul	—	7,000
Total	<u>\$41,000</u>	<u>\$48,000</u>
Accumulated depreciation	<u>40,000</u>	<u>47,000</u>
Residual value	<u>\$ 1,000</u>	<u>\$ 1,000</u>

GAINS AND LOSSES ON SALES OF FIXED ASSETS

Gains or losses on the disposal of property, plant, and equipment are inevitable. They are usually measured in a cash sale by the difference between the cash received and the net book value (net carrying amount) of the asset given up.⁸

Income Statement Presentation

Gain on Sale of Equipment is usually shown as a separate item on an income statement as a part of "other income" or some similar category.

In single-step income statements, the gain is shown at the top along with other revenue items. For example:

Revenue:	
Sales of products	\$xxx
Interest income (or interest revenue)	X
Other income: Gain on sale of equipment	x
Total sales and other income	<u>\$xxx</u>

When a multiple-step income statement is used, the gain (or loss) is usually excluded from the computation of major profit categories such as gross profit or operating profit. Therefore the gain or loss appears in some type of "other income" or nonoperating income section in the lower part of the income statement.

In most instances, gains or losses on disposition of plant assets are not significant, so they are buried as a part of "other income" and are not separately identified. For example, W. R. Grace & Co. includes an item

⁸ When an old asset is traded for a similar new asset, the new asset is valued at its cash equivalent value for purposes of computing gain or loss. For example, consider the trade-in of a five-year-old truck for a new truck. The cash-equivalent value of the old truck is the difference between the cash cost of the new truck without the trade-in and the cash paid with the trade-in. The trading of assets can become complex. It is explained in advanced accounting texts. Also see Accounting Principles Board *Opinion No. 29*, "Accounting for Nonmonetary Transactions."

on its income statement immediately after sales labeled “Dividends, interest, and other income.” American Telephone and Telegraph (AT&T) shows “Other income, net (Note D)” on a separate line after operating income in a recent annual report Note D lists Gains (loss) on sale of fixed assets, \$9.0 million, out of a total of \$251.8 million of net other income.

■ Recording Gains and Losses

Suppose the equipment in Exhibit 8-2 (p. 322) were sold at the end of Year 2 for \$27,000. The sale would have the following effects:

	A		=	L	-	SE
+27,000	-	41,000	+	20,000	=	+6,000
Increase Cash		Decrease Equipment		Decrease Accumulated Depreciation		Increase Gain on Sale of Equipment

Note that the disposal of the equipment requires the removal of its carrying amount or book value, which appears in *two* accounts, not one. Therefore *both* the Accumulated Depredation account and the Equipment account are affected when dispositions occur.

+17,000	-	41,000	+	20,000	=	-4,000
Increase Cash		Decrease Equipment		Decrease Accumulated Depreciation		Increase Loss on Sale of Equipment

Exhibit 8-8
Journal and Ledger Entries
Gain or Loss on Sale of Equipment (in thousands of dollars)

Sale at \$27,000:			
		Cash	
Cash	27	27	
Accumulated depreciation	20		
Equipment	41		
Gain on sale of Equipment	6		
			Equipment
			41
			Accumulated Depreciation, Equipment
			20
			Gain on Sale of Equipment
			6
Sale at \$17,000:			
		Cash	
Cash	17	17	
Accumulated depreciation	20		
Loss on sale of equipment	4		
Equipment	41		
			Equipment
			41
			Accumulated Depreciation, Equipment
			20
			Gain on Sale of Equipment
			4

The T-account presentations and journal entries are in Exhibit 8-8. Note especially that the disposal of the equipment necessitates the removal of the original cost of the equipment *and* the accompanying accumulated depreciation. Of course, the net effect is to decrease the carrying amount of the equipment by \$21,000.

