Optimus SBR Review of RPRA's Cost Allocation Methodology and Fee Model

Project Overview, Scope, and Summary of Findings

Project Overview

The Resource Productivity and Recovery Authority (RPRA) recently identified a need to review the Authority's Cost Allocation Methodology and Fee Model used to set fees under the *Resource Recovery and Circular Economy Act, 2016* (RRCEA). The Cost Allocation Methodology addresses all programs delivered by RPRA, including those delivered under the *Waste Diversion and Transition Act, 2016* (WDTA), the RRCEA, and the *Environmental Protection Act* (EPA). The Fee Model sets fees for all Registry programs under the RRCEA and EPA.

Optimus SBR was engaged to assess the current Cost Allocation Methodology and Fee Model, identify opportunities for improvement, and provide recommendations to RPRA on options for a Cost Allocation Methodology and Fee Model for 2022 and beyond.

Project Scope

Optimus completed numerous activities to assess the Cost Allocation Methodology and Fee Model used by RPRA in 2020 and 2021, and to propose recommendations for 2022. Activities completed as part of this work included:

- Reviewing multiple documents to understand current cost allocations, current fees charged to producers, past fee consultations, and stakeholder feedback collected by RPRA;
- Reviewing comparable organizations in Canadian and International jurisdictions to document best practices and alternative approaches;
- Assessing fee-setting principles in RPRA's General Fee-Setting Policy and proposing revisions;
- Assessing a refined 2022 Cost Allocation Methodology developed by RPRA staff over the course of the engagement; and
- Facilitating a number of individual and group interviews as well as numerous working sessions to identify and assess Fee Model options for 2022.

The table below summarizes in scope programs for Cost Allocation and Fee-Setting.

Table 1: In Scope Programs for Fee Model and Cost Allocation Methodology

Program	Fee Model	Cost Allocation
RRCEA Programs		
Tires	✓	✓
Batteries	✓	✓

Program	Fee Model	Cost Allocation
ITT/AV (EEE)	✓	✓
Lighting*	✗	✓
Hazardous and Special Products (HSP)	✓	✓
Blue Box	✓	✓
EPA Programs		
Excess Soil	✗**	✓
Hazardous Waste Program (HWP)	✗	✓
WDTA Programs		
WDTA Programs	✗	✓

** Tentative Lighting Program producer and supply volume estimates were developed by RPRA in parallel with this project, but model effects on prospective Lighting producers were not explored due to a lack of data in advance of the program launch.*

***2022 fees for Excess Soil were set before the future state Fee Model was recommended and* developed by Optimus SBR.

Findings – Summary

Optimus SBR's assessment of RPRA's 2021 Cost Allocation Methodology and Fee Model resulted in the following key findings:

- **Guiding Principles listed in RPRA's General Fee-Setting Policy can be consolidated and simplified**, while still allowing enough flexibility for RPRA to be agile as it matures and adjusts its approach to fee-setting over time.
- **The 2021 program weight approach to cost allocation appears to have been a reasonable method for allocating the compliance, communication and other Registry- and non-Registry-related shared costs**. While there are more precise alternatives to allocating costs that are employed by some comparator organizations, given RPRA's evolving nature, the program weight approach provides a reasonable estimation of the costs for each program. If RPRA uses the program weight approach in the future, better documentation of the rationales for the program weight would be desirable so that the program weights – both relative to one another and over time – can be well justified to external stakeholders.
- RPRA worked to identify new data sources that could be used to more precisely allocate costs to programs. **This refined Cost Allocation Methodology proposed for 2022 is reasonable**, is based on the best data available, and is consistent with the fee-setting Guiding Principles.

- **The 2021 Fee Model of a 2-tiered flat fee and fixed rate (weight- or unit-based) is considered reasonable.** In general, having a flat fee helps to avoid excessive burden on small producers while also setting a minimum fee amount; and having a fixed rate reflects large producers' share of regulated products and packaging supplied into the Ontario marketplace. **This Model is recommended for setting 2022 Registry fees**.
- A **number of other Fee Model options were considered and rejected at this time** for various reasons, but could be considered in future years as RPRA reaches a steady state.

Findings – Guiding Principles

RPRA's *General Fee-Setting Policy*, dated April 2018, sets out the principles and rules the organization applies in setting fees, costs or other charges under the RRCEA. Optimus SBR has proposed revisions to the Guiding Principles listed in the General Fee-Setting Policy in order to consolidate and simplify the Guiding Principles, while still allowing enough flexibility for RPRA to be agile as it matures and changes its approach to fee-setting over time. The existing policy lists nine Guiding Principles; we propose to reduce this number to seven by eliminating two of those principles, revising four, and retaining three as they are.

