

## Enhancing the Fairness of the Fee Setting Methodology for Packaging and Printed Paper

### Introduction

On March 20, 2014 Stewardship Ontario held a consultation to discuss potential changes to the fee setting methodology with the objective of enhancing its fairness for all stewards. The detailed technical briefing has caused some confusion in the steward community, particularly the use of 2013 fee rates which were shown for illustrative purposes only and were not intended to be interpreted as recommended fees.

Therefore, to assist stewards to understand the proposed options from a principled perspective, we would like to explain them in the context of the fee setting methodology's original principles and the three-factor formula.

### Background

#### *Original Principles of the Fee Setting Methodology*

Four key principles underpin the fee setting methodology as set out in the Blue Box Program Plan. These principles are designed to result in a fee structure that:

1. Reflects the actual costs to manage each designated Blue Box material type;
2. Takes into consideration the benefits to all stewards (and materials) from the high recycling rates achieved by some materials; (This is accomplished by allocating some of the costs of high performing materials (those that exceed the target recycling rate) to under-performing materials that are below the target recycling rate)
3. Encourages increased material recycling rates; and
4. Reflects the positive contribution of some materials to the overall system (e.g. revenues of materials).<sup>1</sup>

When evaluating options to change the fee methodology, it is important to ensure that they are tested against these principles.

#### *The Three-factor formula*

Supply chain costs are allocated in accordance with the three-factor formula, designed in accordance with the four principles above, and which consists of the following basic components:

1. **Recycling Rate Factor:** 35% of cost assigned based on the recycling rate. Given that the higher the recovery rate of any material in the Blue Box Program Plan, the higher the potential costs to the Stewards of these materials, the fee methodology should not penalize stewards for this

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<sup>1</sup> Blue Box Program Plan, Page 101



Stewardship Ontario

success.<sup>2</sup> Therefore, materials with lower recycling rates must assume a larger share of costs than materials with high recycling rates.

2. **Net Cost Factors:** 40% of net cost assigned to each material based on how much it costs to manage the material. Given that the net costs to recycle each of these materials vary significantly, the fee methodology should provide stewards with a financial incentive to select materials with lower recycling costs.<sup>3</sup>
3. **Equalization Factor:** 25% of net costs assigned based on how much it would cost to manage the material if it were recovered at the target rate (i.e. 60%). Given that some individual Blue Box materials are being recycled at far higher rates than others, yet responsibility for reaching the overall diversion targets is shared collectively, the fee methodology should aim to reach the overall diversion targets in the most cost effective manner to all stakeholders while sharing total program costs fairly among all stewards.<sup>4</sup>

In summary, the three-factor formula is designed to redistribute costs from high-performing to low-performing materials subject to one condition—that the redistribution is restricted to transferring costs only *within* the packaging and printed paper categories but not *between* printed paper and packaging. This restriction is known as the cost transfer barrier.

The cost-transfer barrier was initially created to reflect a time when printed paper was typically collected and processed separately, as distinct from today, when the materials are increasingly co-mingled. In keeping with the principle that actual costs need to be reflected and cross subsidization should be avoided, the barrier was put in place.

### ***The Issue***

In 2013 Stewardship Ontario made a commitment to conduct a third party review of the fee setting methodology with Blue Box Program stewards, in an effort to address an anomaly that arose in part because of the cost-transfer barrier between packaging and printed paper.

The anomaly appeared in the printed paper category in 2012 and effectively defeated the fairness intention of the three-factor formula for magazines and catalogue stewards. In this case, the high recycling rate of 94.7% for magazines and catalogues should have provided fee relief to this material in accordance with the equalization component of the three-factor formula, which transfers cost away from high-performing materials. Instead, magazines and catalogues actually attracted cost.

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<sup>2</sup> Blue Box Program Plan, Page 100

<sup>3</sup> Op. cit.

<sup>4</sup> Op. cit.