AMORTIZATION OF LEASEHOLDS AND LEASEHOLD IMPROVEMENTS

Leaseholds and *leasehold improvements* are frequently classified with plant assets. A leasehold is the right to use a fixed asset (such as a building or some portion thereof) for a specified period of time beyond one year. A **leasehold improvement** incurred by a lessee (tenant) can take various forms. Examples are the installation of

new fixtures, panels, walls, and air-conditioning equipment that are not permitted to be removed from the premises when a lease expires.

The costs of leases and leasehold improvements are written off in the same way as depreciation. However, the straight-line method is used almost exclusively, probably because accelerated methods have not been permitted for income tax purposes. Furthermore, these systematic write-offs are often described as amortization rather than as depreciation.

Sometimes the useful life of a *leasehold improvement* is expected to exceed the life of the lease. In such cases, amortization must be based on the shorter time span, the life of the lease. For more on leases, see Chapter 9, page 411.

DEPLETION

Natural resources such as minerals, oil, and timber are sometimes called *wasting assets*. **Depletion** is the gradual exhaustion of the original amounts of the resources acquired. Depletion differs from depreciation because the former focuses narrowly on a physical phenomenon and the latter focuses more broadly on any cause of the reduction of the economic value of a fixed asset, including physical wear and tear plus obsolescence.

The costs of natural resources are usually classified as fixed assets. However, the investment in natural resources can be likened to a lump-sum acquisition of massive quantities of inventories under the ground (iron ore) or over the ground (timber). Depletion expense is the measure of that portion of this "long-term inventory" that is used up in a particular period. For example, a coal mine may cost \$20 million and originally contain an estimated one million tons. The depletion rate would be \$20 per ton. If 100,000 tons were mined during the first year, the depletion would be 100,000 x \$20, or \$2 million for that year; if 150,000 tons were mined the second year, depletion would be 150,000 x \$20, or \$3 million; and so forth.

As the above example shows, depletion is measured on a units-of-production basis. The annual depletion may be accounted for as a direct reduction of the mining asset, or it may be accumulated in a separate account similar to accumulated depreciation.

Another example is timber. Boise Cascade Corporation, a large producer of forest products, describes its approach to depletion as follows:

- Timber and timberlands are shown at cost, less the cost of company timber harvested. Cost of company timber harvested and amortization of logging roads are determined on the basis of timber removals at rates based on the estimated volume of recoverable timber and are credited to the respective asset accounts.

The "cost of company timber harvested" is Boise Cascade's synonym for "depletion" of timber.

AMORTIZATION OF VARIOUS INTANGIBLE ASSETS

Intangible assets are a class of long-lived assets that are not physical in nature. They are rights to expected benefits deriving from their acquisition and continued possession. Examples of intangible assets are *patents*, *copyrights*, *franchises*, and goodwill.

Intangible assets with a definite life are accounted for like plant and equipment. That is, the acquisition costs are capitalized as assets and are then amortized over estimated useful lives. Because of obsolescence, the *economic lives* of intangible assets tend to be shorter than their legal lives.

Intangible assets with an indefinite life (registered trademarks for example) are not subject to amortization. Rather, they are tested for impairment by comparing the recorded value of the intangible asset to the asset's estimated fair value. An impairment charge is recognized to the extent that recorded value exceeds the estimated fair value.

Patents are grants by the federal government to an inventor, bestowing (in the United States) the exclusive right for 17 years to produce and sell the invention. Suppose a company acquires such a patent from the inventor for \$170,000. Suppose further that because of fast-changing technology, the *economic life* (the expected useful life) of the patent is only five years. The amortization would be $\$170,000 \div 5 = \$34,000$ per year, rather than $\$170,000 \div 17 = \$10,000$ per year. The write-offs of intangible assets are usually made via direct reductions of the accounts in question. Thus accounts such as Accumulated Amortization of Patents are rarely found. Furthermore, the residual values of intangible assets are nearly always zero.

