FACTS TO ACT ON

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Fighting Waste Industry Consolidation with Local Ownership of Recycling Facilities

By Peter Anderson, Brenda Platt, and Neil Seldman

Overview

During the last three decades, the waste hauling and disposal industry has undergone considerable consolidation. Large consolidators have bought out not only many smaller independent firms but also each other in mega-mergers.[1] A few companies such as Waste Management Inc. (WMI) and Allied Waste/Browning Ferris Industries (BFI) dominate a growing number of local and regional markets. These companies -- referred to in this article as "the consolidators" -- maintain market power by being vertically integrated; that is, they control collection, waste transfer stations, and landfills. Landfills in particular are a bottleneck for competition in the industry. When competition disappears, the consolidators will raise prices, gouging local government agencies and businesses.

In mid-1998, the CEO of WMI stated: "with some weaker companies gone from the industry in recent years and continuing consolidation, disposal prices can be increased without losing competitors."[2] In mid-1999, one year after its merger with USA Waste, WMI raised tip fees 40% to 138%. Landfills in Pennsylvania, Virginia, and Ohio were among those affected. The new rates affected about one out of every eight tons of trash disposed at WMI facilities.[3]

Fortunately, recycling is one key to breaking the pending monopolization of the waste industry. Recycling has not yet come under the dominant control of these companies. Thus, increased recycling is not only an environmental strategy, but also a strategy for nurturing competition and keeping discard management costs low.

San Jose, California, is one community that embraced recycling as a way to break up monopoly control of trash collection and

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handling. In 1982, with a lock on all landfill capacity and acquisition of several garbage firms, BFI tried to raise the City's garbage collection rates by 89%. In partial response, city officials paved the way for a new landfill within San Jose and started recycling. As a result, BFI ending up dropping its garbage disposal rates by one-third. (See the side bar on San Jose for more details.)

Local or public ownership of recycling facilities is one effective escape hatch for avoiding the coming garbage monopoly. If recycling comes under the control of the consolidators, recycling rates will probably erode and, when consolidators gain control over all the landfills in a market, disposal costs will soar. These companies earn far more profits from using their disposal facilities than when they recycle. Large consolidated firms cannot aggressively pursue recycling without negatively impacting their investors. Why? Their monopoly power, and higher profits, depends upon tight supplies of landfills that they control.

The effort to counter the trend toward monopolization requires citizen and local government action to guarantee local control of recycling processing operations, often referred to as material recycling facilities (MRFs).

Currently, communities are debating whether to build publicly owned MRFs or leave processing to the private sector. So far, the debate has focused on which form of ownership is more efficient, private vs. public. The debate should be broadened to take into account the impact of ownership on competition and the future of recycling as a significant discard management option.

This means reframing the MRF ownership debate from one of private vs. public to that of consolidator controlled vs. locally controlled, or put another way, monopoly ownership vs. diversified ownership. Local control is an insurance policy against a future trash monopoly. Local control can take several forms: ownership by public agencies, ownership by independent small-scale for-profit firms, and ownership by nonprofit mission-driven organizations.

San Jose, California Breaks BFI's Trash Monopoly and Keeps Prices Competitive

San Jose, California (pop. 923,000) has one of the best urban recycling programs in the country. Over 50% of its municipal solid waste is diverted from landfill disposal. Despite the availability of close-in landfill space and low tipping fees, San Jose's City Council has supported recycling for two major reasons:

1. In 1982, the City Council faced the prospect of less than 9 months of remaining capacity at the City's only landfill, Newby Island Landfill, owned and operated by Browning Ferris Industries (BFI). Even though it won a permit battle that provided more than 30 years of capacity there, the Council realized it needed to diversify into recycling to protect the City's long-term interests. The success of local recycling programs has dramatically extended the life of San Jose's landfills as well.
2. The City Council was also upset at BFI requesting an 89% increase in garbage collection rates in 1982. In 1972, BFI purchased two local San Jose garbage firms. By 1982 BFI believed it was in a position to dramatically increase rates. In 1979, the City had tried to attract competition for the City's garbage collection contract, but all the competitors contacted said they would not pursue it because BFI had a lock on the landfill capacity (the only operating landfill in the area at the time).

