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## 1. DEFINITIONS

- 1.1. In this Policy:
- 1.1.1. “BCMB” means the Beverage Container Management Board. The BCMB is a management board within the meaning of the *Environmental Protection and Enhancement Act* (Alberta) whose mandate is to regulate and enhance a leading beverage container system that protects Alberta’s environment;
  - 1.1.2. “Container” means a bottle, can, plastic cup or paperboard carton or a package made of metal, plastic, paper, glass or other material, or a combination of them, that contains or has contained a beverage;
  - 1.1.3. “Data Collection Agent” or “DCA” means the person appointed by the BCMB for the purpose of collecting and analyzing information about the beverage container system in Alberta and reporting on that information;
  - 1.1.4. “DCA’s Return Margin Expert” means the expert selected by the DCA to provide the DCA with recommendations as to the Return Margin to be applied in a Handling Commission Review and how that Return Margin is to be applied by the DCA;
  - 1.1.5. “Depot” means a place operated as a business for the collection of empty Containers;
  - 1.1.6. “Depot Viability Handling Commission” is the amount payable to a Depot in addition to the Handling Commission for the first 1.5 million containers shipped to the CSA by that Depot in every calendar year commencing January 1, 2022, excepting refillable containers and regardless of whether there is a change in effective control of the Depot or a change of Permit Holder at the Depot location;
  - 1.1.7. “Handling Commission” or “HC” means the amount payable for each Container collected from a Depot in accordance with section 13(b) of the Regulation;
  - 1.1.8. “Handling Commission Review” or “HCR” means a review of Handling Commission amounts directed by the Board pursuant to the Handling Commission By-law;
  - 1.1.9. “Interested Parties” means those parties directly affected by a Handling Commission Review and includes any or all of the Manufacturers and their respective associations and any or all of the Depots and their respective associations, the Collection System Agent, any Collection Service Provider and such other parties as may be specifically determined to be Interested Parties by the Board or an Arbitration Panel;
  - 1.1.10. “Pre-tax Return” means the quantum of money to be included in Revenue Requirement which is analogous to pre-tax profit in a non-regulated context and is provided in order to compensate Depot owners;

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- 1.1.11. “Pre-tax Return Margin” or “RM” means the ratio to be applied to revenue to calculate the Pre-tax Return to be included in Revenue Requirement;
  - 1.1.12. “Revenue Requirement” means the amount of money that all Depots as a group must collect through Handling Commissions and Depot Viability Handling Commissions in a given period of time in order to recover prudently incurred costs and expenses and to earn a fair pre-tax return;
  - 1.1.13. “Risk Comparable Entities” means a non-regulated Canadian or US firm, industry or industry group which is comparable in risk to the Depot industry; and
  - 1.1.14. “Uniform Code of Accounts” or “UCA” means the series of forms identified as such and provided to each Depot by the Data Collection Agent for the purpose of collecting financial and operational data on an annual basis.
- 1.2. Terms identified in the Beverage Container Recycling Regulation or in the Handling Commission By-law have the same meaning when used in this Policy unless otherwise indicated.

## **2. BACKGROUND TO POLICY**

- 2.1. Alberta Depots are regulated by the BCMB and Handling Commissions are set based on regulatory cost of service principles applied to Depots as a group. Traditional infrastructure utilities, with large invested capital, are cost of service regulated and earn a return on undepreciated equity invested (rate base). In contrast, Depots have relatively small capital investments. Accordingly, the Return for Depots, similar to other regulated industries with relatively small invested capital, have historically been determined as a percentage of total gross revenue (this percentage is known as a Return Margin) in order to ensure an adequate and competitive compensation for Depots.
- 2.2. Alberta Depots, as a group, must have the opportunity to earn a fair return which has been calculated after consideration of appropriate regulatory principles including the following:
  - 2.2.1. Comparable Investments – the Pre-tax Return is comparable to other industries of similar risk;
  - 2.2.2. Capital Attraction – the Pre-tax Return is sufficient to allow the Depot industry to attract additional financial capital as needed; and
  - 2.2.3. Financial Integrity – the Pre-tax Return is sufficient to ensure the Depot industry viability.
- 2.3. Alberta Depots are subject to a range of business risks including those described in the Appendix to this Policy.