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The only recourse under the current methodology, which prohibits cost transfers between paper and packaging, was to transfer the cost to the lowest performing printed paper sub-category, which in this case was “other printed paper”. While the recovery rate for “other printed paper” in Ontario is 50.9%, and therefore should rightly attract some of the cost of the higher performing paper subcategories, its recovery rate is much higher than many packaging subcategories (e.g. paper laminates at 0.9% or gable-top cartons at 32.1%) which, under the current methodology, would attract none of this cost and yet benefit by sharing in the high overall recovery rate, which exceeds the 60% mandated target.

It is therefore unfair that these low-performing packaging subcategories do not share some of the cost of the high-performing printed paper subcategories, especially when paper and packaging materials are increasingly comingled when they are collected, and in some cases, processed and sold to market.

### **Option 1: Remove cost-transfer barrier between packaging and printed paper**

It has been proposed that Stewardship Ontario remove the cost-transfer barrier between printed paper and packaging. Removal of the barrier will allow costs to be transferred from materials with high recovery rates to those with low recovery rates, regardless of whether they are printed paper or packaging. This change would be consistent with the principles of the three-factor formula because packaging, at a 49.9% recovery rate, is currently performing below the 60% mandated target, and is performing well below the 85.1% recovery rate for printed paper.

### **Option 2: Allocate costs of unsteawarded materials to all stewards as a common cost**

The current methodology assigns the full cost burden of unsteawarded material to the material category that it most resembles. Unsteawarded material includes packaging and printed paper supplied by companies that fall below the government-mandated de minimis of \$2 million in revenue or 15 tonnes of material. Unsteawarded material also includes products that resemble packaging but are not obligated such as sandwich bags, aluminum foil, plastic cutlery; and paper products such as paper that householders buy to use in their home-printers, as well as calendars, posters, and bound books. These are items that householders regularly put in their blue boxes, and which are in some cases processed and sold to market, but for which no steward exists as they are either not designated as Blue Box wastes or they are expressly exempted.

Arguably, the costs/revenues attributed to materials for which there is no identified steward should be shared by all material categories rather than a single material category that most resembles the item. This component of the current methodology also contributed to the magazines and catalogues anomaly because the cost of unsteawarded paper-related products (printer paper, posters etc.) is borne entirely and exclusively by the printed paper category.

It has been suggested that Stewardship Ontario change the current practice of allocating the costs of unsteawarded materials to the material category that they most resemble, and instead allocate those



Stewardship Ontario

costs to all stewards on the basis that unstewarded material is a “system” problem, not a material-specific problem.

This proposed change would be consistent with the principles of the three-factor formula because it places the actual costs to manage unstewarded materials where they rightly belong – shared amongst all stewards, rather than assigned to a single material subcategory.

### **Summary of Change Options**

The recent review of the fee setting methodology for packaging and printed paper revealed an opportunity to enhance its fairness by making two changes to the way material management costs are allocated:

1. Remove the cost-transfer barrier between printed paper and packaging to better enable the costs from all high-performing materials to be transferred to all low-performing materials regardless of category; and
2. Change the current practice of allocating the costs of unstewarded materials to the material category that they most resemble, and instead allocate those costs to all stewards.

### **What are Next Steps?**

On Thursday March 20, 2014 Stewardship Ontario initiated a consultation with stewards to explore support for enhancing the fairness of the current fee setting methodology. Stewardship Ontario is asking stewards to answer the following two questions:

1. Do you agree that the option to integrate the three-factor formula (i.e., remove the cost-transfer barrier between printed paper and packaging) would result in a fairer fee setting methodology? If not, why not?
2. Do you agree that the option to redistribute all costs for unstewarded material across all materials results in fairer application of the setting methodology? If not, why not?

Ontario stewards have been asked to provide their feedback by April 4, 2014. Feedback will be evaluated and shared with the SO and WDO boards and the appropriate next steps will be assessed. The proposed options represent a material change to the fee methodology and would therefore require Ontario’s Minister of the Environment.

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