

OTS Incentive Consultation Session July 10th 2013 Q&A

On July 10th 2013 Ontario Tire Stewardship held a Consultation session for all registered Collectors, Haulers, Processors and Recycled Product Manufacturers (RPMs) to discuss changes OTS is proposing to make to the existing incentive programs and other program elements. This session presented a comprehensive high-level overview of the current financial situation of OTS, the regulatory, operational and financial challenges faced by the program, and the proposed plan developed by OTS to address these issues.

This session will be followed by consultations with individual stakeholder groups in August. OTS will follow-up with all stakeholders regarding the timing of these sessions.

OTS Deficit

In the 2009-2012 program years the UTP accumulated significant debt in the OTR tire program area.

Q: To whom must OTS repay the OTR tire program debt?

A: As the debt is repaid the payments would be credited to the On-Road tire program to offset costs associated with the diversion of On-Road tires.

Q: Is it a requirement of the Waste Diversion Act that OTS must return this money back to the on-road tire Stewards?

A: Under the Waste Diversion Act there is a prohibition on cross-subsidization between material categories. From 2009 to 2012 OTS effectively ran 2 programs, and On-Road tire program and an Off-Road tire program, and each needs to “pay its own way” and not be reliant on revenues from the other category. In designing the program back in 2007-2008 we set up two categories of tires, “On- Road” and “Off – Road”, and the diversion and costs are tracked separately. While OTS has been cash flowing the accumulated debt in the Off-Road program with surplus revenues from the On-Road program the policy restriction on cross-subsidization means that OTS must address this imbalance and pay down the debt using revenues from Off-Road tire fees.

Q: Why did it take so long for OTS to address the deficit?

A: OTS has been working since 2010 to try and implement plans to change our revenue stream and the TSF's however OTS has not been able to or allowed to make these adjustments. The fees are a very political issue and there have been a lot of concerns on what changes in fees will mean. In March 2013 the Government of Ontario passed a prescriptive Regulation that specifies how OTS is to calculate TSF rates, and this finally allowed OTS to make the necessary changes, albeit with some allowance subsequently made for Agricultural tires.

Q: Why is OTS forecasting a deficit in 2013?

A: There are three things combined which are impacting the OTR revenue for 2013 and result in OTS forecasting a deficit:

1. OTS had forecasted getting the new TSFs in place by February 1st 2013 however it took longer to get the regulation completed than initially anticipated, and OTS was not able to implement new fees until the regulation was complete.
2. Within the first quarter there was then a surge in supply of OTR tires (as compared to previous years data) as tires were supplied in advance of the implementation of the new TSF rates.
3. The adjustments made to the TSFs levied on Agricultural tires had a negative impact on overall OTR TSF revenues.

OTS is in the process of examining forecasted program costs and identifying savings to revise this forecast and meet the program's financial obligations for 2013.

Q: Is tonnage a reasonable basis for allocating costs for shared expenses like R&D, P&E and Administration?

A: OTS uses tonnage because weight it is the biggest driver of costs. Approximately 80% of OTS's budget goes towards collection, hauling, processing and manufacturing incentives, which are primarily based on weight.

Q: What does it cost OTS to administer the program?

A: Approximately 6.1% of the OTS program cost is associated with Administration (when uncontrollable expenses such as WDO and HST are backed-out).

Q: With the change to the new categories, and the addition of a debt repayment portion to the OTR tire TSF will all the OTR tires which formerly were remitted on as either PLTs or MTs also attract the share of the deficit?

A: Yes, when OTS moved to the new weight based categorization, we assigned OTR tires which used to be reported on as a PLT or MT tire and created categories specifically for tires of that size. It is important to note that while some OTR tires supplied were formerly reported and remitted on as On-Road tires they were always counted as OTR tires for the purposes of assigning costs, so including them in the debt repayment program is appropriate.

Collection Allowance

OTS is proposing to shift the payment of the Collection Allowance (CA) to the Processor as part of their Processing Incentive (PI) effective July 1st 2014.

Q: If the Processor is going to be receiving the Collection Allowance they would then have to pay the Collector, however most Processors within the program are not certain of which Collector the tires originated from because that relationship rests with the Hauler. How will Processors be able to effectively flow the CA to the Collector?

A: OTS is aware that at the moment there is a significant amount of activity in the market where Collectors are receiving payments from their service providers for their tires, and that this is being funded by the Processors. As a result the fact that the Processor may not have a direct connection with a Collector is not seen by OTS to be an impediment to the Processor being able to pay the Collector a direct incentive for their tires.

It should be noted that this approach also would likely result in some benefits for Collectors including:

- Receiving payment more quickly (vs. quarterly through OTS);
- Reducing the amount of information required to be reported to OTS on a regular basis;
- Reduced liability for errors in reporting quantities of tires being picked-up.