Copyrights are exclusive rights to reproduce and sell a book, musical composition, film, and similar items. These rights are issued (in the United States) by the federal government and provide protection to a company for 75 years. The original costs of obtaining copyrights from the government are nominal, but a company may pay a large sum to purchase an existing asset from the owner. For example, a publisher of paperback books will pay the author of a popular novel in excess of a million dollars for his or her copyright. The economic lives of such assets are usually no longer than two or three years, so amortization occurs accordingly.

Trademarks are distinctive identifications of a manufactured product or of a service taking the form of a name, a sign, a slogan, or an emblem. An example is an emblem for Coca-Cola. Trademarks, trade names, trade brands, secret formulas, and similar items are property rights with economic lives depending on their length of use. For stockholder-reporting purposes, their costs are amortized over their useful lives, but no longer than 40 years.

Franchises and licenses are privileges granted by a government, manufacturer, or distributor to sell a product or service in accordance with specified conditions. An example is the franchise of a baseball team or the franchise of a local owner of a Holiday Inn. The lengths of the franchises vary from one year to perpetuity. Again, the acquisition costs of franchises and licenses are amortized over their economic lives rather than their legal lives.

Goodwill, which is discussed in more detail in Chapter 11, is defined as the excess of the cost of an acquired company over the sum of the fair market values of its identifiable individual assets less the liabilities. For example, General Motors acquired Hughes Aircraft for \$5 billion but could assign only \$1 billion to various identifiable assets such as receivables, plant, and patents less liabilities assumed by GM; the remainder, \$4 billion, is goodwill. Identifiable intangible assets, such as franchises and patents, may be acquired singly, but goodwill cannot be acquired separately from a related business. This excess of the purchase price over the fair market value is called "goodwill" or "purchased goodwill" or, more accurately, "excess of cost over fair value of net identifiable assets of businesses acquired."

The accounting for goodwill illustrates how an *exchange* transaction is a basic concept of accounting. After all, there are many owners who could obtain a premium price for their companies. *But such goodwill is never recorded.* Only the goodwill arising from an *actual acquisition* with arm's-length bargaining is shown as an asset on the purchaser's records.

For shareholder-reporting purposes, goodwill is no longer amortized. Rather, goodwill is subject to an annual impairment test in which the estimated fair value of the company is compared to its recorded value. As long as the fair value of the company exceeds its recorded value, goodwill is not considered impaired. In the event the recorded value exceeds the fair value, a second test is required in which the implied fair value of goodwill is compared to the recorded goodwill. Recorded goodwill is subject to an impairment charge in the event the recorded goodwill exceeds the implied goodwill.

HISTORICAL THRUST TOWARD CONSERVATISM

■ **Goodwill**

The Financial Accounting Standards Board issued Statement No. 142, Goodwill and Other Intangible Assets in June 2001. This Statement, which became effective for fiscal years beginning after December 15, 2001, addresses the accounting for goodwill and intangible assets. Goodwill and certain intangible assets are no longer amortized. Rather, they are subject to an annual impairment test to determine if a portion or all of the recorded goodwill should be charged off as an impairment charge. Additionally, intangible assets that have been identified as having an indefinite life (trademarks for example) are subject to a similar impairment test. Those intangible assets with a definite life (customer lists or patents for example) continue to be amortized to income.

■ **Research and Development**

Before 1975, many companies regarded *research and development costs* as assets and amortized them over the years of expected benefit, usually three to six years. Such costs result from planned search or critical investigation aimed at obtaining new products or processes or significant improvements in existing products or processes. Since 1975, the Financial Accounting Standards Board (*Statement No. 2*) has required that all such costs be charged to expense when incurred. The FASB recognized that research and development costs may generate many long-term benefits, but the general high degree of uncertainty about the extent and measurement of future benefits led to conservative accounting in the form of immediate write-off.

An exception to the immediate expensing of all research and development costs is accounting for the costs of developing computer software to be sold or leased. Such costs should be expensed only until *the technological feasibility* of the product is established. Thereafter, software production costs should be capitalized and amortized based on anticipated revenue.

