

Consultancy report

Collection Industry Arrangements under Container Deposit Legislation

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Government
of South Australia



South Australia



**Collection Industry Arrangements for
Used Beverage Containers Under
Container Deposit Legislation**

January 2005

Acknowledgement

*Hudson Howells acknowledges the valuable contributions made to this project by the industry
Super Collectors and Collection Depots .*

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Appendix 1: Industry Consultation Template

1.0 Introduction

1.1 Background

In September 2003, Hudson Howells was appointed by the Environment Protection Authority (EPA) to undertake a consultancy on Collection Arrangements (with Emphasis on Sorting Requirements) for Used Beverage Containers Under Container Deposit Legislation (CDL). CDL has litter control as its primary focus with a resultant emphasis on aggregating and recycling collected materials.

The EPA is South Australia's primary environmental regulator. It has responsibility for protection of air and water quality, control of pollution, waste and noise, and protection and restoration of coastal, marine and riverine environments. The EPA administers CDL which regulates the sale of certain sealed beverage containers in South Australia.

1.2 Study Objectives

This report addresses the specific project objectives detailed below.

1.2.1 Purpose and Scope of Project

The purpose of the project was to investigate, review and provide achievable recommendations for change to the working arrangements between Collection Depots and the 'Super Collection' industry, with particular emphasis on (but not limited to) the requirement to sort containers by brand owner; and the absence of industry initiatives for the 'bulking' of containers. Recommendations should be focussed on achieving public, environmental and economic benefits whilst having regard to the requirements of the Trade Practices Act.

1.2.2 Objectives

Through personal consultation with industry stakeholders (it is expected that a 'round table' process will be part of this process) provide:

- An objective and thorough analysis of current industry arrangements.
- A review of the current arrangements including identification of the key issues (including any anti-competitive concerns as they might apply under the Trade Practices Act).
- Recommendations to the State Government for legislative change or other means by which the current system may be streamlined or improved to achieve public, economic and environmental benefits, whilst minimising the potential for conflict between the stakeholders and retaining competition

1.2.3 Outcomes

The following outcomes are being sought from the project:

- Minimisation of stakeholder conflict in order to maintain stability of the scheme.
- Achievable recommendations for streamlining and improving the current system.

- Public, economic and environmental benefits.
- Maintain the 'point of difference' provided by the South Australian CDL scheme.

2.0 Current Industry Arrangements

2.1 *The Current Legislation*

The CDL provisions of the Act, 1993 control the proliferation of beverage container litter by requiring:

- approval of specified beverage containers before they may be sold; and
- retailers to be located within collection areas to which specified classes of containers can be taken.

The legislation imposes refundable deposits on specified classes of containers, which can be redeemed by the public on the return of those containers to specified locations (collection depots or retail venues).

Under section 68 of the Act, a retailer may not sell a beverage in a container unless:

- the EPA has approved a class of containers to which a container belongs as either Category A containers or Category B containers; and
- the EPA has approved the refund marking for the particular class of containers to which the container belongs and the container bears the approved refund marking.

Similarly, a person may not supply a beverage in a container to a retailer or sell a beverage in a container for consumption unless the above requirements have been met [section 68(2)].

A Category A container attracts a 10 cent refund which may be redeemed at the point of sale.

A Category B container (which attracts a 5 cent refund) may not be sold unless a retailer's premises are situated within a collection area which includes an approved collection depot for the collection of the particular class of container [section 68(3)(a)].

Additionally, where the EPA requests, a retailer must display a sign in its premises stating the location of approved collection depots [section 68(3)(b)].

The EPA may refuse to approve a class of containers where it is not satisfied that the empty containers would be aggregated and re-used or their materials recycled or otherwise disposed of in a manner which the EPA considers appropriate [section 69(3)]. Consequently, although the legislation is directed principally at litter control, the potential for recycling of materials is a factor which may determine whether or not the EPA approves a class of containers for use within South Australia.

Approvals are notified in the *Government Gazette* and may be subject to conditions imposed by the EPA.

2.2 *Payment of Refunds*

A retailer who sells a beverage in a Category A container is obliged to accept delivery of the containers of that class and pay the refund amount for that container. This requirement is generally regarded as point of sale refund' [section 70(1)].

A person operating a *collection depot* must accept delivery of empty category B containers and pay the specified amount [section 71(1)].

2.3 Industry Structure

The current beverage container provisions of the Act introduce a litter control system comprising the following essential elements:

- Approvals of classes of containers before they may be marketed in South Australia;
- The imposition of a prescribed refund on each such class, redeemable by the purchaser or any other person who has collected the container;
- The establishment of collection depots; and
- An obligation upon some retailers and all collection depots, in relation to specified classes of container, to pay to the returner of the container, the specified refund.

Container Deposit Legislation has resulted in the emergence of a recovery system for refundable containers in South Australia that is financially supported by 'handling fees' paid by beverage fillers (manufacturers) to collection depots.

The major industry categories involved in the recovery system include:

- Container Manufacturers
- Beverage Fillers/Distributors
- Retailers
- Collection Depots
- Supercollectors
- Material Recyclers

Other stakeholders involved in CDL include:

