



City of  
**Peterborough**

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**To:** **Members of the General Committee**

**From:** **W.H. Jackson,  
Commissioner of Infrastructure and Planning Services**

**Meeting Date:** **August 27, 2018**

**Subject:** **Report IPSWM18-004  
Recycling Contract Update and Amendment**

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## **Purpose**

A report to examine the changes in the processing of recyclable material and to recommend an amendment to the existing recycling processor contract.

## **Recommendations**

That Council approve the recommendations outlined in Report IPSWM18-004, dated August 27, 2018, of the Commissioner of Infrastructure and Planning as follows:

- a) That the following adjustments to the existing HGC Management Inc. contract with the City for the processing of recyclable materials at the Pido Road Recycling facility be made for the period January 1, 2018 to June 30, 2018 inclusive:
  - The processing fee for recyclable material be increased by \$1.86 per tonne for a total increase of \$7,824.54 and, in addition;
  - The contract be increased by \$8,000.00 to account for container recyclable materials collected in bags.
- b) That staff have quarterly inbound material audits undertaken at the Materials Recycling Facility on Pido Road to determine the City curb-side collected:

- Residue level;
  - Cross contamination level; and
  - Bagged container level in the blue boxes; and
- c) That Staff make future adjustments to the HGC Contract, using the verified results of quarterly audits to be completed over the remainder of the contract based on the adjustment factors described in Attachment 4 to Report IPSWM18-004.

## Budget and Financial Implications

Based on the results of the first audit, the contract with HGC Management Inc. will be increased by \$15,824.54 from an estimated \$992,042.00 (depending on actual tonnage) to \$1,007,866.41 plus HST. Depending upon the results of future audits, additional increases to the contract may be necessary.

There are sufficient funds to allow for the cost of the quarterly audits (City's share is approximately \$2,500.00 per audit) in the 2018 budget and the 2019 budget will include the audit costs.

## Background

The City has operated, via several contractors, the Pido Road Materials Recycling Facility (MRF) since 1989. Since 2002, HGC Management Inc. (HGC) has operated the MRF on the City's behalf.

### 1. Recycling Processing Contract History

HGC initially won the processing contract in 2002. The last RFP issued for these services was in 2007 for a contract to run from January 1, 2008 to December 31, 2014.

On September 9, 2013, through Report USWM13-007, an extension of the contract for two additional years, to December 31, 2016, was approved due to uncertainties around fundamental changes that were broadcast to be coming for the blue box system in Ontario. The promised changes did not occur by 2016, but provincial efforts to implement them continued. The Province enacted a change in law under Bill 151, Waste-Free Ontario Act, 2016 in November of that year, and it appeared that the shift from municipal to producer-run recycling programs was imminent and inevitable.

Based on this, Council approved, on September 8, 2015 (Report USWM15-008), a further three-year extension of HGC's contract to the end of 2019. At the time of the contract extension, it was expected clarity about the impact of legislative changes would be in place by the time a new contract was needed or the Producers took over.

Unfortunately, this clarity has not materialized. In fact, there is some thought that the recent Provincial Election may, in the shorter term, create even more uncertainty. When this last extension was negotiated with HGC, there was no request from them for any changes to contract conditions other than an additional charge for handling bulky Styrofoam.

The City is now in a position where two extensions to the MRF processing contract have been given without going to the market and despite the fact that uncertainty still prevails around the timing of Producers taking over responsibility for the blue box, it is believed a third extension to HGC's contract would not be prudent. Their existing contract will end on December 31, 2019.

## **2. Standard Material Recycling Processing Contract**

The standard recycling processing contract has two relatively simple items: payment to the contractor for material that is processed and payment to the City for processed material that is sold.

### **a. Payment to the Contractor for Processing Material**

The City pays HGC on a per tonne basis for all incoming material from our programs that are processed at the MRF. There is an allowance (5%) for material that is not recyclable ("residue"). Any amount of residue above the 5% allowance must be disposed at the Landfill at HGC's cost (\$95/tonne tipping fee).

### **b. Payment to the City for Processed Material Sold**

To balance the cost of processing the recyclable material, the City receives payment for materials sold, based on an Ontario Composite Price index for the "basket of goods" that are marketed. This price index is published monthly by the Continuous Improvement Fund (CIF). The CIF is a partnership between the Association of Municipalities of Ontario, the City of Toronto, Stewardship Ontario and the Resource Productivity and Recovery Authority (formerly Waste Diversion Ontario). The CIF commenced operations on May 1, 2008 under a Memorandum of Agreement signed by the program partners. The CIF's mandate is to improve the effectiveness and efficiency of Ontario's municipal blue box Programs.