AMORTIZATION OF DEFERRED CHARGES

Sometimes prepaid expenses are lumped with **deferred charges** as a single amount, *prepaid expenses and deferred charges*, that appears on the balance sheet at the bottom of the current asset classification or at the bottom of all the assets as an "other asset." Deferred charges are like prepaid expenses, but they have longer-term benefits. For example, the costs of relocating a mass of employees to a different geographical area, or the costs of rearranging an assembly line, or the costs of developing new markets may be carried forward as deferred charges and written off as expense over a three- to five-year period. This procedure is often described as the amortization of deferred charges.

Another example of deferred charges is organization costs, which include certain types of expenditures made in forming a corporation: fees for legal and accounting services, promotional costs for the sale of corporate securities, and the printing costs of stock certificates. These costs theoretically benefit the corporation indefinitely, but they are usually amortized for both shareholder and tax purposes over five years (which happens to be the minimum span allowed by the Internal Revenue Service).

INTERNAL COSTS AND EXTERNAL COSTS

As we have seen, accountants tend to be extremely conservative about intangible assets and deferred charges, and most intangibles are swiftly amortized. The contrast between the accounting for tangible and intangible long-lived assets raises some provocative and knotty theoretical issues. Accountants are sometimes overly concerned with physical objects or contractual rights, tending to overlook the underlying reality of future economic benefits.

This preoccupation with physical evidence often results in the expensing of outlays that should be treated as assets. Thus expenditures for research, advertising, employee training, and the like are generally expensed, although it seems clear that in an economic sense such expenditures represent expected future benefits. The difficulty of measuring future benefits is the reason usually advanced for expensing these items. The Financial Accounting Standards Board requires that all internal research and development costs be written off to expense as incurred.

In summary, accounting practice for intangible assets is not consistent. An annual report of Omark Industries exemplifies this inconsistency: "Costs of internally developed patents, trademarks and formulas are charged to current operations. Costs of purchased patents, trademarks and formulas are amortized over their legal or economic lives."

CONFLICTS WITH INCOME TAX PURPOSES

As mentioned earlier in this chapter, accounting for shareholder purposes often coincides with but sometimes differs from accounting for income tax purposes. Tax and shareholder accounting for leaseholds, leasehold improvements, patents, and copyrights generally coincide. However, they differ for perpetual franchises, trademarks, and goodwill. The acquisition costs of such assets must be amortized for shareholder reporting but must not be amortized for income tax purposes; the Internal Revenue Service will not allow amortization because of the indefinite duration of their usefulness.

The following table recapitulates how accounting for two purposes can conflict:

TYPE OF INTANGIBLE ASSET	MAXIMUM USEFUL LIVES IN YEARS FOR MEASURING ANNUAL AMORTIZATION IN REPORTS ^a	
	To Shareholders	To Internal Revenue Service
Patents	17	Same as first column
Copyrights ^b	40	75
Sports player contracts	Length of contract	Same
Franchises and licenses	Length of contract	Same
	or	
	40 if length is unlimited	No amortization permitted ^c
Trademarks	40	No amortization permitted ^c
Goodwill	40	No amortization permitted ^c
Research and development	Full write-off as incurred	Same
Covenants not to compete ^d	Length of contract	Same

a These maximums are frequently far in excess of the economic lives. Thus patents and copyrights are often written off in two or three years because the related products have short lives.

b Assumed to be a company's copyright on works created by employees. Personal copyrights are for the life of the author plus 50 years.

c The Internal Revenue Service does not permit amortization of intangible assets with indefinite useful lives. Examples are franchises of unlimited duration such as a football franchise, goodwill, and trademarks.

d For example, the seller of a pest control business promises not to open a competing business within one hundred miles for five years.