### **3. RETURN MARGIN EXPERT**

- 3.1. As part of every Handling Commission Review process, the DCA shall retain the services of a Return Margin Expert, the DCA's Return Margin Expert, to recommend the Pre-tax Return Margin to be used by the DCA in calculating the Pre-tax Return to be included in the Revenue Requirement.
- 3.2. The DCA's Return Margin Expert shall be knowledgeable and experienced in Return Margin rate setting.
- 3.3. When selecting the DCA's Return Margin Expert the DCA shall adhere to the following procedure:
  - 3.3.1. The DCA shall prepare a Return Margin expert terms of reference that outlines the services the DCA requires of the Return Margin expert. The DCA shall also prepare a list of potential experts who will be asked to respond to a Request for Proposal.
  - 3.3.2. The DCA shall provide the Interested Parties with the opportunity to recommend additions, deletions or amendments to both the terms of reference for the DCA's Return Margin Expert and the list of potential experts. The DCA will also ask Interested Parties if they have an objection to any of the potential experts and will require that the Interested Party identify the rationale for the objection. The role of the Interested Parties shall at all times be advisory. Subject to section 4.2 the DCA has the sole prerogative to make the final determination on the terms of reference for the DCA's Return Margin Expert and the list of potential experts. The DCA will provide the Interested Parties with a copy of the final terms of reference for the DCA's Return Margin Expert prior to conducting the Request for Proposal. The DCA shall inform the Interested Parties as to the successful respondent to the Request for Proposal.
  - 3.3.3. Any Interested Party has the right to engage their own Return Margin expert in the Handling Commission Review process if they should so choose. Prior to Interested Parties engaging their own Return Margin expert, the BCMB will facilitate a meeting of Interested Parties to discuss a potential alternative course of action. Interested Parties will retain the sole prerogative to determine whether they will engage their own Return Margin expert.

### **4. DETERMINATION OF RETURN AND REPORTING**

- 4.1. The objective of the DCA's Return Margin Expert is to provide the DCA with recommendations as to the Pre-tax Return Margin to be applied in a Handling Commission Review and how that Pre-tax Return Margin is to be applied by the DCA.

- 4.2. Determination of the Pre-tax Return Margin and how the Pre-tax Return is to be calculated will be at the sole discretion of the DCA's Return Margin Expert based upon their expertise. The process followed by the DCA's Return Margin Expert will be identified in the DCA's terms of reference and will include the following steps:
  - 4.2.1. Identify and select Risk Comparable Entities after considering the risks of the Alberta Depot industry as discussed in item 2.3 and Appendix A. Notwithstanding that Alberta Depots perform a variety of activities and are subject to a variety of risks, a Risk Comparable Entity shall be risk comparable to Alberta Depots as whole businesses;
  - 4.2.2. Consider the appropriate number of years of data to be analyzed, entities to be included or excluded, the appropriate weighting of results, prevailing market conditions and the applicability of alternative screens in selecting the Risk Comparable Entities;
  - 4.2.3. Calculate the Pre-tax Return Margin associated with the Risk Comparable Entities, which Pre-tax Return Margin, subject to any adjustment recommended by the DCA's Return Margin Expert, shall be used as the Pre-tax Return Margin of the Depots; and
  - 4.2.4. Direct the DCA on how the Pre-tax Return Margin recommended should be applied to determine the Pre-tax Return for the Depots.
- 4.3. The DCA's Return Margin Expert will provide a written report to the DCA which addresses each of the steps outlined in item 4.2. Any variation to the process will be thoroughly discussed in the written report.

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## Appendix

### 1. RISK COMPARABLE ENTITIES

Determination of Pre-tax Return Margin for the Depot system relies on analysis of the RM of Risk Comparable Entities which are selected based on the following **primary risk characteristics**:

- a. Operate in an open, unregulated free market such that they accept risk by purchasing products in competitive wholesale markets and also accept risk by marking-up the price of these products and reselling them to retail consumers who can choose their retailers; and
- b. Operate with relatively small invested capital.

### 2. RISKS AND RISK MITIGATING FACTORS

2.1. Consideration of additional risks and risk mitigating factors assists in assessing whether the Pre-tax Return Margin quantum determined by application of the two main risk factors listed in Appendix Item 1 is reasonable and robust. Alberta Depots are single whole businesses engaged in primary activities associated with the redemption of empty beverage containers:

- a. Purchase of empty beverage containers by paying out the deposit value; and
- b. Conducting logistic and supporting administrative operations related to the redemption and sorting of beverage containers for recovery by manufacturers.

2.2. In assessing the risk facing Alberta Depots the Return Margin Expert should give consideration to the following risk factors and to what extent the risk mitigating factors attenuate that risk:

**2.2.1. Small Size Business Risk:** Firms with less market capitalization or size face greater risk. Even considered on a collective basis the Depot system is materially smaller than many individual businesses within Risk Comparable Entities.