- State Government
- Local Government
- Industry Interest Groups

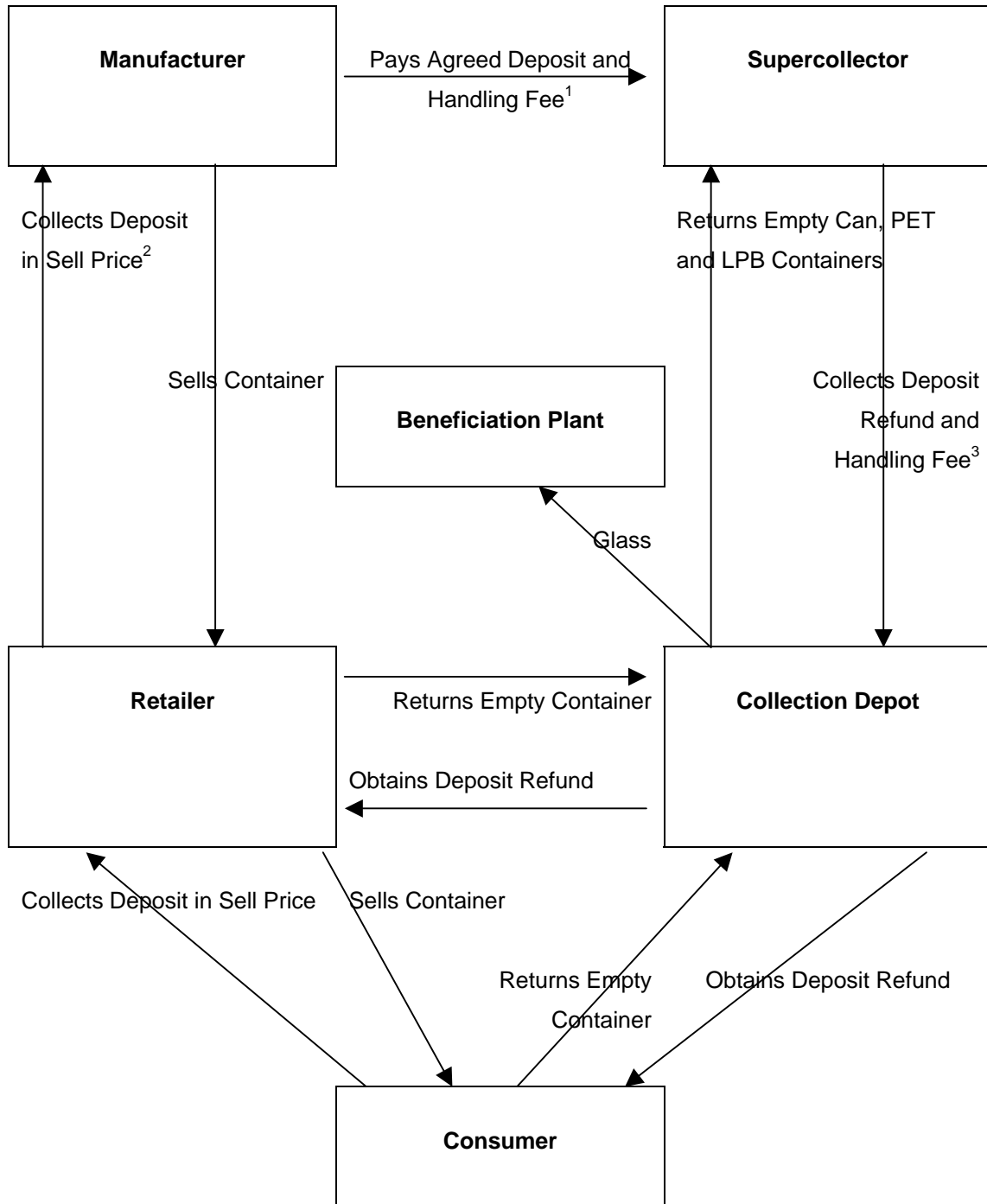
The system involves the following participants and CDL related transactions:

- The container manufacturer - supplies containers to beverage fillers/distributors and does not engage in the refund system.
- The beverage filler/distributor - theoretically includes the 5 cent refund and agreed handling fee in the wholesale price to retailers (pricing strategies vary between companies and are not necessarily based entirely on cost structures). If the refund and handling fee are not included in the wholesale price, they may be partially or fully absorbed by the beverage filler/distributor.
- The retailer - sells to consumers at prices incorporating the 5 cent refund and handling fee (when passed on by the beverage filler/distributor).
- The consumer - consumes the contents of the container and a refund is redeemed by the person returning the container to a collection depot or point of sale.
- The collection depot or point of sale vendor - reimburses the consumer (or person returning the container) and sorts the containers.

- The supercollector - collects the containers from the various collection depots for auditing and recycling and pays the collection depots the refund and agreed handling fee. The supercollectors are paid the refund and agreed handling fee by the beverage fillers/distributors on the basis of documented container returns.

The following diagram depicts the current CDL cycle:

The CDL Return Cycle



¹ The rate is paid on 100% of declared sales and takes into account an estimated return rate and the costs and profit margin of the supercollector.

² Deposits around the cycle are 5 cents per container inclusive of GST ie: the net deposit is 4.545 cents per container.

³ This handling fee is different to (1) and is a contracted figure between the supercollector and the collection depot

3.0 Current Collection Arrangements

3.1 Overview

CDL supports a fragmented (ie: many small businesses) Collection Depot structure throughout the State, estimated to support the direct employment of over 800 people in 114 businesses. It also supports a small Super Collection industry which currently has four EPA recognised super collectors.

It is considered by some that the high number of collection depots may have a negative impact on overall industry efficiency and individual depot profitability. Certainly it is the nature of highly fragmented industries not to display 'super normal' profits. With such low barriers to entry and exit, any tendency for profits to rise would normally be met by new entrants seeking a share of the benefits. Companies leaving the industry are therefore quickly replaced as new entrants take up opportunities. Without government intervention, this situation is expected to prevail, to the benefit of the consumer. That is, a proliferation of depots increases consumer convenience, as an increase in the number of depots results in more locations where consumers can obtain refunds.

The South Australian CDL model requires brand owners and distributors to financially underpin the refund system to ensure Collection Depots, upon honouring the mandatory requirement, are reimbursed for refunds paid to consumers and are, in turn, remunerated for this process by receipt of a 'handling' fee. The Super Collection industry brokers these financial arrangements.

Super Collectors act as agents for various brand owners and distributors and, by way of contractual agreements that they also have with depots, arrange for the financial disbursement as described above. This requires containers to be sorted by generic brand owner at the Depot according to which super collector has organised the collection for a particular container. Super collectors audit returns from depots and sell the collected material to the recycling and reprocessing industry.

Further, it is a component of the EPA approval process for Super Collectors to provide written confirmation that financial arrangements are in place with the brand owner or distributor of a particular beverage/containers. Through this process the EPA can be assured that the 'loop' of consumer refunds, depot remuneration and appropriate disposal (landfill is not considered as appropriate disposal) of the containers is complete.