Table 2: Proposed Guiding Principles

Current RPRA General Fee-Setting Policy Objectives	Draft Principles	Draft Descriptions
Transparent fee-setting process	**Clear legal authority** (status quo)	The Authority has legal authority to set and collect fees and charges to recover its costs in carrying out its mandate.
	Transparency and consultation (proposed addition)	The Authority is committed to *transparent communication and open consultation with stakeholders* about proposed fees, including describing the rationale for proposed fees and final fee decisions, and how consultation informed the final determination of its fees or charges.
Fees, costs and other charges are reasonable and reflect costs incurred by the Authority	**Determine and reasonably allocate full costs** (proposed addition)	The Authority is guided by a set of overarching procedures that provide consistency in fee-setting decisions. The Authority reasonably allocates its costs between programs. This allocation includes direct costs attributable to specific programs, as well as common costs, which are shared equitably across programs.
	Commitment to continuous Improvement (proposed addition)	The Authority is committed to regularly reviewing and refining its business processes to promote both efficiency and effectiveness in executing its mandate. The Authority will continually seek to refine its approach to allocating costs and setting fees between programs over time as costs to support new and transitional programs become more stable and predictable.

Current RPRA General Fee-Setting Policy Objectives	Draft Principles	Draft Descriptions
	Recognize equity considerations (status quo)	The Authority aims to promote an equitable approach to determining fees, costs and other charges that considers the impact of system costs on regulated parties in support of a robust Ontario marketplace. Fees are designed to minimize marketplace distortions, and fairly reflect higher volume producers' share.
Fee predictability for regulated parties	**Simplicity and predictability** (proposed addition)	The Authority aims to establish fees that are simply understood and result in predictable costs for fee payors.
Long-term financial sustainability of the Authority	**Sustainability and agility** (status quo)	Fees, costs and other charges must be sufficient for RPRA to effectively and efficiently carry out its mandate. RPRA must also maintain prudent reserves to provide it with the operational agility to be responsive to emerging risks and priorities.

Findings – Cost Allocation Methodology

RPRA's Cost Allocation Methodology for 2021 attributed direct costs to the programs for which they were incurred, and shared costs that could not be attributed to a specific program to all programs according to "program weights" that reflected *relative effort required to administer and monitor the program.* Tires, the first and most established RRCEA program, was used as the baseline and assigned a program weight of 1.0. All other programs were weighted in relation to the Tires Program.

Based on Optimus SBR's experience, conversations with RPRA leadership, and review of comparator best practices, and given the previous lack of available data and evolving nature of RPRA's regulatory activities[1], **the program weight approach appears to have been a reasonable method for allocating the compliance, communication and other Registry- and non-Registry-related shared costs**. While there are more precise alternatives to allocating costs that are employed by some comparator organizations, given RPRA's evolving nature and the lack of relevant available data (which would have been administratively burdensome to collect), particularly as the organization was starting up and adding new programs, the program weight approach provided a reasonable estimation of the costs for each program, given the data constraints and evolving nature of RPRA's operations at the time.

Following Optimus SBR's assessment of RPRA's current state Cost Allocation Methodology, RPRA worked to identify data sources that could be used to more precisely allocate costs to programs, and developed a revised Cost Allocation Methodology for 2022, which would replace the "Program Weight" methodology.

[1] RPRA's regulatory activities are evolving because of the nascent stage of some of its RRCEA programs (with new programs continually being added, including major additions in 2021, 2022, and 2023), and its wind-up of WDTA programs.