***Risk mitigating factor(s):***

One of the purposes of the Handling Commission Review process administered by the BCMB is to maintain the viability of the Alberta Depot industry. Of note, BCMB policy states that, “Handling Commissions must provide an opportunity, on a Network wide basis, and not on an individual Depot basis, to earn a fair return, but there shall be no guarantee of profitability for individual Depots in Alberta.” Some risk mitigating factors to be considered include:

- a. The Regulation establishes a fixed deposit amount as an incentive to consumers to return beverage containers through the Depot network;

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- b. The BCMB has historically tried to promote and educate consumers about using the depot network;
  - c. The BCMB has historically recognized the importance of providing public access to depots located throughout the Province; and

The Regulation requires all Manufacturers of beverage container to register those containers.

**2.2.2. Regulatory Lag Risk:** Data gathering and timing limitations constrain the HCR's ability to establish Handling Commissions that reflect actual costs and revenues experienced by Depots at the time those HCs are to come into effect (the Target Date). Specifically:

- a. UCA cost data, upon which the Revenue Requirement is based, are 18-30 months older than the Target Date; and
- b. After HCs are implemented on the Target Date they remain fixed until the next review (Annual Update or HCR) - there is no dynamic adjustment or use of balancing accounts to reflect the impact of economic and government policy changes in the period that the Handling Commissions are in effect.

***Risk Mitigating Factor(s):***

- a. Application of inflation indices to escalate the UCA data up to the Target Date; and
- b. Annual updates of the UCA data and indices to recalculate the Revenue Requirement and attendant HCs (See Handling Commission By-law).

**2.2.3. Change in Law Risk:** The depot system exists solely under the aegis of the Beverage Container Recycling Regulation (BCRR) and the policies of its regulator, the BCMB. The economic viability of investments in the Depot system is thus subject to the risk of changes to the BCRR by the Government of Alberta as well as BCMB policies (e.g. Depot siting policies can decrease volumes to incumbent depots, 5-year permits can influence the financing of the cost of Depot land, buildings and operations).

***Risk mitigating factor(s):***

- a. The multi-stakeholder nature of the BCMB, where Depots hold 1/3 of seats on the Board helps to ensure Depot perspectives are considered regarding BCMB policies.

**2.2.4. CSA and CSP Performance Risk:** Depot activities are dependent on CSA and CSP operations. Interruptions to "downstream" processing (e.g. issues with transportation, software, payments or processing plant availability) can quickly impact a Depots' ability to function.

***Risk mitigating factor(s):***

- a. The BCMB regulates the performance of CSAs and CSPs through operating agreements that contain performance standards. Each CSA and CSP has an operating agreement with the Alberta Bottle Depot Association (ABDA) by which they have agreed to certain performance standards.
- 2.2.5. **System Container Forecast Risk:** The DCA's forecast of empty beverage container sales volumes, container mix and returns is a fundamental component for the setting of HCs. The accuracy of the DCA's volume forecast is contingent on how well the forecast model anticipates changes to key variables affecting consumption and returns of beverage containers. These key variables include consumer choices and broad economic factors affecting returns which are outside of Depot control.

***Risk mitigating factor(s):***

- a. The DCA's model has been updated continuously since 2007 and is assessed by the Interested Parties through the HCR process.
- 2.2.6. **Individual Depot Volume Risk (Revenue risk):** Although the BCMB controls the number of Depots licensed, a Depot's permit does not provide a protected market or guaranteed income for any one Depot. Depots compete with each other because the public is free to select any Depot it chooses to return a container and because other Depots are not prohibited from offering collection services from areas outside their nominal trading area.

***Risk mitigating factor(s):***

- a. BCMB siting policies can mitigate or exacerbate individual Depot volume risk.
- 2.2.7. **Operational Risks:** Include the following:
- a. **Shrinkage** (breakage, miscounting, theft) and **Staff turnover** (loss of productivity, resources to hire and train new staff);
  - b. **Front-end errors:** miscounting of containers and purchase of unregistered containers can result in losing deposit and HC revenues and higher operating costs;
  - c. **Back-end errors:** Improperly sorted containers and/or breakage of glass can result in non-payment to a Depot and potential compliance penalties;
  - d. **Theft:** The cash-based nature of Depots presents opportunities for theft. This can occur at the front end (more cash paid out than containers returned); back end (theft of containers already purchased); or robbery of cash held on Depot premises; and

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- e. **Technology:** Investment in technology is generally intended to improve Depot efficiency but requires significant upfront capital investment with uncertain returns.

**2.2.8. Meta Risks (COVID-19 pandemic and similar):** COVID-19 highlights the Depot system's particular vulnerability to external meta risks as most Depots are single-purpose businesses lacking revenue diversification and cannot adjust their prices in real time.