From a program perspective this approach would save OTS approximately \$1 million in HST costs as payments to a Processor have been ruled not to be consideration as a taxable supply, as well as result in some administrative savings for OTS.

Q: Will OTS be reducing the CA?

A: At the moment OTS is not proposing a CA rate reduction.

Q: If OTS is not going to be reducing Collection Allowance why does OTS not enforce the requirement for Collectors to store tires in accordance with the vendor standards?

A: The Collector should be following the vendor standards in regards to how the tires are being stored. Collectors should have the tires ready for pick-up for the Hauler, accessible and free of any accumulated snow, ice, rims, debris etc... in order to receive the free pick-up agreed to by OTS. However if the tires are not stored in a manner consistent with the vendor standards the Hauler should either advise the Collector that they will not be picking up the tires or the Hauler should charge the collector a fee for picking up tires. If a Hauler is willing to provide service without any incremental cost even where the tires are not being stored according to the OTS requirements than that is at the Hauler's discretion.

Transportation Incentives

OTS is proposing to shift the Transportation Incentive (TI) program from one where credits are earned based on location of pick-up to one based solely per tonne of tires delivered effective January 1st 2014. Payment of TI would be shifted to the Processor as part of PI effective July 1st 2015.

Q: Since the introduction of the program since September 2009, have there been any other participants besides Haulers who have seen a reduction in their incentives?

A: OTS has consulted on and will be implementing a 10% decrease in the Processing incentives as of January 1st 2014.

Q: With the changes to the TI structure how will OTS ensure that all areas of the province continue to be serviced by Haulers picking-up tires?

A: Whatever changes are implemented OTS remains committed to ensuring all areas of the province are able to access free pick-up of their used tires. Based on current market dynamics OTS does not believe that this service will be interrupted as there is currently a greater demand for tires by Processors than there are actual tires, resulting in Processors being highly motivated to ensure that tires from all over Ontario are picked-up and delivered to meet their needs. Additionally OTS has accumulated considerable data on tire pick-up and delivery costs and so anticipates being able to effectively set TI rates which will be adequate to ensure appropriate levels of service are maintained

In the event that there are areas of the province which end-up being underserved OTS has a number of options it may pursue to address these needs, including issuing an RFP for transport of tires from that area and contracting directly with a Hauler to provide the required service.

Q: If the Hauling incentive is paid to the Processor would that then make the Processor responsible for paying the HST?

A: OTS is currently working with CRA to clarify the treatment of the HST on the payments that OTS makes under the revised approach however the intent of these changes is not to shift costs away from the program and onto the stakeholder. While OTS is seeking clarity regarding whether a Processor making a payment to a Hauler or Collector would be responsible for paying HST it is important to note that Processors would be able to offset any payments against HST collected on TDP sales, resulting in the HST being simply a flow through as opposed to a cost (as it is for OTS). If HST payments are larger than HST collected a Processor would be eligible for a rebate of the difference from the CRA.

Q: If Haulers are receiving their payment for transportation of tires from the Processor they have chosen to work with, would it eliminate the requirement for a Hauler to pay the HST to the CRA?

A: At the moment OTS is waiting on clarification from the CRA on the issue, but to our understanding the Haulers would continue to remit HST.

Q: Who would be responsible for the TI rate changes, OTS or the Processor?

A: OTS would set the PI rate (intended to cover the costs of collecting, transporting and processing tires) which they would be paying the Processor. The process for setting the rate to be paid would continue to take into account the same cost drivers for these various activities as is

currently done for the separate rates. OTS would continue to provide the rate setting, however what a Processor chooses to pay would be a discussion between the Processor and the Hauler/Collector.

Q: If the Processor becomes the point in which OTS decides to inject all the incentives, would the Processor be the one determining how much they pay to their downstream providers?

A: It would be up to the commercial relationship between the Processor, Hauler and Collector to determine what the appropriate payment terms and amounts would be. OTS will undertake the rate-setting in a transparent manner so all parties know what the assumptions and cost drivers are that go into determining the final rate.

Q: If you have a Processor making a lower end TDP would they then have less money to incent a Hauler or a Collector?

A: What OTS pays for the Processing Incentive would still be based on the type of TDP that a Process is making and selling, however the transportation and collection components of the PI would still be based on the costs drivers which OTS takes into account today in setting the TI and CA rates.

Q: Why is OTS proposing to move the transportation incentives two years from now and not sooner so they would be able to start saving sooner?

A: OTS is trying to respect the current market and provide stakeholders with time to adjust their current business dynamics. OTS wants to ensure we are providing our stakeholders with enough time to adjust. If the stakeholders feel that OTS should move more quickly to implement these changes then OTS would like to hear that feedback, along with a suggestion of what the accelerated timeline should be.