The City allowed only half of the 1982 rate increase and noted the need to break BFI's monopoly on garbage disposal to keep collection rates stable. They hired a new Solid Waste Program Manager at a high level, who was charged with helping to site another landfill within San Jose to break BFI's monopoly. Within 3.5 years, Waste Management Inc. (WMI) had designed, permitted, and constructed the Kirby Canyon landfill in San Jose (with the City's strong support at every permitting hearing). This resulted in a *real* competitive environment for the City's 1985 garbage collection request for proposals (RFP).

San Jose split the RFP into two contracts -- disposal and collection -- in order to lock in access to disposal capacity before soliciting proposals for garbage collection. BFI actually dropped its garbage disposal rates by one-third and kept the City's garbage disposal contract. However, WMI won the garbage collection contract by cutting BFI's rates by more than 20%. The start of the new system offered a new curbside recycling program and lots of public outreach promoting "More services, at lower costs..." -- definitely a winning message!

Source: Gary Liss, Gary Liss & Associates, Loomis, California, personal communication, August 2002. Gary Liss is the former Solid Waste Program Manager for the City of San Jose who was responsible for these activities.

County and city government agencies responsible for discard management may balk at the price of publicly built, owned, and operated MRFs. The multi-million dollar capital investment is often a main reason for opting toward private ownership. But communities would do well to keep in mind that future increases in disposal fees are likely to easily exceed the public's cost of building and maintaining its own MRF or exceed the public's cost to assist a local entrepreneur or non-profit organization in doing this. The consolidators have a vested interest and market power to raise disposal fees and limit recycling to a minimal role.

Higher overcharges for waste services could easily dwarf the dollars associated with the cost of maintaining public or independent processing capacity.

The decision of MRF ownership -- one avenue through which communities can avoid monopoly waste fees -- is extremely important.

Today, markets are still generally competitive. The endgame -- when all of the structural conditions come together to create market power -- is normally considered to arise when one or two consolidators control or "lock down" all the landfills in a local market and cooperate on pricing. Until the lockdown is total, a small hauler that has access to even one last remaining public or uncontrolled landfill can still be competitive. This issue of MRF ownership is of special importance to the many areas of the country where competition may soon disappear with the imminent existence of waste monopolies, duopolies, or oligopolies.

Introduction

Since the late 1960s, consolidation of waste management companies has been commonplace. In the first stages, the consolidation consisted of small companies buying other small companies. Eventually Waste Management Inc. (WMI) and Browning Ferris Industries (BFI) went public in order to gain capital for further acquisitions on a large scale.

More than 200 asset swaps in the 1990s reveal an apparent tacit agreement among consolidators that the number one firm keeps, and the others leave, town. Their abandonment of large (as well as small) cities has become the norm. For example, like a revolving door, BFI handed over its St. Louis assets to Allied who later turned around and passed them off to Superior. BFI also gave Phoenix and Columbus to Superior who soon handed them over to Allied. Allied gave up its Boston business to BFI (before their merger), its Milwaukee territory to Superior, and Cincinnati to Republic. BFI also transferred Chicago to Allied (again before their merger), and Phoenix and San Diego to USA Waste.

The pace of consolidation did not slow until the early-1990s, when waste management companies hit their first hard financial times.

These financial difficulties were the result of over-built landfill capacity, investments in hazardous waste and European markets that turned sour, exposure of accounting irregularities by the companies, a Justice Department investigation into the industry's business practices, and payment of $50 million to settle a class action antitrust suit for national price fixing.[4, 5]

USA Waste, at the time a relatively small player in the race for industry consolidation, in 1994 hired John Drury, former CEO of BFI, and began a new buying spree financed with private equity. Consolidation advanced from taking over small independent operations to acquiring other publicly traded consolidators. The goal of all this consolidation – control over waste in major markets by a few cooperating vertically integrated companies – seems to be just around the corner.

In fact, attaining market control is vital to the future financial wellbeing of waste industry consolidators. Absent this control, waste hauling is a highly competitive industry where start-up ventures can enter the market with a relatively small investment and undercut any existing companies engaged in price gouging.

Acquisition Investors Demand High Returns

Consolidation requires the big waste management companies to generate returns greater than those needed to sustain independent waste haulers. Why? Because consolidation brings acquisition penalties, and the private investment pools and Wall Street investors that financed the consolidation exert pressure on the company to generate high returns. Acquisition

Consolidation Costs

Premiums: Typically, independent hauling companies land on the market when their founder retires and the children decide against entering the business. To accelerate consolidation, buyers will generally pay above market value for independent hauling companies. This convinces a larger than normal number of owners to sell before their time.

