

TO: James L. App, City Manager
FROM: Doug Monn, Public Works Director
SUBJECT: Paso Robles Waste Disposal and Paso Robles Roll-Off, Inc.
Financial and Operational Audit
DATE: August 2, 2011

NEEDS: For the City Council to receive and file the auditor's report on Paso Robles Waste Disposal/Paso Robles Roll-Off and to direct staff to negotiate terms of an amended contract with the waste hauler.

FACTS:

1. The City owns a Class III municipal solid waste landfill located near the intersection of Union Road and Highway 46.
2. The 145-acre facility has been in operation since 1970 and is permitted to dispose of non-hazardous waste. An estimated 32,000 tons of waste are buried each year in the landfill.
3. Paso Robles Waste Disposal (PRWD) has collected trash in town for 18 years and the agreement term runs through 2014. Paso Robles Roll-Off, Inc. (PRRO) has provided roll-off services for 8 years.
4. Combined annual revenues are approximately \$5.9 million and City franchise fees are approximately \$735,000.
5. In November 2010, the City Council retained R3 Consulting Group to prepare a financial and operational audit of both PRWD and Paso Robles Roll-Off, Inc.
6. The auditor submitted their findings in the form of a report dated July 2011.

ANALYSIS AND

CONCLUSION: The auditor's principal findings are:

1. Both companies were found to be in substantial contractual conformance and while staffing levels appear reasonable, officer pay deserves scrutiny.
2. PRWD underpaid the City \$30,031 from 2005 to 2010, but made up this payment earlier this year.
3. The contract language between the City and PRWD does not clearly define revenues subject to the franchise fees, expenses, and other key terms.
4. Current contract language is silent as to limits on expenses, rent, salaries, benefits, etc.
5. R3 made favorable field observations regarding trash collection but found equipment being depreciated that is no longer in use.

The auditor recommends that a future contract be put in place that more clearly specifies the applicable franchise fee, includes support for the reasonableness of rent paid, better defines/limits expenses, profit sharing and profits, and updates the agreement terms. Should negotiations on such future contract language fail, the City could consider competitively procuring these franchise services,

POLICY

REFERENCE: Economic Strategy; 2009 Landfill Master Plan

FISCAL IMPACT: Negotiating terms of an amended contract with the waste hauler and with the roll-off services company will require administrative and legal support services, likely under \$30,000.

Solid waste is a General Fund service. City Council has allocated funds derived from the sale of right of way frontage to the State of California (Cal Trans) in FY 08/09 to offset preparation cost of the Landfill Master Plan and audit. Approximately \$140,000 remains to fund the contract renegotiation.

- OPTIONS:**
- a. Receive and file the auditor's report on Paso Robles Waste Disposal/Paso Robles Roll-Off and to direct staff to negotiate terms of an amended contract with the waste hauler.
 - c. Should negotiations fail, direct staff to seek competitive bids for waste collection services.
 - b. Amend, modify, or reject the above option.

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ATTACHMENT: Executive Summary of Auditor's Report

Executive Summary

The major objectives of the review of Paso Robles Waste Disposal (PRWD) and Paso Robles Roll-Off (PRRO) (collectively referred to as the Companies) were to:

- Determine if all required franchise fee payments have been made;
- Determine if the Companies are in compliance with the major terms and conditions of their franchise agreements;
- Provide an assessment of the current franchise agreements;
- Provide an assessment of the effectiveness of the Companies' operations; and
- Provide an assessment of the reasonableness of the Companies' expenses.

As part of our review, R3:

- Reviewed and analyzed documents provided to us by both the City and the Companies;
- Reviewed collection operations and management and administrative functions;
- Conducted field audits and observed operations;
- Interviewed management and staff; and
- Reviewed and analyzed various financial and operating data.