## **3. Recycling Industry Changes**

Over the years, and especially since 2013, recycling has changed dramatically. Two major changes have occurred called the "evolving tonne" and the "National China Sword", and one, more minor change, called "wishful recycling".

### **a. Evolving Tonne**

The "evolving tonne" is a term that describes the phenomenon of more, lightweight plastics, less glass and fewer newspapers now filling the blue boxes, resulting in more air and less weight.

This light-weighting, with declining tonnage, results in less processing revenues. At the same time, costs to process have increased since the lighter plastic materials tend to be more voluminous and require more handling.

#### **b. China's National Sword**

The biggest impact to the recycling business is the more recent occurrence of China - the world's biggest importer of recyclables - virtually closing its doors to all but the most pristine materials. On January 1, 2018, China began enforcing its new "National Sword" policy which bans 24 types of solid waste, including various plastics and unsorted mixed papers, and sets a much tougher standard for contamination levels. For example, the remnants of a greasy pizza box that gets thrown in with the recycling and ends up in the paper bales would be above the allowable contamination levels.

China's "National Sword" has resulted in a massive worldwide drop in commodity prices and much tighter specifications. Because the vast majority of recyclable materials were going offshore, local mills have been slow to develop to handle this material. With the tightness in the market place there might be mills that will be built but that could take upwards of four to five years to put in enough mills to handle the lost Chinese capacity. The ebb and flow of commodity markets and prices is not new for the recycling industry, but the scale of this change is unprecedented.

While times were good and materials were moving well, municipalities and their processors were able to accept a broad range of mixed plastics and other non-traditional items. But now, as specifications tighten, these formally acceptable items are considered contaminants, and the tolerance for contamination has dropped to virtually zero. Some municipalities have had to resort to landfilling their products, something unheard of before now. We are now challenged with the need to pull back on what residents can throw in the blue box, an extremely difficult task.

#### **c. Wishful Recycling**

In addition, despite continuous education of residents by the City, the blue box mix has become "dirtier" over time. As the acceptable items expanded, tolerance was high and with strong markets, people began to assume virtually anything was recyclable. Its called "wishful recycling" whereby the general public, if in doubt, puts objects in the blue box assuming somebody will figure out what to do with it.

For instance, certain items that we once encouraged, such as Styrofoam, no longer have a market, and therefore must be treated as contamination and end up in landfill. Over time, the contamination levels appear to have increased within the blue box.

### **4 Impacts to Existing Contract**

The situations described in Section 3 have created a perfect storm for municipalities and their contractors who must try to process and market recyclables. In consideration

of these issues, HGC is seeking adjustments to their existing contract to account for alleged increases in contamination in the inbound material and the decreased ability to market materials, especially fibre products.

Under the existing contract between the City and HGC there is a “Force Majeure” clause that allows for the consideration of occurrences beyond the control of the parties to the contract and how these occurrences may impact either party. It is under this clause that HGC has requested a review of the terms of the contract requesting an increase in the contract of approximately \$665,000.00 annually.

HGC’s proposal for compensation (see Attachment 1) includes multiple adjustments, which are outlined below with staff comments.

#### **4.1 Allowable Residue Adjustment**

Currently, the amount of residue or contamination that the City allows HGC is 5%. This was put in place to ensure they did their best to extract the highest amount of recyclables possible. We pay a processing fee on 100% of the tonnage brought to them, but receive revenues for 95% when they are sold. Five percent of the inbound tonnage can be land filled at the Peterborough County/City Waste Management Facility for no charge but for anything over that, HGC pays the current tip fee to dump.

- a) **HGC’s Request** – That the City allow them a 12% residue level, thereby allowing them to landfill 7% more material at no charge. The City would also be paid for 7% less material each month. Based on 2017 costs, this would result in a loss in revenue to the City of approximately \$170,000.00 per year.
- b) **Staff Recommendation** – the City, County and HGC contracted a third party auditor (AET) to complete inbound audits of both the City and the County’s inbound materials during the week of July 16-20, 2018 to verify HGC’s contention that contamination levels have increased markedly.