Surprise Costs: These costs occur when the purchaser discovers liabilities of the purchased company that undermine its profitability after the deal has closed. Examples include cooked books and long-term liabilities created by changes in the Superfund program. When the pace of consolidation accelerates, the likelihood of discovering these liabilities diminishes.*

Cultural Conflicts: Different companies have different corporate cultures and operating and accounting systems, and the task of merging many cultures in the process of rapid consolidation can lead to personnel tensions, miscues and abortive communications that create inefficiencies and lead to missed opportunities.

Additional Management Layer: When a company acquires far-flung operations, an additional layer of management must be hired, trained, supervised, and paid to control them. Also, that intervening level of management can slow down and may becloud decision-making.

Loss of Operational Focus: Once a hauler "goes public" with an initial public offering in the equities markets to attract sufficient capital for acquisitions, all of the company's energies tend to devolve on maintaining and increasing the value of the stock. This financial focus is typically at the cost of operations. For example, companies may forego investment in fleet maintenance and customer relations in order to generate returns.

Entrepreneurial Loss: After buyouts, local managers' compensation usually depends less on their divisions' performance and more on the entire company's performance. As a result, entrepreneurial initiative is lessened at the local level where most of the operational decisions are made.

*See WMI SEC Form 8-K (Aug. 15, 2000), p. 19, which states that WMI is a potentially responsible party in connection with 85 locations listed on the Superfund National Priorities List that may be expected to require remediation. "All of the sites ... were initially developed by others as land disposal facilities."

penalties are costs that arise as a result of purchasing other companies. In order for a deal to be profitable, the new company must generate returns over and above the penalties. Acquisition penalties include premiums and surprise costs, and can arise because of company cultural conflicts, the need for additional management layers, a loss of focus on operations, and a loss of local entrepreneurial spirit. See side bar above.

Despite the acquisition penalty consolidators had to bear, the private investment pools that financed their purchasing spree demanded the waste management companies do the impossible and produce rapid growth in earnings per share.

Yet a competitive waste hauling industry is not capable of satisfying these financial demands. Garbage is a steady cash generator but not one likely to produce spectacular earnings. The business is low-tech, with no brand name value, and no economies of scale beyond the local level. See side bar next page.

If the company's financial performance after acquisitions did not meet investor expectations, heads could – and did – roll. So how was a waste management company executive to retain his job?

In the absence of clear financial benefits from consolidation, waste management companies resorted to accounting tricks and illegal methods to inflate actual earnings and satisfy their investors. Part of the earnings' updraft has been generated by legitimate accounting anomalies available for mergers. These include pooling of interests and recording the new company's whole year revenues for end-of-year acquisitions. The industry generated other earnings by using overly aggressive and potentially illegitimate accounting gimmicks that misstate items, such as depreciation and future liabilities.[6] The large waste management companies also have increased their earnings through the illegal tactics of price fixing and threats.

Investor alerts, exposés in *Barron's*, the *New York Times*, the *Wall Street Journal* and *Business Week*; criminal charges; SEC investigations; and private class action securities and antitrust law suits have effectively eliminated or severely restricted the consolidators' ability to generate returns using these questionable methods.[7] The only remaining avenue for consolidators to now generate the requisite returns demanded by Wall Street was to find a route that would be more discrete and create a lower profile with stockholders, regulators, and prosecutors.

EPA Landfill Regs Help Consolidators

In the 1990s, consolidators got help from an unlikely source. The U.S. EPA unintentionally handed waste management companies a tool that allowed them to generate the needed returns. The enactment in 1991 of EPA's first national standards for land disposal resulted in the closure of thousands of disposal sites. In 1970, 20,000 unlicensed dumps dotted the U.S. landscape; now there are only slightly more than 2,000 licensed facilities.

Waste hauling companies have been able to squeeze out competitors by vertically integrating. By gaining control of regional disposal capacity, large companies can penalize competitors by overcharging for disposal and sending competitors' trucks for very long waits at the scale house or having loads given a white glove inspection and turned away for carting proscribed materiel. "We don't fear competition on the street," Jerry Antonacci, president of New York City hauler, Crown Waste Corp., pointed out. "Our fear for the future is the dumps. The public companies control the dumps, and if they want to raise the price to $70 a ton, they can -- with a snap of their fingers -- put everyone out of business."[8]

Once competition among haulers has been eliminated by price squeezes at landfills, the consolidators are free to set their own prices. However, this strategy only works in locales where there are no competitively priced, publicly owned landfills, because a public facility provides a relief value for non-vertically integrated independents. Consolidators have been using a practice known as "internalization" to close these relief valves.