Super Collectors are presently the only non-regulated stakeholders within the scheme, although proposals for amendments to the Act are presently being drafted to address this situation.

3.2 Specific Arrangements

Used empty containers are delivered to Collection Depots by the community in car boots, trailers, plastic bags, boxes, etc and are manually processed and counted. This system is lacking in the benefits of appropriate technologies and has been used since the inception of CDL. ***Failure to improve this system threatens current recovery rates which are at least equivalent to identified world's best practice.***

Under current collection industry arrangements, the majority of Collection Depots are manually counting and splitting containers as follows:

Table 1	
Current Container Splits By Super Collector	
Container	Number of Splits
Glass	6 splits – for 2 Super Collectors (Visy and Marine Stores) by three colours
Cans	3 splits – for three Super Collectors (Statewide, Visy and Marine Stores)
PET	1 split – already bulked (Statewide)
HDPE	1 split – already bulked (Statewide)
Liquidpaperboard	1 split – already bulked (Statewide)

The following arrangements between Super Collectors put the current collection industry arrangements into perspective:

- Marine Stores, which is owned by the South Australian Brewing Company and Cooper Brewery, process its own cans and sub-contracts PET to Statewide.
- Statewide, which is owned by Coca-Cola and Schweppes, handles all plastics (PET, etc.) and Liquidpaperboard on behalf of all other Super Collectors. This is the only form of bulking in the industry although Marine Stores advised that a small number of country depots do bulk glass where the volume is so small that the length of time to return the stock in sorted bins and be paid, the cost of infrastructure (bins) and the transport of the glass to Adelaide is inhibitive to the Collection Depots' cash flow. Marine Stores also advised that there is a large number of Collection Depots in country areas where the volume of green glass is also so small that sorting is not required and bulking is common practice. However, when such small businesses grow and glass volumes increase, Marine Stores encourages Collection Depots to migrate to sorting and delivering the glass according to Super Collector.
- Visy purchased the previous Toll Recycling business and handles the CUB contract. Statewide handles Visy's LPB. Visy is predominantly a glass recycler supplying ACI and AMCOR with glass cullet for bottle manufacturing.
- Flagcan, which is owned by a group of Collection Depot owners, sub-contracts all container handling to Statewide. The company has contracts with non-aligned manufacturers such as Pure and Natural and Choice Brand.

Current Handling Fee arrangements are detailed below:

Table 2		
Current Handling Fees - \$ per Dozen		
Super Collector	Cans (Aluminium)	Glass
Statewide Recycling	0.42	0.4052
Marine Stores	0.422	0.4052
Visy Recycling	0.4415	0.4517

Source: Letter from RSA dated 23rd November 2003

Marine Stores and Statewide are therefore Super Collectors vertically integrated with South Australia's major beverage manufacturers. Flagcan is vertically integrated in the opposite direction as it is owned by a syndicate of Collection Depots. The motive for this vertical integration by the Collection Depots is unclear as Flagcan is not an active Super Collector since it outsources its contracts to other Super Collectors.

4.0 Industry Competition and Collection Efficiency

CDL supports a fragmented (ie: many small businesses) Collection Depot structure throughout the State, estimated to support the direct employment of over 800 people in 114 businesses. It also supports a small Super Collection industry which currently has four EPA recognised super collectors. Industry negotiating strength clearly rests with the four large Super Collectors.

The Collection Depots compete with each other for consumers returning containers for refunds. However, the price paid for the container is fixed so, in reality, there is no scope for price competition and business won is generally a factor of geographic coverage, rather than strict competition. Once in receipt of a container, the Collection Depot has no choice in the selection of a Super Collector. As previously highlighted, a manufacturer appoints one Super Collectors to receive containers on its behalf and the depots must therefore deal with that particular Super Collector. The Super Collectors do not have to compete between themselves for containers. However, the reverse is also true in that a Super Collector must have agreements with all Collection Depots if it is to maintain a system for deposit refunds.

In effect, the price and container approval requirements of the legislation, designed to protect the consumer and ensure the progress of the container to recycling, result in an industry that negotiates arrangements but does not compete for business. As such, the pricing of handling fees is based on negotiations and market power, not competition. Normal industry economics do not apply.

It is considered by some that the high number of collection depots may have a negative impact on overall industry efficiency and individual depot profitability. Certainly it is the nature of highly fragmented industries not to display 'super normal' profits. With such low barriers to entry and exit, any tendency for profits to rise would normally be met by new entrants seeking a share of the benefits. Companies leaving the industry are therefore quickly replaced as new entrants take up opportunities. Without government intervention, this situation is expected to prevail, to the benefit of the consumer. That is, a proliferation of depots increases consumer convenience, as an increase in the number of depots results in more locations where consumers can obtain refunds.

This situation serves to strengthen the market power of the Super Collectors who enjoy relatively high barriers to entry and exit, and are able to use such a position of strength in negotiations with depots. Inefficiencies are brought about by disputes between Collection Depots and Super Collectors where, for example depots must accept contractual terms and handling fees proposed by Super Collectors, while being bound by the mandatory requirement to honour refunds on approved containers.

It is the collection arrangement contractual terms that give rise to inefficiencies at the Collection Depot.

It has been generally agreed during the consultation for this project that the streamlining of sorting, recording and accounting procedures has the potential to substantially reduce the cost of the CDL system to all industry participants and consumers. The current system is inefficient because of contractual arrangements which require the sorting and accounting for containers based Super Collector contracts (sorting by brand). When combined with the need to also sort by glass colour and deposit and non-deposit containers, the system becomes

quite inefficient, lacking in the benefits of bulk processing. The existence of more than one supercollector also contributes to system inefficiencies.