Analyses of the audit (Attachment 2) results indicate that the City’s true contamination level is in fact less than 5%. Therefore, Staff believes there is no rationale for an adjustment to the allowable residue level of 5% at this time.

#### **4.2 Process Fee Adjustment**

Currently, the City pays HGC \$109.63 per tonne to process our inbound materials. This fee has remained essentially unchanged since 2008, except for the annual CPI increases.

- a) **HGC’s Request** – that an additional \$15.00 per tonne (a 14% increase from 2018 rates) be paid by the City to assist with the additional labour they say is required to meet tightened commodity specifications, and to deal with the cross-contamination found at the curb (e.g. papers going into the container blue box,

and vice versa). This equates to an additional cost to the City of approximately \$135,000.00 per year based on 2017 tonnages.

- b) **Staff Recommendation** – The recent audits indicate that the level of cross-contamination in City materials is 3.7%. There is nothing in the literature, nor in the existing contract with HGC, that talks to an acceptable level of cross-contamination. Given that HGC must essentially double handle this material, Staff feels that a fair means of compensation would be to increase their current processing fee by the percentage of cross-contamination that is above a minimal level since total elimination of cross-contamination can not be expected by either the processor or the City.

Without any better information, Staff believes the baseline cross-contamination level should be set at 2%. Any cross-contamination above this would result in compensation to HGC.

Based on a 2% baseline and a 3.7% audited cross-contamination level, HGC is therefore entitled to a 1.7% increase in the current processing fee, which amounts to \$1.86 per tonne, for a total processing fee of \$111.49 (2018). The total increase for the period from January 1 – June 30, 2018, in which the City had 4206.74 tonnes of material processed, would be \$7,824.54.

The cross-contamination percentage is completely separate from the true “residue” or “contamination” considered in Section 4.1. Cross-contamination material is still to be recycled so does not count towards the residue number.

### 4.3 Adjustment to Optical Sorter Investment

HGC is seeking financial compensation for a second optical sorter that was installed at the Pido Road facility in late 2017. They maintain that they expected their contract to be extended by three years, which would have allowed them to amortize the sorter over five years.

- a) **HGC’s Request** – that an adjustment of \$16.55 per tonne of inbound material be paid to HGC for 2018 and 2019. This equates to approximately \$150,000.00 per year based on 2017 rates.
- b) **Staff Recommendation** – Although there were informal discussions about the possibility of another extension to the recycling contract (given uncertainties with the industry on a provincial level), at no time was HGC ever guaranteed an extension. This was made clear at the time HGC advised they wished to install the second optical sorter. No requests were made to the City nor were there any discussions at that time about the City providing financial assistance. The decision was made by HGC and its new partner Canada Fibers to install this sorter, because it greatly increases processing efficiencies, allowing for better, faster sorting and ultimately, higher revenues through higher sales. So, the decision to proceed was made without a guarantee of a contract extension from the City. Since the sorter was

installed, HGC has imported ever-increasing volumes of materials from their other contracts around the province to be sorted at Peterborough's MRF, being paid by those customers to do so. Staff feels the City has no obligation to compensate HGC further for this sorter, which they own outright.

#### 4.4 Change in Revenue Formula for Paper Grades

HGC pays the City each month for every tonne of material marketed from its program (inbound tonnes minus 5% for allowable residue). The payment is based on the CIF Price Sheet, which is updated each month. The Price Sheet relies on the input of various processors to say how much revenue they received for the materials they processed and sold each month. An example is attached as Attachment 3.

- a) **HGC's Request** – There has been a severe softening in the prices paid for newsprint (or more recently called Sorted Residential Paper #56) since China's National Sword was implemented, and HGC does not feel this is being reflected in the CIF Price Sheet. HGC is therefore requesting that the City adjust the Price Sheet, effectively deleting the Newspaper/#56 entry. Based on the month of June 2018, the impact would be a \$26 per tonne decrease in City revenues or a total loss of revenue to the City of approximately \$210,000.00 per year.
- b) **Staff Recommendation** – The CIF Price Sheet has been used for over 20 years and for the entirety of this contract without complaint by HGC, and by a great many other Ontario municipalities for evaluating commodity prices. Adjusting the fundamental precepts of this tool for Peterborough alone would be challenging and risky for the City. It would require constant monitoring by staff (who do not have marketing knowledge), and there are factors and influences that we have virtually no direct knowledge of or control over. It is entirely HGC's decision as to how it operates its business, whether or not they produce a #56 grade of paper or not. We do not and will not necessarily know if they do or they don't. Some recycling facilities market it successfully, albeit at a reduced revenue currently, and HGC has the choice to also do so. The decision is theirs. As markets constantly fluctuate, Staff and HGC would need to continually chase the current price indices, a time consuming endeavour. The Price Sheet takes into account a total of 14 different blue box items, including various papers, plastics, glass, metal and aluminum. Aluminum, the highest valued item in the blue box basket of goods, has increased by 17% since January 2018. A number of items have experienced increases, including PETE plastics, steel, polycoat and even glass. These increases would serve to partially compensate for the losses resulting from the newspaper decline.