SUMMARY

Depreciation, depletion, and amortization are similar concepts, providing for systematic write-offs of the acquisition costs of long-lived assets over their useful lives. By itself, depreciation does not provide cash. Customers provide cash. However, depreciation is deductible for income tax purposes. Therefore the larger

the depreciation in any given year, the greater the amount of cash from customer⁵ that may be kept by the business instead of being disbursed to the income tax authorities.

Accumulated depreciation is a deduction from an asset, not an increasing pile of cash for replacing assets.

Reporting to shareholders and reporting to income tax authorities some, times diverge. Keeping two sets of records to satisfy these two purposes is necessary, not illegal or immoral.

Goodwill is never shown as an asset unless it was acquired through the purchase of another business.

SUMMARY PROBLEMS FOR YOUR REVIEW

■ Problem One

"The net book value of plant assets is the amount that would be spent today for their replacement." Do you agree? Explain.

■ Solution to Problem One

Net book value of the plant assets is the result of deducting accumulated depreciation from original cost. It is a result of cost allocation, not valuation. This process does not attempt to reflect all the technological and economic events that may affect replacement value. Consequently, there is little assurance that net book value will approximate replacement cost.

■ Problem Two

"Accumulated depreciation provides cash for the replacement of fixed assets." Do you agree with this quotation from a business magazine? Explain.

■ Solution to Problem Two

Accumulated depreciation is a contra asset. It is the amount of the asset already used up and in no way represents a direct stockpile of cash for replacement.

■ Problem Three

Refer to Exhibit 8-3 (p. 326). Suppose the predicted residual value had been \$5,000 instead of \$1,000.

1. Compute depreciation for each of the first two years using straight-line, sum-of-the-years'-digits, and double-declining-balance methods.
2. Assume that DDB depreciation is used and that the equipment is sold for \$20,000 cash at the end of the second year. Compute the gain or loss on the sale. Show the effects of the sale in T-accounts for the equipment and accumulated depreciation. Where and how would the sale appear in the income statement?

■ Solution to Problem Three

1.	STRAIGHT-LINE DEPRECIATION $C - R/n$	SYD DEPRECIATION = FRACTION $\times (C - R)$	DDB DEPRECIATION = RATE \times (BEGINNING BOOK VALUE)
Year 1	$\$36,000/4 = \$9,000$	$4/10 (\$36,000)$ $= \$14,400$	$.50 (\$41,000)$ $= \$20,500$
Year 2	$\$36,000/4 = \$9,000$	$3/10 (\$36,000)$ $= \$10,800$	$.50 (\$41,000 - \$20,500)$ $= \$10,250$

A C - R = \$41,000 - \$5,000 = \$36,000.

b
$$\frac{\text{Number of remaining years of life}}{\text{Sum of digits}} = \frac{4}{1 + 2 + 3 + 4} = 4/10 \text{ in Year 1 and } 3/10$$

2.		
Revenue		\$20,000
Expense: net book value of equipment sold is		
\$41,000 - (20,500 + \$10,250), or \$41,000 -		
\$30,750=		\$9,750
Gain on sale of equipment		<u>10,250</u>

The effect of removing the book value is a \$10,250 decrease in assets. Note that the effect of a *decrease* in Accumulated Depreciation (by itself) is an *increase* in assets:

Equipment			
Acquisition cost	41,000	Cost of equipment sold	41,000
Accumulated Depreciation, Equipment			
Accumulated on equipment		Depreciation for:	
Sold	30,750	Year 1	20,500
		Year 2	<u>10,250</u>
			30,750

The \$9,750 gain is usually shown as a separate item on the income statement as Gain on Sale of Equipment or Gain on Disposal of Equipment.

■ **Problem Four**

Review the important chapter illustration in the section "Depreciation and Generation of Cash," pages 328-333. Suppose the equipment had been acquired for \$80,000 instead of \$40,000. The predicted residual value remains zero.