5.0 Industry Consultation and Key Issues

5.1 Organisations Consulted

At the commencement of the project a Consultation Template addressing the project's objectives was designed and approved by the EPA (see Appendix 1). In addition to the EPA, the following organisations were consulted during the project:

Super Collectors

- Statewide Recycling
- Marine Stores Pty Ltd
- Visy Recycling
- Flagcan Distributors Pty Ltd

Collection Depots

- Recyclers of South Australia Inc.
- Green Triangle Recyclers

Manufacturers

- The South Australian Brewing Company Pty Ltd
- Coopers Brewery Limited
- Coca – Cola Amatil (Aust) Pty Ltd
- Cadbury Schweppes
- Knispel Fruit Juices Pty Ltd
- Berri Limited
- Dairy Farmers
- Pure and Natural Beverages

Industry Organisations

- Association of Liquidpaperboard Carton Manufacturers
- Australian Citrus Industry Association

5.2 Major Consultation Findings

This section of the report summarises the major findings of the industry consultation undertaken during the project. The views of manufacturers and industry organisations have not been included as both sectors expressed little interest in the detailed consultation – manufacturers because their interests were represented during intensive Super Collector consultation and/or they had no major concerns with the current system; industry associations because they had no major concerns regarding the current situation at the time of preparing this report.

All consultation was undertaken on a confidential basis with only aggregated results presented.

5.2.1 Super Collectors

All four Super Collectors were keen to participate in the consultation process but, with the exception of Flagcan, which is owned by Collection Depots, there was general concern about

the prospect of Government intervention in the collection system. This is discussed further below.

The Super Collectors were quick to point out what they perceived to be the **major strengths** of the current system, which included:

- Freedom of choice for manufacturers to choose a Super Collector (eg: select own company). It was argued that the manufacturer is the customer and therefore must have a choice of Super Collector.
- Low cost of container retrieval by international standards.
- Creation of jobs and youth employment.
- Excellent cash flow for Collection Depots – 7 day terms compared with normal trading terms of 30 days.

Despite being protective of the current collection arrangements, the Super Collectors did recognise that the system does have inherent **weaknesses** including:

- Inefficiencies and higher costs caused by the high number of Collection Depots throughout the State.
- Depots being undercapitalised and unable to make substantial investments in technology based infrastructure and equipment.
- A proliferation of small brands in the market creating system inefficiencies through the sorting process.

While collective bargaining appears to contravene the Trade Practices Act, the Super Collectors had few concerns about potentially anti-competitive behaviour on the part of Collection Depots. While they are obviously aware that Recyclers of South Australia has authority to negotiate on behalf of the majority of Collection Depots, they are also aware that they can negotiate separately with Collection Depots and that RSA does not have the authority to collectively sign agreements for the Depots.

All Super Collectors were cautious about identifying opportunities to reduce the number of container splits, although they did recognise this as an area of system inefficiency. Their caution can be directly attributed to the following factors identified during consultation:

- The Collection Depots bear the costs of existing inefficiencies and Recyclers of South Australia have not, in the past, been prepared to negotiate lower handling fees for future efficiency gains (the reasons for this are outlined elsewhere in this report). However, through this consultancy and industry initiated roundtables, Recyclers of SA has made an offer to the Super Collectors to lower handling fees in return for new bulking arrangements.
- The Super Collectors are responsible to their customers (the manufacturers) for minimising costs. In the case of Marine Stores and Statewide, these organisations are owned by the manufacturers and as such essentially operate as non-profit centres. There is no incentive at present for the Super Collectors to pursue efficiencies in the collection system.
- There is a risk perceived by some Super Collectors that bulking to reduce the number of splits could lead to higher costs as their recovery rates are lower than others or

industry averages and/or their contamination rates are lower. There is a preference in these situations to control their own cost structures.

It was claimed by one Super Collector that, despite the concerns raised by Recyclers of South Australia, most members of RSA are happy with the current system and that sorting and bulking is not an issue for them.

The following potential supply chain improvements were identified by Super Collectors:

- Reduce the amount of containers coming from long distances in a non-compressed form. However, it was noted that most Collection Depots would be unable to fund balers.
- Depots could operate outside normal trading hours to cater for better public access.

5.2.2 Collection Depots

Consultation with Collection Depots was primarily via Recyclers of South Australia, representing the interests of the majority of Collection Depots throughout the State. The major independent Collection Depot, Green Triangle Recyclers, was given an opportunity to contribute to the consultation but had not respond at the time of preparing this report.

Recyclers of South Australia were consulted on numerous occasions and forwarded submissions during the project. Many of the issues raised by RSA were outside the scope of this project and related directly to their ongoing contract negotiations with Super Collectors. However, RSA did make some very strong contributions to collection arrangement issues and possible improvements. The following table summarises the views expressed by RSA in relation to reducing the number of container splits:

Table 3	
Collection Depot Options Assessment	
Option	Major Benefits
<i>Colour coding for container identification</i>	<ul style="list-style-type: none"> ➤ The 'Deleted Items List' would no longer be required ➤ Super Collector product lists would no longer be required ➤ Reduction in staff training requirements ➤ Reduction in contamination issues ➤ Potential for consumer pre-sorting
<i>Container Bulking</i>	<ul style="list-style-type: none"> ➤ Reduced Super Collector and Collection Depot administration costs ➤ Reduction of three pressing machines to one for Super Collectors ➤ Transport savings for Super Collectors ➤ Economies of scale and potentially better prices for Super Collectors ➤ Reduced contamination ➤ Potential reduction in handling fees ➤ Time savings at benefaction plant ➤ Potential for pooled resources for technological improvements ➤ Improved Collection Depot efficiencies – less sorting ➤ Reduced depot training costs ➤ Potential introduction of electronic counting machines in metropolitan regional centres ➤ Improved OH&S ➤ Reduced consumer waiting times ➤ Reduced consumer confusion ➤ Improved Collection Depot logistics ➤ Fewer industry disputes

A return to the colour coding of containers would be strongly resisted by the Super Collectors and manufacturers due to branding and national labelling issues. This was confirmed during consultation with Super Collectors.

While container bulking is a central option being considered in this project, the following constraints were noted in discussions with Super Collectors:

- Potential increased liability for South Australian manufacturers compared with those that label nationally.
- Disclosure of brand market shares by manufacturers.