Staff acknowledges that the revenues for HGC have taken a hit recently as a consequence of China Sword. However, there have also been times over the duration of the contract when revenues were excellent, and there was no

adjustment made to the Price Sheet. It is the nature of the recycling industry that commodity prices raise and fall. Therefore, staff cannot recommend making monthly adjustments to this Price Sheet used for calculating revenue payments.

#### **4.5 Bagged Recyclables**

Although HGC's letter of June 5, 2018 did not specifically talk to an issue with bagged materials, there has been frequent mention by the processor of this being a significant problem.

Staff does not believe any compensation should be allowed for bagged fibres (newspapers etc.) since the bagging of papers and the inclusion of plastic film (in bags) in the fiber stream has always been allowed in this contract.

However, bagging of container recyclable material does cause a double handling of this material. Based on the July audit, 8.45% of the container recyclable material is bagged. Although education and advertisement efforts will be made to reduce this number, it is clear that additional work by HGC is required to deal with these bags, especially at this contamination level. The allowable residual level is set at 5% so, accordingly, it is believed that the allowable bagged container level should also be set at 5%. For any level above this, staff believe HGC should be compensated for the additional labour required to open all the bags and distribute the recyclable material inside the bags.

For the period January 1, 2018 to June 30, 2018, Staff proposes that the cost of ½ an FTE be added to the HGC contract. At a rate of \$15.00 per hour, this amounts to \$16,000.00 per year before tax or \$8,000.00 for the period January 1 to June 30.

#### **4.6 Provincial Minimum Wage Policy**

In addition to the adjustments HGC has requested, they had previously asked for, and received from the City, compensation for the mandatory increase in their labour costs through the province's minimum wage policy. It was determined that \$23,400 was the annual impact from this mandatory change of law, which is the amount the City is paying HGC for 2018. We await word on the new government's policy on this matter before determining if any further increases are needed for 2019.

## **Discussion**

HGC's requested amount in total is roughly \$665,000.00 per year (based on 2017 statistics and current market data), or a 58% increase over our current net costs. These adjustments are requested for the two remaining years of the contract, 2018 and 2019.

Staff acknowledges that these are unusual times, and that some of the troubles HGC is experiencing were impossible to anticipate and budget for, especially back in 2007. The



only increases to the original price bid for processing has been the annual CPI. Consequently, some level of compensation is felt to be justified to keep HGC Management whole and allow them to continue to finish out the City's contract.

In consideration of the results of the recent audit, a number of adjustments to the HGC contract have been proposed for the period January 1 – June 30, 2018 in addition to the already approved adjustment related to the minimum wage increase.

Third-party quarterly audits are planned for the duration of the contract and a process to adjust the HGC contract based on the results of these audits is proposed for the periods July 1, 2018 to December 31, 2019 inclusive as detailed in Attachment 4.

## Summary

Significant changes in the operation of the blue box system have given cause to re-examine the existing recyclable processing contract between the City and HGC Management Inc., the City's processor. Based on the results of an external audit, certain amendments to the contract with HGC Management, based on residue rates, cross-contamination rates and bagged container rates are proposed. The contract amendments will be based on quarterly third-party audits to be conducted until December 31, 2019.

Submitted by,

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### Attachments:

- Attachment 1: June 5, 2018 letter from HGC Management to the City and County of Peterborough
- Attachment 2: Summary of July 2018 Audit results (by AET)
- Attachment 3: Example of CIF Price Sheet (June 2018)
- Attachment 4: Proposed Amendments to the HGC Contract for the period July 1, 2018 to December 31, 2019 inclusive.