Internalization Locks up Formerly Competitive Markets

Internalization simply means that waste haulers will dispose of their trucks' waste at their own landfills even if that entails driving more than an hour or, in some places like Southern California, two hours, past a competitor's or a public entity's facility to get to their own. This policy can significantly reduce flows to publicly controlled landfills. Internalization has created a situation where the public landfill sector has been increasingly starved for supply with which to amortize its debt. Most municipalities have been reluctant to finance this debt through tax increases. Furthermore, potential Superfund liabilities have dampened the enthusiasm for

Barriers to High Industry Earnings

Low Tech: The basic industry's operations are rudimentary and low tech. They do not involve skill, resource or technological barriers or the sale of luxury products or services, which can sometimes sustain premium pricing. WMI and later Republic co-founder Wayne Huizenga reflected in 1999 that "we still pick up the waste pretty much as we did in the '70's."*

No Brand Name: There is no brand name value from going national that helps sell its collection service to customers over a reputable local independent. USA Waste's Mr. Drury, former CEO of BFI, has acknowledged that "as much as big waste companies like to think they have a valuable brand name, customers buy [waste services] on price."**

No Scale Efficiencies: There are no economies of scale a consolidator can reap to justify transforming an industry from a local business into a national business, much less scale efficiencies that are great enough to offset the costs consolidation imposes and to realize the outsized profitability the equity markets demand. Efficiencies that generate greater profitability can occur when a company grows from being a small local hauler with just a few trucks to a dominant local hauler within a metropolitan region. These arise by spreading overheads, fully utilizing equipment and staff, increasing route densities and having enough activity to switch vehicles into and out of accounts as they are won and lost. But, there are no such efficiencies to be gained when moving from a metro region to a national arena, and national reach is what the waste industry consolidation is all about. "The reality of this business is that it's local," boasted Thomas Van Weelden, CEO of Allied, a company with a decentralized management structure, when he acquired second tier BFI, which operated centrally.***

*B. Brown, "Huizenda: The more things change..." *Waste News* (May 3, 1999).

**B. Brown, "USA Waste swallows the leader: No. 3 outfit snares WMI," *Waste News* (March 16, 1998).

***M. Malloy, "Allied Waste Industries: Letting Them Grow," *Waste Age* (Aug. 1998), p. 28.

public control of disposal capacity. As a result, many municipalities have sold their disposal facilities to the national firms or closed them and the consolidators successfully locked up formerly competitive markets.[9]

When one or more companies achieve control over regional markets, the price increases they contemplate can be significant. Consider the series of landfill tipping fee increases WMI imposed in the Northeast. This happened after its combination with Eastern Environmental Services was approved by the Justice Department in 1999, and WMI thought -- prematurely it turned out -- that the merger had eliminated effective competition. Although it subsequently developed that Waste's ambitions were ahead of the facts on the ground, the tipping fee increases ranged from 40% to 138% in that region, for an unweighted average of 89%.[10]

Consolidation in the Twin Cities

The Twin Cities region of Minneapolis/Saint Paul provides an illustration of consolidation's effect on competitiveness in the waste management industry. WMI, Allied Waste Industries, and Superior Services effectively control all of the significant landfill capacity currently used by the metro area. In 1999, WMI controlled 69% of the landfill capacity used by Twin Cities' haulers, Allied/BFI, 24%, and Superior, 2%.* Similarly, in the Twin Cities' region hauling market, the consolidators' 1995 19% market share increased to 48% in 1999. During the same period, independents' share of the hauling market dropped from 72% to 43% and the public sector's share remained stable at 9%.

At first glance, it would appear that the independent haulers control enough of the hauling market to challenge the power of the consolidators. In 1999, there were 137 different independent garbage-hauling companies in the metro region, but only a few were large enough to affect the competitive market. In general, a hauling company needs ten to twelve trucks in order to compete effectively with other companies for customers. With less than that number, a hauler cannot optimize the use of swing drivers, backup vehicles or a maintenance staff, and would have substantial difficulties even finding enough time when he or she is not driving or repairing one of the trucks to go out and find new customers.