- Super Collectors could need a price increase from manufacturers to compensate for higher contamination rates.
- Possible Trade Practices impediments.
- Super Collectors unwilling to let others handle their products (different return rates).

Anti-competitive behaviour was not an issue with the Collection Depots. From the RSA's perspective, it is the Collection Depots that are disadvantaged by a non-competitive environment as they do not have a choice when it comes to passing the containers on to Super Collectors.

Finally, Collection Depots via RSA raised the issue that one Super Collector, Visy, was restricting delivery times for glass to Monday – Thursday.

5.2.6 *Industry Roundtable*

Most industry participants consulted during the project were cautious in their support for an Industry roundtable on collection industry arrangements. The majority indicated that they would participate but only if there was something documented and circulated beforehand for consideration and negotiation at the Roundtable. Super Collectors considered that past negotiations had been fruitless and one stated that it would not participate unless the Collection Depots were prepared to negotiate on handling fees.

The purpose of a Roundtable would be to achieve agreement on the implementation of changes that would bring about improvement in collection industry arrangements. Super Collectors have indicated that they are prepared to discuss and negotiate options but would seek a sharing or the benefits of future bulking through lower handling fees. Positively disposed to participation in an open forum, Recyclers of South Australia is prepared to negotiate lower handling fees for higher paying Super Collectors as trade-offs for improved bulking arrangements, and it is understood to have offered 1.25 cents per dozen for glass and 0.3 cents per dozen for cans, thereby offering the lowest handling fees currently paid for these commodities by any Super Collector. RSA is cautious in its negotiations because it believes it has been misled in the past to accepting lower handling fees on the basis of promised bulking, and has accepted system changes and not shared in the benefits of improved productivity, while incurring additional costs. These changes include:

- Removal of coloured ends and the introduction of Super Collector lists.
- Payment by weight.
- Introduction of an additional Super Collector (Toll, now Visy) and additional container splits.
- Statewide's introduction of cages.
- Manufacturers national labelling putting pressure on Collection Depots near borders.

At the commencement of this consultancy, RSA was considered unlikely to participate in a Roundtable where they would be expected to negotiate lower handling fees for improved collection industry arrangements. On the other hand Super Collectors were unlikely to participate in a Roundtable unless there was something to negotiate. This situation exposed the EPA to high degree of risk should it have decided to sponsor an Industry Roundtable on

collection industry arrangements and ***it was therefore recommended that, at that stage, the Roundtable be deferred until both parties were prepared to negotiate or the EPA had agreed to pursue other courses of action discussed later in this report. The desired result, an industry initiated Roundtable, was achieved on 26th May 2004 and the parties held a second Roundtable on 21st July 2004. However, despite productive negotiations, the situation regarding improved industry sorting arrangements remains unresolved.***

5.2.7 International Research

South Australia is the only State in Australia to have a CDL system. Interstate examples are therefore not available for comparison purposes and there have been no specific international research projects or studies undertaken to compare the South Australian system with international standards and best practice. The lack of such research and first hand experience with other successful systems places this study, and general CDL advancement, at a disadvantage. ***It is strongly recommended that the EPA give consideration to a well structured research program in USA States that have successfully implemented Bottle Bills in order to benchmark South Australia's CDL system and make recommendations to achieve/maintain international best practice.***

Notwithstanding this lack of first hand knowledge, secondary research was undertaken during this project to identify USA research that could assist investigations. The best reference source identified was a recent major study undertaken by R.W. Beck in 2001⁴.

The purpose of the Beck study was to 'provide an objective, unbiased source of information on US beverage container recovery programs as they operated in the study year of 1999'. The major conclusions of this study included:

- Beverage container recycling rates are likely to steadily decline in future years in the absence of new recovery and market development initiatives. The reasons for this finding include the maturation of the drop-off collection program and the declining relative value of deposit amounts. ***This, perhaps, is a timely warning for South Australia's CDL system.***
- Deposit systems result in the highest level of recovery.
- Beverage container recovery has a net cost that must be covered by some type of funding mechanism.
- Traditional deposit systems have the highest gross cost. Traditional deposit systems include sorting containers by distributor and/or by brand.

While all of these findings have implications for South Australia's CDL system, the last finding is of greatest interest for this project. The Beck study estimates that traditional systems are at least 38% more costly than other systems, including bulking systems and reverse vending machines. Assuming a handling fee of 3 cents per container, this represents a potential saving of 1.14 cents per container. ***Based on an estimated 360 million containers per annum, this represents a potential for efficiency gains in South Australia's CDL system***

⁴ Understanding Beverage Container Recovery, A Value Chain Assessment prepared for the Multi-Stakeholder Recovery Project Stage 1, 2001.

of \$4.1 million per annum, or around \$35,000 per Collection Depot. It is important to note that this an estimate based on very limited research and lacking in the rigor and verification that a comprehensive study would incorporate, work that was not included in the scope of this project. However, it a best estimate based on the information available at the time of preparing this report and is not inconsistent with the findings of the recent EQAS report on the impact of sort requirements on recycling efficiency⁵. **It is therefore recommended that the EPA undertake the research necessary to more accurately estimate the potential cost savings from improved collection industry arrangements.**

⁵ EQAS Business Development, Impact of Sort Requirements on Recycling Efficiency, January 2003

6.0 Discussion and Major Project Findings

The objectives of this project, and preliminary discussions with EPA staff, identified that there are some major issues threatening the efficient operations and longer term stability of the CDL system. These include:

- Unbalanced market power allowing Super Collectors to dominate negotiations on handling fees and sorting arrangements.
- The inefficiencies of brand based sorting and the consequences for Collection Depot profitability and handling fee costs.
- Higher consumer prices brought about by high handling fees.
- A fragile system based on contracts between Super Collectors and Collection Depots. Disputes arise and contracts can lapse leaving maintenance of the system dependent on goodwill between the parties.

Also of major concern to the EPA is that CDL operates only in South Australia and that there are strong lobby groups working against the introduction of CDL systems in other States and Territories. There is potential, therefore, for the South Australian system to be undermined, or for inefficiencies to be sustained, in order to progress national objectives.