Q: How will stranded cost be dealt with by OTS in the event that a Processor may go out of business?

A: OTS would definitely have to look into a situation like this. We would maybe have to look into how much material the Processor may have on their property. OTS will be taking this question down and will come back with some solutions in our next consultation session. (A

Processor noted that OTS should require all Processors to post performance bonds to address this issue).

Q: Is OTS unfairly disadvantaging independent Hauler's by proposing a change where the Transportation Incentives are paid to the Processors?

A: There are many Processors within the program which do not operate their own Hauling company and so as a result will continue to work with independent Haulers to secure quantities of used tires. The relationship between the Hauler and Processor will continue to be the responsibility of the stakeholders to manage.

Q: Would OTS be able to hold a separate consultation session for smaller haulers only?

A: OTS is willing to hold several consultation sessions for all the different participant groups to ensure all stakeholders have an opportunity to comment on these changes.

Processing Incentives

On July 1st 2014 OTS will be reducing Processing Incentives (PI) rates by 15% and reduce OTR tire PI rate PI rate premium to 15% (vs. current 25%), and on July 1st 2015 PI rates will be reduced an additional 15% and the OTR PI premium reduced to 10%

Q: Are the rates shown in the chart for the Processing Incentive inclusive of the introduction of the collection and transportation cost?

A: No, the rates for the Processing Incentive shown in these slides are only for the Processing Incentives as that program currently operates. OTS will be adding the Collection and Transportation cost to these numbers.

Q: Will OTS be considering adopting an RFP/Allocation approach where OTS awards quantities of tires to Processors based on a tendering process?

A: OTS is seeking to minimize its direct intervention into the market and so is not planning on moving to a program model where we directly manage used tire flows to individual Processors.

Manufacturing Incentives

OTS is proposing to reduce the Manufacturing Incentive (MI) on July 1 2014 by 60%, and then another additional 38% on July 1st 2015.

Q: In the January consultation sessions OTS put forward an approach that would see the emphasis on incenting manufacturing increase over time, why now is OTS presenting a plan that is the opposite of this strategy?

A: Since the January consultations the operating landscape has significantly changed for OTS and the necessity to reduce costs and streamline the program has taken on increased prominence. Longer-term strategic initiatives and strategies such as the focus on developing new markets and growing manufacturing capacity are not at this time consistent with these new priorities.

Overall General Questions

Q: OTS has presented significant changes to the various incentive programs, are there not savings to be found within OTS's own operations?

A: OTS has consistently reduced Administration costs over the past 3 years, and is projecting lower costs again in 2013. Additionally OTS is proposing to contract R&D and P&E expenditures to minimum levels.

Q: How many more consultation sessions will OTS have before all the incentive changes come into effect?

A: This will depend on the feedback which OTS receives, however OTS will definitely be holding individual consultation for each participant group in August.

Q: There has been no mention of the incentive rates dropping from the government in Bill 91, therefore who is actually driving the changes to incentive rate deductions?

A: OTS will be driving the cost reductions. The changes which are being proposed are not being driven by the government or the Waste Reduction Act.

Q: What is the process which OTS follows when it comes to stock pile clean –ups?

A: There are two different ways in which OTS handles various stock pile clean-ups across the province.

1. If the stockpile clean- up is approximately under 5000 tires, we administrate these clean-ups through the program and they are known as Special Tire Collection (STC) clean up.
2. If the stockpile of tires is more than 5,000 tires OTS would issue out an RFP to all processors within the program and issue the clean-up to the Processor who provides OTS with the best price.

Q: OTS has indicated that it is seeking to reduce program expenses by an annual average of approximately \$7 million per year for the next 5 years. Can OTS provide a breakdown of the amount of savings it expects to realize by incentive category?

A: OTS will provide additional detail regarding the forecast savings by incentive category as part of the subsequent consultation sessions.

Q: How does the process for revising the incentives, or coming up with changes to the plan being presented here by OTS work? Do the stakeholders get a vote? What is the process by which stakeholders can make their concerns known to the OTS Board?

A: Changes to the incentive programs are not going to be put up for a vote to stakeholders, however OTS is committed to consulting with stakeholders in order to develop and implement a program which affects the market fairly while still achieving the financial objectives of OTS.

The plan being presented today has been reviewed and approved by the OTS Board. OTS staff are responsible for managing the consultation process and will be keeping the Board apprised of the substantive issues/suggestions/concerns raised through the consultation process. Any major changes to this plan which may result in OTS not being able to meet the financial targets set-out in this consultation would be taken back to the Board for approval.

Q: Will OTS be holding further consultations with the stakeholders in a combined session?

A: OTS will be holding consultation sessions for individual stakeholder groups in August (dates to be confirmed) and will host a follow-up consultation for all stakeholders in September to present the plan that OTS will be implementing going forward.