Franchise Fee Payments

PRRO pays a franchise fee of 10 percent of gross receipts. PRWD's franchise fee was originally set at 3 percent and subsequently increased to 10 percent by resolution, although there was not an accompanying amendment to the franchise agreement. The rate adjustment that was made at the time the franchise fee was increased to 10 percent, however, was incorrectly calculated. As a result, there was an understanding between the Director of Administrative Services and PRWD that the fee would be set at 9.34 percent to account for the error in the rate adjustment calculation. That "understanding," which was in the form of a letter from the Director of Administrative Services, was never formalized as an amendment to the franchise agreement. The rates were nonetheless set to provide for a 9.34 percent franchise fee and PRWD calculated its franchise fee payments on that basis.

In response to our review of the Companies' franchise fee payments, the Companies directed their accountant to review their franchise fee payments. That review found that the Companies underpaid the City approximately \$30,000 for the six year period

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from 2005 through 2010. The Companies issued a check to the City in that amount after receiving the results of the review.

It should also be noted that Amendment 3 to the PRWD franchise agreement (2007), which focused on the changes to the agreement to address the County's newly adopted Integrated Waste Management Fee, "reset" the franchise fee at 3 percent. It appears, however, that this was not intended as the rates were not reduced and PRWD has continued to pay franchise fees at 9.34 percent of gross revenues.

Contract Compliance

PRWD and PRRO are in compliance with the majority of the terms and conditions of their Agreements. There are several items, however, that require review and/or clarification by the City, including confirming that the insurance certificate endorsements and indemnifications satisfy the contractual requirements.

On a related matter, the issue of what information related to the Companies franchises is or is not to be considered confidential was a point of ongoing discussion during this project. The franchise agreements state that the Companies, "Keep accounting and statistical records of their revenue and expense items, to be provided to City upon request."

The Companies were not willing to provide requested information to R3 without a confidentiality agreement. After ongoing discussions, R3 signed a confidentiality agreement and the Companies then provided all requested information in a complete and timely manner. After reviewing a draft of this report the Companies did not object to the publication of any of the information set forth in that draft, with two limited exceptions, which R3 supported.

While the issue of what information is or is not to be considered confidential did not ultimately limit R3's ability to present all information that it felt was relevant, we strongly recommend that this issue be clarified as part of any new or extended franchise agreement. Specifically, we recommend that any future agreements clearly specify that any and all information related to the franchise be considered public information (i.e., not confidential) and is to be provided to the City upon request without limitation.

Assessment of the Current Franchise Agreements

The City's existing franchise agreements with both PRWD and PRRO have been in place since 1993 and have been amended several times. Neither of those agreements contains many of the contract terms and conditions that have become standard in franchise agreements or reflect best management practices. In addition, the agreements do not effectively support the City's long-term solid waste management goals.



The City is considering additional amendments to both franchise agreements. Rather than continue to amend the existing agreements, we strongly recommend that those agreements be replaced with a single new agreement. The terms and conditions of that agreement should reflect current industry standards and best management practices and support the City's long-term solid waste management goals. In support of that recommendation we have provided the City with a single complete preliminary draft franchise agreement. That agreement is intended to provide a starting point for negotiating any contract extensions with PRWD and PRRO and / or serve as the basis for a draft franchise agreement to be used as part of a competitive procurement process, should the City decide to pursue that option.

Assessment of Operational Performance

In general, we found that the Companies are providing effective operations and have embraced a number of newer industry innovations to improve performance. Those innovations include route management software to improve customer service and billing accuracy, as well as split commercial carts to provide recycling opportunities for businesses where there are space limitations for container storage.

Additional findings from our performance review include the following:

- Residential and commercial routes are operating in a safe and effective manner and are achieving reasonable productivity;
- Diversion rates for franchised tonnage increased steadily from 2005 (27%) through 2010 (33%); however, ongoing attention to increased commercial and multi-family diversion is warranted. The diversion rate for single family accounts was 53% in 2010 as compared to 17% for commercial and multi-family accounts;
- Vehicle maintenance operations appear reasonable, with the Companies receiving "satisfactory" ratings from the California Highway Patrol's biennial vehicle maintenance inspection program;
- The Company has in place an effective process for tracking and controlling overweight vehicles, helping to minimize the impacts refuse vehicles have on the City's street maintenance costs; and
- The Company's safety record exceeds industry standards. The Company's insurance carrier reported that "...*Paso Robles Waste Disposal operates one of the safest refuse companies in California.*"

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The logo consists of the letters 'R' and '3' in a stylized, blue, handwritten font. The 'R' is on the left and the '3' is on the right, both rendered in a consistent blue color.