The following **major findings** were drawn by Hudson Howells from the consultation and research undertaken during the project:

- It is generally acknowledged by most industry stakeholders that the current collection industry arrangements are inefficient and are lacking in the application of technology and best practice. This impacts on the Collection Depot industry and is reflected in higher cost structures. This also impacts on consumers in their dealings with Collection Depots, reflected in the time (and associated cost) spent at Collection Depots.
- The potential for significant cost savings exists in current collection industry arrangements although it appears that the Super Collectors have no immediate incentive to improve collection industry arrangements. Higher container recovery rates mean lower profits or higher costs (passed on to manufacturers). It is also possible that the marginal costs of recovery vary between container types, which raises the possibility that some manufacturers and Super Collectors might be subsidising others. Super Collectors with low recovery rates will obviously be cautious about bulking with others where average recovery rates will raise costs to Super Collectors and manufacturers. It is also recognised that national beverage manufacturers may not wish to see CDL introduced in other States and may therefore view any move to improve the current system in South Australia as an economic disadvantage to their industry.
- As a result of this consultancy and two industry initiated Roundtables, Recyclers of South Australia is prepared to negotiate lower handling fees for higher paying Super Collectors as trade-offs for improved bulking arrangements, and it is understood to

have offered 1.25 cents per dozen for glass and 0.3 cents per dozen for cans, thereby offering the lowest handling fees currently paid for these commodities by any Super Collector.

- *There is no evidence to suggest that Collection Depots are generally not profitable and that they are not in a position to share the benefits of improved efficiencies, should they be realised.* In support of this claim, the Super Collection industry has pointed to the absence of Depots failing and closing down which suggested that they are generally profitable businesses. Although it should be recognised that some collection depots, particularly in country areas, are run in conjunction with other businesses (general stores, transport companies etc) and may in fact be operating more as a community service rather than as profitable businesses on a 'stand alone' basis.
- *Based on research and experience in the US (there is a lack of quantitative data relating to CDL in SA), it is estimated that the current inefficiencies in collection industry arrangements in South Australia are valued at \$4.1 million per annum or approximately \$35,000 per Collection Depot p.a.*

The current situation can be simply summarised as:

- The Super Collection industry is of the view that, left to its own devices, the industry will rationalise and restructure, and will ultimately arrive at collection arrangements that achieve the efficiencies and lower costs on offer.
- The Collection Depot industry, represented by RSA, is determined to achieve efficiencies and lower costs but its current offer is not sufficient for the Super Collection industry. However, Collection Depots individually and RSA do not appear to have the capital required to invest in improved sorting technologies. Consequently they are seeking Super Collector commitment to bulking arrangements.

While a number of options (or desired outcomes) have been considered during this project to achieve the estimated industry benefits available from improved collection industry arrangements, *it is clear that under the current industry circumstances there are only two realistic outcomes that will achieve the desired results:*

1. ***Bulking at the Collection Depot for glass and non-glass containers (two splits as glass is breakable and must be handled differently) with a maximum of two of the Super Collectors (preferably one) undertaking the sorting and administrative arrangements (one glass and the other non-glass).*** Clearly this outcome would require collaboration and the sharing of information between Super Collectors/manufacturers which is currently a major obstacle. Such arrangements would also come under the scrutiny of the Trade Practices Act but it is considered that the overall community benefits of such arrangements may outweigh any anti-competitive costs.

- 2. *Bulking at the Collection Depot for each Super Collector. Depots could bulk all containers by Super Collector, thereby requiring only 4 splits (as one Super Collector currently contracts its containers to another, and there currently exists a voluntary bulking arrangement for glass) and Super Collectors could install their own sorting, counting systems, etc. as they have the greater financial resources to do so.***

Under both of the above these arrangements:

- Consumers would benefit from an improved service and less time required at the Collection Depot.
- Collection Depots would benefit from maximum improved efficiencies without incurring capital costs which would otherwise be required.
- Super Collectors would benefit from improved economies of scale.

The above outcomes could be achieved through:

- Voluntary industry negotiations and/or scheme which could be incorporated into an Industry Code of Practice.
- Industry restructuring at the Super Collector level.
- Government intervention via legislation (not preferred but maybe essential).

Options for Government intervention that might be considered by the EPA include:

- Eliminate the handling fee negotiations – Government to set the handling fee via an independent regulator. This could be combined with a fee scale that recognised inefficiencies in collection industry arrangements should this be necessary to bring about improved arrangements. It could also be combined with the lowering of handling fees commensurate with increases in recovery rates.
- Reduce the disincentive not to improve efficiencies and return rates by legislating to have un-redeemed deposits returned to the Government for industry initiatives, such as the Code of Practice, etc. Again, this could be combined with the lowering of handling fees commensurate with increases in recovery rates.
- Give industry 6 - 12 months to commence to rationalise and bulk or implement one of the above options. Government could give consideration to offering a financial incentive to Super Collectors or other organisations prepared to invest in new sorting technology.
- Mandate sorting arrangements via legislation and incorporate the arrangements in an Industry Code of Practice. This could be considered over-regulation but is less anti-competitive than other measures.
- A combination of the above.

The initial Draft Report to the EPA recommended that the collection industry be given ample opportunity to improve collection industry arrangements without Government

intervention. It was further recommended that the EPA initiated Roundtable process only be implemented once industry had an opportunity to consider the Discussion Paper circulated to facilitate negotiations between the Super Collectors and the Collection Depots (Recyclers of South Australia). It was recommended that, should these negotiations not result in actions that will deliver the improved collection industry arrangements as sought by the EPA, then the EPA could consider implementing other options as identified above.