In 1999, only nine of the 137 independent haulers in the metro region had ten or more trucks. Furthermore, without access to any landfill outside of the control of the consolidators, all the independents are vulnerable to price squeezes when they try to unload their trucks.

In the Twin Cities, the trend has generally followed national trends of increasing control of recyclables processing capacity by consolidators. The consolidators' market share of regional processing capacity, after declining for a number of years, reached 75% by 1999. Consolidators gained even larger shares of regional recycling processing capacity when on December 31, 2000, Ramsey County closed its Rice Street MRF. Furthermore, WMI is aggressively expanding its control over regional processing capacity. In 1999, WMI bought Super Cycle, Inc., one of the last independent recyclers in the area, and opened a new, single-stream MRF in 2001.

The single-stream MRF could be debilitating for recycling in the region. Recycling haulers delivering to a single-stream MRF collect mixed paper and commingled containers together. Generally, a single-stream MRF automatically separates the paper from the containers and then follows the same processing approach as a two-stream MRF. However, a single-stream MRF can be improperly operated to minimize costs (which also maximize residuals to over 30%) by increasing the speed of the conveyor system. If the new MRF can obtain municipal business by offering low tipping fees and the cities ignore the fact that the actual quantities recycled are plummeting, recycling rates in the region could suffer. For example, data from single stream MRFs indicates that, counting downcycled glass, residual rates average 27.2%.**

The trend of increasing consolidation in waste hauling and disposal, and recyclables processing in the Twin Cities may be eliminating avenues of escape from the consolidator's stranglehold on the industry. One bright initiative is the City of St. Paul's decision to contract with the nonprofit Eureka Recycling to manage all of the City's recycling programs. Eureka has a 12-year contract and is considering building processing capacity for the City's recyclables.

*1999 Metropolitan County Certification Annual Reports.

**Governmental Advisory Associates data base.

For more information on Eureka Recycling, contact: Dianna Kennedy, Communications Director, Eureka Recycling, 624 Selby Avenue, St. Paul, MN 55104, (651) 222-7678, email: diannak@eurekarecycling.org, www.eurekarecycling.org.

Break-up of Oligopolies

The waste consolidators seem to be approaching their long sought after goal of creating an oligopoly within their industry. However, past experience has demonstrated that oligopolies can come unraveled due to pressures both internal and external of the industry.

Internal pressures exist because individual businesses may decide to break ranks. In fact, according to game theorists, defection is the logical choice for members of a cartel to make. In an oligopoly, each business faces what is known as the "prisoner's dilemma" in trying to decide whether to continue to cooperate with the rest of the industry.[11] Imagine a situation with just two companies sharing a regional market. As long as both companies cooperate, prices remain artificially high and both companies thrive. However if one company breaks ranks and lowers prices, while the other does not, it can build market share at the expense of its competitor. If both companies lower prices simultaneously, market share should stay about the same, although profit margins may drop a bit. The worst outcome for a company arises when it maintains the collusive price structure and its competitor does not. Therefore, the logical choice for each company is to defect.

In the case of the waste consolidators, however, another force exists to counteract the prisoner's dilemma. The institutional investors and equity pool managers who have financed the waste industry combinations have acted to dethrone executives who pursued market share over profit margins. Furthermore, the large investment houses have threatened retaliation against consolidators who were suspected of lowering prices in order to gain market share. So far, the financiers have been able to avoid antitrust actions. Although the Sherman Act bars collusion among direct competitors, the investment analysts are not themselves competitors in the waste market.

Recycling's Threat to Consolidators

External threats to a cartel's ability to sustain market power arise when consumers can shift to substitutes or new technologies that meet the same need. It is sometimes thought that garbage pickup is a necessity that is immune from substitution, however increased diversion of materials from disposal through recycling and composting may undercut the waste industry's ability to exploit consumers.