The new Methodology segments costs into 3 distinct classifications, with each classification possessing unique allocation methods:

- **Direct Costs** – costs that are attributed to a specific program, which are allocated directly to those programs.
  - *Example Direct Costs: Costs for developing a specific program's Registry portal, and any specific expense that relates to a WDTA or specific Registry Program.*
- **Indirect Expenses** – costs that are not directly related to a specific program and are needed for RPRA's overall health and operations. These costs are fixed and do not vary based on volume, size, or complexity of the program. They include salary and non-salary support costs such as general administration, Board, finance, IT, and communications. These costs are split equally across the number of programs they apply to (i.e., if the cost only applies to Registry programs, it is split across the number of Registry Programs, whereas if it applies to both WDTA and Registry programs, it is split equally across all WDTA and Registry Programs). However, for office/overhead expenses, indirect costs are allocated based on a program's percentage share of salaries.
  - *Example Indirect Expenses: Insurance, Board related expenses, HR and Finance support costs.*
- **Shared Service Expenses** – costs that are incurred centrally based on RPRA's operating model but that deliver direct services to a subset of RPRA programs, as opposed to costs needed for RPRA's overall health and operations. Although these services are centrally delivered, and costs vary based on the volume, size, and complexity of the programs. Shared service expenses include costs such as Registry software, Registry development and management services, and support and compliance officer salaries. These costs are allocated based on the cost drivers of the particular expense: the number of programs, number of producers, or number of registrants, or an average of the three.
  - *Example Shared Service Expenses: IT services, registry support staff costs, compliance related staff, and professional fees.*

Within each classification of costs, there may be additional unique allocation methods that apply to particular costs incurred by RPRA. From time to time, as more data and information becomes available, RPRA may amend or introduce additional cost allocation methods to allocate indirect and shared service expenses.

Compared to the current program weight Cost Allocation Methodology, the proposed Cost Allocation Methodology uses more quantitative inputs and data to estimate the costs incurred by each program. The use and refinement of these inputs is expected to result in continually improved program cost allocations as the organization matures and approaches steady state operations over time.

Findings – Fee Model

At present, each program's Fee Model contains both a fixed rate and flat fee component. Based on Optimus SBR's assessment, **it is reasonable that the current state Fee Model of a 2-tiered flat fee and fixed rate could be applied for 2022 and in the future state.** In general, applying a flat fee of $75 consistently across all programs keeps the fees paid by small producers consistent and avoids excess burden on small producers **(simplicity and equity considerations)**. Having a **fixed rate** based on unit or weight reflects large producers' share of regulated products and packaging supplied into the Ontario marketplace **(equity considerations)**. Other Fee Models considered produced very large per-producer impacts and would hence be unpredictable for producers in 2022 **(predictability)**; however, they may be considered by RPRA in future years as the organization reaches a steady state.

As compared to 2021, in 2022 changes in the fees paid by producers are driven by multiple factors including:

- An increase in RPRA's annual budget due to RPRA's growing mandate and organizational structure;
- A change in cost allocation methodology;
- Updated producer volume estimates based on additional years of data; and
- Deficit or surplus resolution from previous years.

Large producers are the only producers who experience a change in fees, as the changes from the cost allocation are borne entirely by those who pay the fixed rate, while small producers paying a fixed fee of $75 experience no change. There is a possibility to increase the fixed fee from $75 to $100. This change would recognize RPRA's budget growth since 2018, and given large producers fees are increasing, from an equity perspective, small producers' fees could be increased as well. However, this change would have a marginal impact on RPRA's overall revenue from Registry Programs, as small producers contribute only ~1% of programs' cost recovery. Implementing a new Fee Model that increases burden on small producers while only having marginal revenue impacts is not recommended at this time.

A multitude of other Fee Model options were considered and rejected at this time for various reasons. For example:

- changes to the basis on which certain programs' fees were calculated (e.g., weight of tires versus number of tires); or
- a 3-tiered flat fee model, with a flat fee being charged to each size of producer (small, medium and large).

This last model in particular was considered as stakeholders had requested that RPRA explore it. In general, however, the addition of a third tier flat fee leads to a shift in fees from the largest producers to the medium sized producers.

In addition to the above considerations, as RPRA transitions towards a steady state (i.e., has completed adding or winding-up programs over time), RPRA may wish to consider moving towards an amalgamated Fee Model, which would combine all RRCEA Registry program costs and recover them across all RRCEA producers, regardless of program. This alternative Fee Model approach may be desirable for various reasons:

- Compared to RPRA's current Fee Model, it is a simpler approach to setting fees.
- With programs being in a steady state, costs to be recovered by RPRA will be more predictable across programs.
- Year-over-year, producer fees will be more consistent.
- All producers of similar size will be treated the same, regardless of program.

Using this amalgamated approach, an array of Fee Model options will exist for consideration, including, for example, a 3-tiered flat fee for small, medium and large producers, with an additional fixed rate weight-based fee for medium and large producers. At a future date, if RPRA chooses to move in this direction, Fee Model options could be prepared and consulted on.