Industry has since initiated two Roundtables during which the RSA offer has been tabled for consideration. At present, the situation remains unresolved but negotiations are continuing on issues such as the CPI component of future increases in handling fees. It is understood from discussions with RSA that three of the four Supercollectors are seriously considering the revised handling fee proposal. It is also understood that two of the Super Collectors are in bulking negotiations. **These are positive outcomes from the consultancy and are contributing to the preferred outcome of industry led change. This should be further encouraged.**

While improved sorting arrangements are taking some time to come to fruition, it is considered that significant progress has been achieved to date through the industry initiated Roundtables and that an EPA sponsored Roundtable would add little to the process at this stage. **The EPA does, however, still have regulatory options to consider, the threat of which could stimulate more rapid industry developments.**

The EPA has sought legal advice from the Crown Solicitors Office (CSO) on competition issues regarding Super Collectors and Collection Depots. The CSO commented on the Collection Depots' 'lack of commercial leverage' and the imposition of commercial terms on Depots by Super Collectors. The CSO advised that the system should ensure that Collection Depots received a 'fair price' for their services including a reasonable return on assets and reasonable profit. Options put forward by the CSO for consideration by the EPA included:

- Implement collective bargaining to redress commercial imbalance. However, this option would have serious Trade Practices Act implications.
- Impose additional obligations on Super Collectors via the licensing scheme.
- Implement a system of price regulation via section 69(3) of the Act.

The CSO states that Section 69 could reasonably include 'ensuring that a fair price is paid to Collection Depots is part of the EPA's role' but it does not state specifically that price determination is part of the EPA's role. **However, it seems reasonable to assume from this that the EPA could be empowered to perform a price review and determination function if this was deemed necessary to improve collection industry arrangements.**

Should the EPA decide to pursue the above, it is likely that any legislative changes will need to be justified under National Competition Policy principles.

Other options/outcomes considered during the project are less desirable under existing circumstances for the following reasons:

- **Elimination of depots from the supply chain** – Consumer convenience and the recovery system demand an extensive geographical spread of collection points throughout the State which the Depot structure currently offers. Any replacement

system would not solve the sorting and bulking issues. Extensive industry resistance could be expected and there is the threat that manufacturers, via their ownership of Super Collectors, will 'control' South Australia's CDL system.

- **Amalgamation of Collection Depots and Super Collectors and a significantly reduced number of collection points covering specific regions** – As above plus the threat of a reduced recovery rates through reduced consumer convenience (this could be offset to some extent by an increase in the deposit value but this issues is outside the scope of this project). However, it is recognised that such an outcome would achieve better economies of scale and reduced costs.
- **Elimination of Super Collectors from the supply chain** – While this would clearly remove the middle agent and simplify collection industry arrangements, investigations have clearly identified that Collection Depots do not have the capital to invest in baling and sorting technologies, although it is recognised that the Collection Depots could collectively establish their own active Super Collection business and deal directly with material recyclers. However, they would not be guaranteed contracts with the manufacturers. Also, Depots would be required to negotiate directly with manufacturers, adding complications to the system and not necessarily solving the current stalemate.
- **Government entry into the supply chain (eg: as a Super Collector)** – it is considered that this is not the role of Government and that this would only serve to escalate current industry tensions.
- **Single Commodity Super Collectors** – While such a system has the potential to deliver major benefits via elimination of brand based sorting, reduction in cross-contamination and improved recovery rates, the Super Collection industry argues that there would not be enough volume in one product type to maintain individual facilities. Notwithstanding this commercial obstacle, single commodity processors brought about through Super Collector agreements would appear to breach Section 45 of the Trade Practices Act as it is a form of market sharing. To be seriously considered as a legislative option, the EPA would need to be sure that the industry economics would support such a structure and that the option would deliver the community benefits to offset anti-competitive costs.

Notwithstanding the above, single commodity processing is often raised as an option because this form of arrangement is already in place as an administrative agreement for one commodity type (PET) and it is recognised among industry stakeholders that the arrangement would significantly improve the efficiency of sorting and handling processes. Industry recognises that the system works. However, in terms of the Trade Practices Act, single commodity processing would restrict market conduct by restricting what a Super Collector can do, and what commodities a Super Collector can accept. This would effectively eliminate multi-commodity type sellers, thereby further restricting competition and market conduct.

Such a system would allow Super Collectors, and potentially Collection Depots, to engage in anti-competitive behaviour such as:

- Exclusive arrangements between Collection Depots and Super Collectors.
- Exclusive membership arrangements (ie: restricting new entrants to the market).
- Exclusive purchase and supply arrangements.
- Market sharing between Super Collectors.
- Price fixing on handling fees.

As Super Collectors are all competitors in the same market, collusion between them could result in reduced competition between participants. Should this produce increased costs, there would be a potential impact on consumer prices for beverages subject to CDL, if increased costs are passed on to the consumer. However, it is important to note that often for national brands additional costs are not directly passed back to the South Australian consumer. For national brands, each State will attract a specific pricing strategy based on many factors including prevailing market conditions, the manufacturer's competitive position, etc. The additional costs could therefore either be absorbed by the manufacturer or passed on to the national consumer through the company's costing/pricing strategy (or a combination of both).

7.0 Conclusion and Recommendation

An important consideration for the EPA when assessing options raised in this report is that organisations and individuals outside the collection industry may have many views on how the industry should best organise in order to realise greater efficiencies, but it is the industry participants themselves who must ultimately commit to commercial arrangements to bring about significant structural change. Government intervention may, in the longer term, prove counter-productive if it places obstacles in front of commercially driven change. For example, Government intervention in price determination could act as a disincentive to vertical and horizontal integration driven by opportunities for economies of scale. It is clear from the consultations undertaken during this project that there is a stated desire at the Super Collector level to achieve rationalisation and that the process is continuing, despite recent difficulties.

