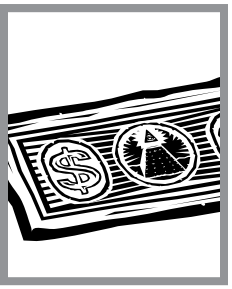
Appendix E: RM Compensation Options



As we've seen in Appendix D, your RFP should be structured to request compensation proposals from bidders so you can ascertain:

- How much it will cost for the RM contractor to take over existing services ("base proposal") (see Appendix D, sections 3.1, 6.2).
- The bidders' proposed compensation format for other RM services (basically a formula for splitting cost savings achieved from the base proposal costs, see Appendix D, section 6.3 and "RM Compensation Options" below).
- Pricing for additional miscellaneous waste streams that not regularly generated and are not specifically included in your request for proposals (see "Miscellaneous Waste Streams" below).

Structuring services in this way will allow you to compare proposed costs with your current cost baseline. It will also allow you to evaluate several different bidders' proposed compensation options to determine which is likely to make the most of RM by providing strong incentives for the selected contractor to reduce, reuse, recycle, and maximize efficiency of service.

This appendix provides sample tables and examples to help structure the RM compensation components of the bid and miscellaneous waste streams as effectively as possible.

**The Link between Base Proposals and RM....
Transparency is the Key**

Getting bidders to present separate pricing for service components such as hauling, disposal, processing fees, container charges, etc. is necessary for RM to work. By making prices "transparent", cost savings from recycling, waste reduction, and other efficiencies can be realized. You are then able to redistribute a portion or all of the cost savings resulting from improvements to your RM contractor. This isn't possible when you are simply paying a lumped fee for all services (which results in a fixed level of service at a fixed cost).

Our experience has shown that disposal and hauling costs often cannot be disaggregated because it is not economical to put scales on trucks (which may be collecting waste from other clients). In this case, structuring pricing on a $$/pick-up level, while less preferable, would still allow you to recoup costs for each avoided pick-up (as a result of waste reduction, etc.)

RM Compensation Options

Two main options exist for the RM compensation component. These can be provided as samples in an Attachment to your RFP. The final choice of which method is selected will be determined by the level of comfort the customer and bidders have with each option and whether consensus can be reached. The goals of such a mechanism is to create a mutually beneficial business relationship that drives inefficiency and cost out of system, reduced costs, achieves cost-effective resource efficiency, recovers savings, and shares savings between you and your RM contractor. The compensation and incentives should be tied to continuous improvement in resource efficiency such that your RM contractor's profit margins improve from helping you decrease waste generation and increase reuse and diversion (recycling and composting). Two different compensation options follow:

Option 1. Pass-Through of Service Costs with "Shared Savings" and Performance Bonus. The contractor provides all required services (e.g., tip fees, hauling fees, container rental) on a "cost pass-through" basis. This cost pass through is based on the bids received to take over existing services (Base Financial Proposal). When the contractor implements changes or improves the system to permanently decrease costs, the contractor shares in some of those savings. Examples of savings opportunities include diverting more materials (taking advantage of marginal total cost of recycling vs. disposal), making handling and hauling procedures more efficient, "right-sizing" containers for cost savings and behavioral change (e.g., smaller trash bins, more prominent recycling stations), and helping to reduce waste generation in the first place.

Shared savings can work in numerous ways, especially in varying the percent of savings received by the customer and the contractor. Several options are outlined below; the percentage split in shared savings is shown for exemplary purposes.

You and the contractor share all cost savings at 50/50 percent.

You get 100 percent of the savings up to a predetermined level (for example, 5 percent). Once this level has been reached, then you and the contractor split the savings above this amount usually in a ratio that benefits the contractor. For example, you could get the first 5 percent and then above this amount, you get 30 percent of the savings and the contractor gets 70 percent.

The use of a performance bonus is a third option. Under such a scheme, you increase the percentage of cost savings given to the contractor when the company meets certain performance targets. For example, as a variation on option 1, initial savings are split 50/50. If the contractor is able to meet certain performance targets, however (such as increasing overall recycling by 10 percent in any given year), you allow the shared savings to be split at a level of 60 percent to the contractor and 40 percent to you.

Option "1-c" is recommended due to its focus on measurable improvements to performance. Without this link between incentives and environmental goals, there is the risk that only the "easy" cost savings from economies of scale and leveraged buying are pursued. Its intent is to increase the incentive to the contractor and the cus-

tomer to decrease system wide costs and achieve pre-determined diversion and waste reduction goals. By tying increasing levels of diversion/waste reduction to increasing incentive levels, there is a proportionately higher incentive to commit resources for these improvements and higher diversion levels.