- Required:
1. Prepare a revised Exhibit 8-6, which is on page 331. Assume an income tax rate of 40%; round all income tax computations to the nearest thousand.
 2. Indicate all items affected by these changes. Also tabulate all differences between the final two columns in your revised exhibit as compared with Exhibit 8-6.

■ **Solution to Problem Four**

1. The revised income statements are in Exhibit 8-9.
2. The following comparisons of Exhibits 8-9 and 8-6 are noteworthy. Sales, operating expenses, and cash provided by operations before income taxes are unaffected by the change in depreciation. Because of higher depreciation, net income would be lower in all four columns of Exhibit 8-9 than in Exhibit 8-6. Comparison of the final two columns of the exhibits follows:

	AS SHOWN IN		DIFFERENCE
	EXHIBIT 8-9	EXHIBIT 8-6	
Straight-line depreciation	20	10	10 higher
Accelerated depreciation	40	20	20 higher
Income tax expense based on:			
Straight-line depreciation	12	16	4 tower
Accelerated depreciation	4	12	8 lower
Net Income based on:			
Straight-line depreciation	18	24	6 lower
Accelerated depreciation	6	16	12 lower
Cash provided by operations based on:			

Straight-line depreciation	38	34	4 higher
Accelerated depreciation	46	38	8 higher



Handout 9
**Accrual Basis and
Cash Basis of Accounting**

ACCRUAL BASIS AND CASH BASIS OF ACCOUNTING

■ Efforts and Accomplishments

The process of determining income and financial position is anchored to the **accrual basis** of accounting, as distinguished from the cash basis. The accrual basis recognizes the impact of transactions on the financial statements in the time periods when revenues and expenses occur. That is, revenue is recorded as it is *earned* (the recognition concept) and expenses are recorded as they are *incurred* (the matching concept)-not necessarily when cash changes hands.

In contrast, the **cash basis** of accounting recognizes the impact of transactions on the financial statements only when cash is received or disbursed. The accrual basis is required under GAAP; the cash basis does not accord with GAAP.

Compare the accrual basis with the cash basis. Transaction 10a in Exhibit 2-2, page 42, shows an example of the accrual basis. Sales revenue of \$160,000 is recognized when sales are made on credit, not when cash is received. Similarly, transactions 10b, 12, and 13 (for cost of goods sold, rent, and depreciation) show that expenses are recognized as efforts are expended or services used to obtain the revenue (regardless of when cash is disbursed). Therefore income is often affected by measurements of noncash resources and obligations. The accrual basis is the principal conceptual framework for relating accomplishments (revenues) with efforts (expenses).

If the *cash basis* of accounting were used instead of the accrual basis, *revenue and expense recognition would depend solely on the timing of various cash receipts and disbursements*. Our Biwheels example for January would show zero revenue because no cash was collected from customers. Similarly, rent expense would be \$6,000 (the cash disbursed for rent) rather than the \$2,000 rent applicable to January. A cash measurement of net income or net loss is obviously ridiculous in this case, and it could mislead those unacquainted with the fundamentals of accounting.