For these reasons it is recommended that the collection industry continue to be given the opportunity to improve collection industry arrangements without direct Government intervention at least in the first instance. **However, it is critical to recognise that recycling rates are likely to steadily decline in future years in the absence of new recovery and market development initiatives. The reasons for this include the maturation of the current collection system and the declining relative value of deposit amounts. Combined with the inefficiencies of the current sorting arrangements, CDL's impact as a litter reduction strategy could be severely compromised. In the absence of industry initiated change, Government intervention may be necessary to achieve the desired improvement in collection industry arrangements along with new recovery and market development initiatives (eg: an increase in the deposit value).**

In relation to improved collection industry arrangements, the following course of action is **recommended** to the EPA based on the findings of this project:

1. Industry participants be advised that the Government will consider legislative intervention unless it can be conclusively proven that a process has been formally entered into by industry to put in place one of the following outcomes and it is further recommended that such a time frame allowing the industry to implement that process should not exceed 12 months:
 - Bulking at the Collection Depot for glass and non-glass containers (two splits as glass is breakable and must be handled differently) with a maximum of two of the Super Collectors (preferably one) undertaking the sorting and administrative arrangements (one glass and the other non-glass). Clearly this outcome would require collaboration and the sharing of information between Super Collectors/manufacturers which is currently a major obstacle. Such arrangements would also come under the scrutiny of the Trade Practices Act but it is considered that the overall community benefits of such arrangements may outweigh any anti-competitive costs.
 - Bulking at the Collection Depot for each Super Collector. Depots could bulk all containers by Super Collector, thereby requiring only 4 splits (as one Super Collector currently contracts its containers to another, and there currently

exists a voluntary bulking arrangement for glass) and Super Collectors could install their own sorting, counting systems, etc. as they have the greater financial resources to do so.

2. Government immediately develop and offer an incentive package on the basis that all industry participants are prepared to enter into arrangements to achieve either of the above outcomes (or other outcomes suggested by industry that will deliver the same collection industry efficiencies and associated cost savings).
3. Should industry fail to demonstrate that new collection industry arrangements are being developed as above, and subject to Trade Practices Act considerations:
 - Government mandate sorting arrangements via legislation (as per the preferred options identified) and incorporate the arrangements in the proposed Industry Code of Practice which would form part of Super Collector regulatory requirements.
 - Eliminate industry sorting and handling fee negotiations by setting the handling fee via an independent regulator.
4. Government seek to resolve the Trade Practices Act implications of the recommended course of action and commence the drafting of legislation for implementation should this course of action become necessary.
5. In relation to new recovery and market development initiatives, it is recommended that the Government give consideration to a comprehensive review of the existing structure and operation of the CDL scheme and industry with a view to ensuring that the scheme is capable of expansion in future years. Any such review should provide a careful analysis of the structure and role of the super collection industry and include an examination of collection industry arrangements in USA Bottle Bill States.
6. The findings of this project be communicated to collection industry participants in the form of a Public Report as a basis for establishing a system to achieve best practice in collection industry arrangements through either voluntary or legislative means.

Appendix 1: Industry Consultation Template

Company:	Contact:
Position:	Phone No:

Hudson Howells has been engaged by the EPA to investigate, review and provide achievable recommendations for change to the working arrangements between Collection Depots (Depots) and the 'Super Collection Industry' (Supercollectors) with particular emphasis on the requirement to sort containers by brand owner, and the absence of industry initiatives for the 'bulking' of containers. The specific objects include:

1. Identification, documentation and analysis of current industry arrangements.
2. Identification and documentation of the 'supply chain', current participants and industry structure.
3. Identification of key issues, stakeholder conflicts and opportunities for improved efficiencies, profitability, customer service, environmental outcomes and industry performance.
4. Recommendations (legislative or other) to improve current collection industry arrangements.

This Consultation Template has been designed to assist personal consultations with industry stakeholders. It can also be used as a self completion survey where persons are responding on an email or fax basis. Completed surveys should be emailed to phill@hudsonhowells.com or faxed to (08) 8212 7144. Any questions relating to this industry consultation and survey should be directed to Phill Hudson on 82127122.

1. Please identify your organisation's current role in the collection industry supply chain:

Beverage Manufacturer	<input type="checkbox"/>	Description:.....
Collection Depot	<input type="checkbox"/>
Supercollector	<input type="checkbox"/>
Material Recycler	<input type="checkbox"/>
Industry Association	<input type="checkbox"/>

2. Does your organisation have any formal links with other organisations in the supply chain?

Yes	<input type="checkbox"/>	If 'yes', who and in which sector?.....
No	<input type="checkbox"/>
Not Sure	<input type="checkbox"/>

.....

.....

.....

.....

3. What is your understanding of the current sorting and 'handling fee' arrangements between Depots, Supercollectors, Manufacturers and Material Recyclers?

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4. What do you believe are the strengths and weaknesses of the current sorting arrangements between Depots, Supercollectors and Material Recyclers?

<i>Strengths</i>	<i>Weaknesses</i>

5. Do you have any reason to believe that any of the existing arrangements are anti-competitive under the Trade Practices Act?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>
Not Sure	<input type="checkbox"/>

If 'yes', please detail?.....

.....

.....

.....

.....

6. Do you believe that it is possible to reduce the number of container splits currently required during the sorting process?

Yes	<input type="checkbox"/>
No	<input type="checkbox"/>
Not Sure	<input type="checkbox"/>

If 'no', why not; If 'yes', please detail how?.....

.....

.....

.....

.....

.....
7. Do you believe that the supply chain from the Depot to the Supercollector and Material Recycler can be improved in any way?

Yes	
No	
Not Sure	

If 'yes', what improvements could be made?.....

.....
8. What specific benefits would the improvements identified in Question 7 deliver to the overall supply chain (eg: Reduced Stakeholder Conflict, Improved Efficiency, Improved Profitability, Improved Customer Service, Improved Environmental Outcomes, etc) and what barriers exist to achieving the improvement?

Improvement	Specific Benefits	Barriers to Change

9. Do you believe that any of the following changes in the supply chain could deliver financial, economic, public or environmental benefits?

Change	Agree?		What Benefits Could Be Achieved?	Barriers to Change/ Other Comments
	Yes	No		
Amalgamation of Depots and Supercollectors with a significantly reduced number of collection points (say 8 – 12) covering specific regions				
Elimination of depots from the supply chain				
Elimination of supercollectors from the supply chain				
Reduced number of Collection Depots				
Reduced number of Supercollectors				
Appointment of one 'Super Collector' by tender for all material types and for a specified period				
Government entry into the supply chain – eg: as a Supercollector				
Have only one supercollector for each container type				
Use technology or specialist processing machines to facilitate bulking (eg scan containers)				
Introduction of a variable deposit scheme for different containers				