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Assessment of the Reasonableness of Operating Expenses

Our assessment of the reasonableness and necessity of the Companies' expenses identified a number of issues, including the following¹:

- The line item expense categories and equipment depreciation expense categories used by PRWD, PRRO, and its related party Country Disposal (which serves unincorporated areas of the County) (collectively referred to as the Company) are inconsistent. This makes it very difficult to effectively test the methods used to allocate shared expenses among the various parties. Going forward, we recommend that the Company use consistent revenue and expense line item categories and allocate shared expenses in a documented and consistent manner;
- The Companies made profit sharing contributions in 2009 of 10 percent of wages to all employees, including officers, and received profit on those contributions. While it is not unreasonable to provide some level of profit sharing contributions, the City should establish guidelines for what level of profit sharing is to be included in the base rate;
- The Company rents office / facility space from a related party (a shareholder and his brother) and has paid for a number of significant leasehold improvements through the rate base (e.g., repairs to the parking lot, HVAC unit, and solar energy system). While the Company provided some information supporting the reasonableness of this related party expense we recommend that it provide formal support as part of any future rate adjustment process. That support should include the impact of any leasehold improvements paid for by the ratepayers;
- Officer compensation for PRWD and PRRO falls within what we consider to be a reasonable range for officers that actively participate in operations on a day-to-day basis. One officer, however, who received a salary and profit sharing contributions in 2009 (~\$121,000 total), is not actively involved in the day-to-day operations of the Companies; and
- PRWD reported Meals and Entertainment expenses of approximately \$20,000 in 2009 and PRWD and PRRO reported donations (Promotional expenses) of approximately \$22,000, including \$300 in political contributions. The City should formally establish guidelines

¹ The Companies reported that it would be inaccurate to assume it considers all expenses for rate making purposes.

for what expenses are and are not to be considered allowable for purposes of setting rates.

Market Service Providers and Rate Comparison

R3 conducted a review of the private solid waste management collection companies providing service to jurisdictions in San Luis Obispo County and the rates that they charge for service. Findings of that review include:

- Residential and commercial collection services are provided by four hauling companies in addition to PRWD and Country Disposal;
- Waste Connections provides services to jurisdictions south of the Cuesta Grade and along the coast, while Waste Management provides services in Atascadero, and San Miguel Garbage and Mid-State Solid Waste and Recycling provide services in various areas of the north County;
- All jurisdictions, with the exception of PRWD and the Cayucos Community Services District, offer 32-gallon service. PRWD does not offer 32-gallon service and is the only jurisdiction that offers 40-gallon carts. Waste Connections offers 20-gallon cart service in four of the jurisdictions it services;²
- The lowest rates are in jurisdictions serviced by Waste Connections³;
- Atascadero's rates are generally higher than those in the City; and
- Templeton's residential rates are generally higher than those in the City. Its commercial rates for one-time per week service are less than the City's, while rates for two and three time per week services are more.

It should be noted that, while comparing rates can provide some useful information, differences in services, fees (e.g., franchise fees and surcharges), service area characteristics, rate structures, subscription levels and other factors can impact rates and the ability to provide an apples-to-apples comparison.

² PRWD reported that one of its operational goals is to provide 20-gallon service in Paso Robles. It has been conducting a pilot program testing the compatibility of 20-gallon containers with its automated trucks and has begun discussions with Quail Run to deliver more than 300 of these 20-gallon containers to their community.

³ Waste Connections also has the second highest residential 32-gallon rate in the County in the Los Osos / Baywood Park Sanitary District, and also owns the landfill where it disposes of the waste that it collects.

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