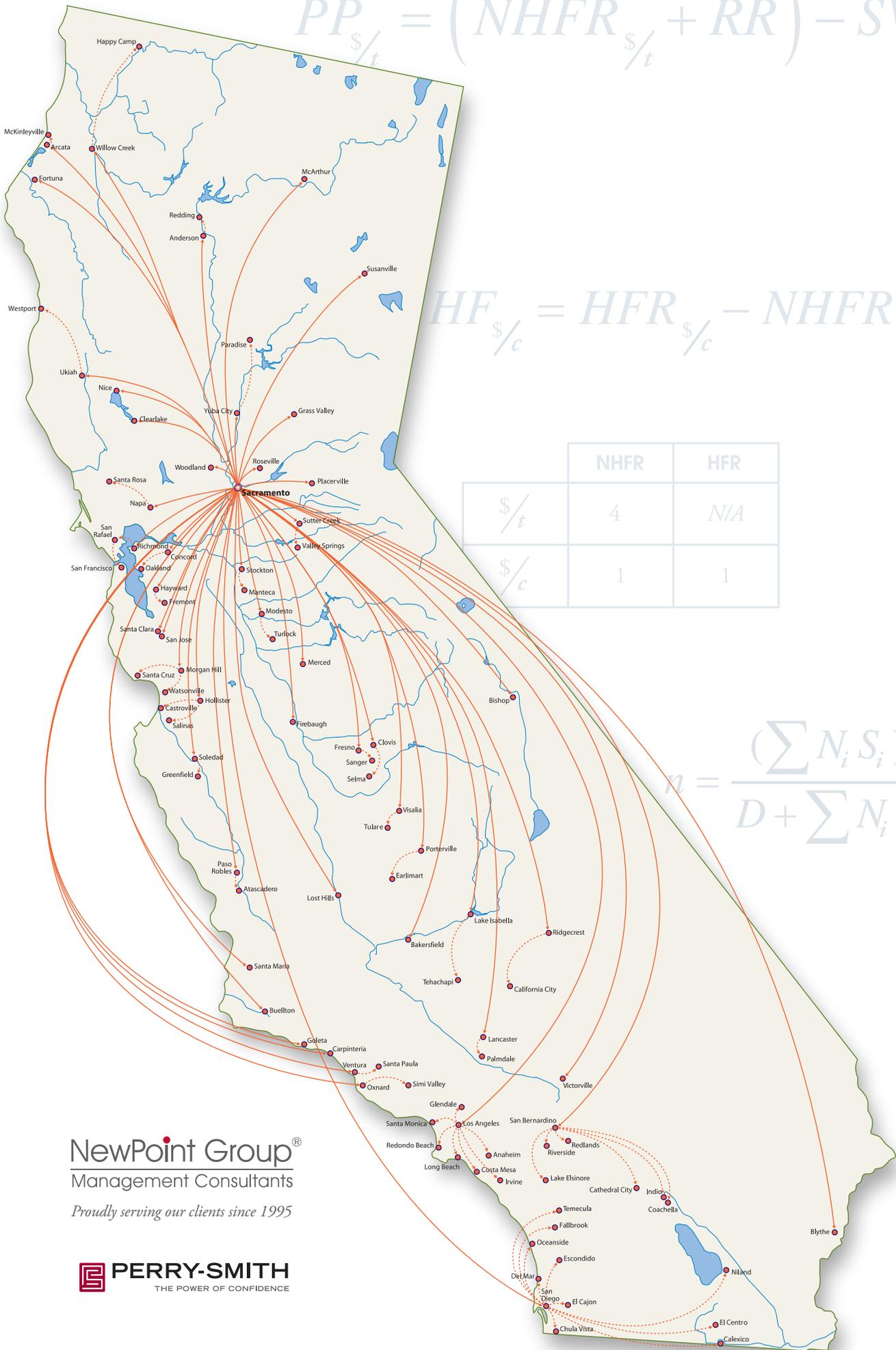
Ponder the rent example. Under the cash basis, January must bear expenses for the entire quarters rent of \$6,000 merely because cash outflows occurred then. In contrast, the accrual basis measures performance more sharply by allocating the rental expense to the operations of the three months that *benefited from the use* of the facilities. In this way, the economic performance of each month will be comparable. Most accountants maintain that it is nonsense to say that January's rent expense was \$6,000 and February's and March's were zero.

$$PP_{\$/t} = (NHFR_{\$/t} + RR) - SV_{\$/t}$$

$$HF_{\$/c} = HFR_{\$/c} - NHFR_{\$/c}$$

	NHFR	HFR
$\$/t$	4	N/A
$\$/c$	1	1

$$n = \frac{(\sum N_i S_i)^2}{D + \sum N_i S_i^2}$$



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