You may choose to ask for a performance bonus proposal as a more favorable split for the contractor, like this:

Tying Diversion Improvement to the Contractor Performance Bonus

Diversion Rate	Split (%Client/Contractor)
Current diversion rate	X%/Y%
Current diversion rate +15%	X-10%/Y+10%
Current diversion rate +20%	X-20%/Y+20%
Current diversion rate +>25%	X-30%/Y+30%

or

Tying Waste Reduction to the Contractor Performance Bonus

Waste Reduction (as measured from baseline, % in total generation, normalized if possible)	Split (%Client/Contractor)
-10%	X%/Y%
-15%	X-10%/Y+10%
-20%	X-20%/Y+20%
-30%	X-30%/Y+30%

Option 2. Fixed Cost with Guaranteed Cost Reductions. The RM contractor provides all services (e.g., hauling, recycling, disposal, containers, personnel, equipment/materials) for a pre-defined, fixed annual cost. This cost is determined based on the previous year's total costs and includes a guaranteed cost reduction.

For example, assume after the initial contract period that for the scope of facilities included in the contract, the customer is paying $120,000 per year for its services. The initial monthly cost would then be $10,000. Further assume that the contractor agrees to provide the customer with a 5 percent[1] annual cost reduction ($6,000 total or $500 per month). Under this option, the customer would then pay the contractor $9,500 per month during the first year. This would be a profitable proposition for the contractor if the company has a decent level of confidence it can realize greater than 5 percent cost savings within the first year. For example if the company achieves a 15 percent reduction in costs, they would keep 10 percent while maintaining the guaranteed 5 percent reduction to the customer. This arrangement can work well when the amount of waste generated remains relatively constant. The

[1] Note: All percent splits are used as examples and may be adjusted for each specific situation.

contract would contain a clause that if waste generation exceeds a threshold (for example +/- 5 percent) over the baseline that was used to determine the annual cost of services, the base fee is revisited. Thus, if some external circumstances (such as expansion of a facility) cause a large increase or decrease over this threshold, both parties reset the base fixed fee.

The advantage of this mechanism is that it is relatively simple, and the customer is able to budget for each year with a high degree of certainty. It provides an incentive to the contractor to provide the required services in a more cost effective way, since savings go straight to the contractor's bottom line.[2] It would also shift more of the responsibility to the contractor to drive down costs. In theory, however, the customer does not have a direct financial incentive to continue to improve since it is guaranteed 5 percent cost reduction (no more and no less). This arrangement generally is used when generation levels have been fairly predictable and stable. It might not be appropriate if generation fluctuates wildly and both parties are constantly re-setting the base fixed fee.

A simple bid table for this option might look like the following:

Sample Bid Table for "Fixed Cost" Proposals

Compensation Component	Year 1	Year 2	Year 3
1. Resource management fee. Indicate the annual fixed fee for the first 3 years to cover the all base services as detailed in Attachment X and additional RM Requirements per Section X of this RFP.	$	$	$
2. Guaranteed savings as a percent for each contract year			
3. Indicate gain-shared savings split beyond guaranteed savings shared between X Corporation and contractor; X Corporation % / Contractor %			

Other Options:

Compensation per unit

(e.g., $/per unit of product made or $/employee, hotel guest, square foot for institutional clients), $$/square foot for retail)

Advantages are that costs "self-adjust" to production or work loads, and there is an incentive to the contractor to decrease costs for larger profit margin. As with other compensation options, however, unavoidable cost increases (rates) can require renegotiation. This "per unit" method is extremely difficult to apply in cases where there are many different types of "units" in play. It may work well for an auto pro-

[2] This can occur either by reducing the unit price of disposal, or, more importantly, decreasing the volume disposed/increasing diversion, or managing the process (hauling, handling, contract management) more efficiently.

ducer or company that makes a single or limited number of products, but will not work well for manufacturers who make tens of hundreds of different products. If the contractor and the customer are confident in the costs, such a mechanism may be worth investigating.

Compensation for any capital expense type project

Some improvements may require some upfront capital costs - the purchase of new recycling containers, for example. In such cases, either the contractor or customer can put up the capital, but any capital costs should be fully recouped before the gain-sharing split takes effect.

Savings should be determined from a baseline of a minimum of 6 months of service/cost records. Savings will first be used to recoup 100 percent (or another predetermined percentage, with dollar cap) of any additional costs associated with the implementation of a proposed activity. Eligible costs should include any costs associated with additional containers, equipment, processing fees, but will not include the contractor labor to design and implement the program. Once any eligible costs have been recouped, the contractor and the customer can split the remaining savings at a 50/50 split, or choose some other split as described above.

In summary, the RM compensation structure must be established in a way that is beneficial for both parties. Mutual benefit is critical to establishing a strong, long-term relationship. Note, however, that the above are EXAMPLES, and other reasonable compensation options that meet the above program goals should be considered.

Miscellaneous Waste Streams

Similar to baseline existing services, the goal is to obtain transparent pricing for additional services that might be requested, such as disposal or recycling of universal wastes (e.g., batteries, fluorescent lighting tubes).

Example:

Unit Priced Items	Qty.	Unit Rate
Mixed batteries per pound	1	$____
Lead acid batteries, per pound	1	$____
Fluorescent bulbs per bulb:		$____
- 4 foot	1	$____
- 8 foot	1	$____
- U-shape, circular, compact	1	$____
- HID	1	$____
Broken bulbs, per pound	1	$____
Mercury, per pound	1	$____