Atkinson County, Georgia, Builds Its Own Small State-of-the-Art Landfill and Recycling Facility

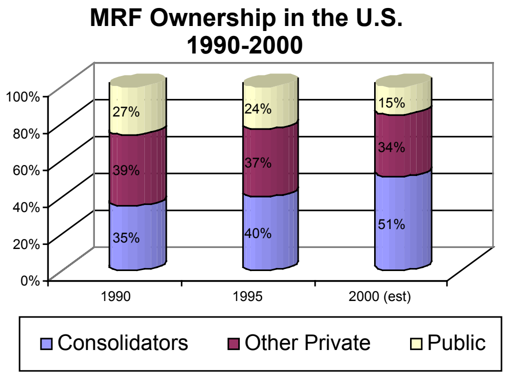
Local public ownership of landfills is one way to stabilize trash disposal costs and overt trash monopolies. This is exactly what Georgia's rural Atkinson County did (pop. 8,000). In 1991, county citizens and officials faced shrinking landfill capacity. Instead of giving in to state pressure to regionalize disposal capacity, a volunteer Citizens Committee voted to pursue a public landfill for the county and implement aggressive recycling and composting. They decided against hauling their waste (50 tons a day) to another community. Why? They would have nothing to show for their investment and contribute to another community's problems. Further, they believed that if private industry took over the landfill business, counties would be at their mercy. In choosing to have their own county landfill with recycling and composting operations, the Citizens Committee concluded that the community could retain better control of solid waste management prices and provide a long-term solution to its waste problem.

Source: E&C Consulting Engineers, *Success Stories from Rural Georgia*, (Snellville, GA: December 1994), reprinted from James Malia and Janice Morrisey, *Rural Communities and Subtitle D: Problems and Solutions* (Tennessee Valley Authority, Center for Rural Waste Management and U.S. EPA, Region IV).

Consolidators' Threat to Recycling

Once collected, materials destined for recovery need to be processed. If consolidators can wrap up recycling processing capacity through ownership of material recovery facilities (MRFs), they can retain their market power. In fact, consolidation has also been building in the U.S. market for processing recyclables. MRF industry consolidators (WMI, BFI/Allied and Casella) have increased their market share of MRFs (based on throughputs) from 35% in 1990 to 51% in 2000 (est.). During this same period the public sector's involvement declined from 27% to 15%.[12] See chart next page.

This trend toward the consolidators owning recycling processing capacity may foreclose communities' options to aggressively pursue increased waste diversion. The economic imperatives operating on the consolidators in the waste industry run in opposition to expanded recovery. For example, if communities and



businesses aggressively expand their recycling and composting programs, less than 35% of the waste stream could be left for landfill disposal. When disposal becomes such a minor fraction of the waste management pie, the leverage that currently derives from control over landfills disappears. Furthermore, one report estimated that WMI's profit margin on landfilling is ten times that for recycling.[13] Therefore, it is unreasonable to expect the large consolidated firms to aggressively pursue recycling at the expense of their investors.

Fighting Consolidation with Locally-Controlled Recycling Facilities

The safety valve against above-market disposal prices for businesses and communities then becomes public or independent ownership of MRFs. The debate about privatization of MRFs is often held solely with regard to which sector (public or private) can build and/or operate the facility in question at the lowest cost. The debate ignores the long-term impacts of turning recycling processing over to an industry that is fundamentally at odds with increased recycling goals. In fact, after briefings by waste industry officers, Morgan Stanley Dean Witter reported "[R]ecycling has long been the enemy of the solid waste industry, stealing volumes otherwise headed for landfills ..."[14] That's definitely food for thought for communities thinking about turning recycling processing capacity over to a waste management giant.

A community can escape from a waste cartel's grip by expanding its recycling and composting programs. Retaining public control over the capability to expand these waste diversion efforts, then, can be an effective strategy to divert enough of the waste stream as to lessen the bottleneck character of landfills. Without the landfill bottleneck, the consolidators cannot retain the power necessary to bar new competitors from entering the market.

Yard debris is commonly diverted from disposal in many areas of the country, but food matter is almost not at all. Furthermore, the amount of paper remaining in the waste stream implies that recovery rates could be substantially increased. However, in order to divert this material, communities or regions will need to develop appropriate processing capacity. It is in a region's interests to aggressively investigate the feasibility of expanded diversion efforts in order to protect competitiveness in solid waste management markets.

However, the current drifts to privatization of recovered materials processing may foreclose implementation of any feasibility plan to control MRFs in order to insure both competition and high recovery levels.

As detailed earlier, the economic imperatives operating on the consolidators in the waste industry run in opposition to expanded recovery. It would not be reasonable to expect a consolidator to act directly opposed to its own interests.

For that reason, if a consolidator controls a significant portion of the MRF capacity in a region, one could not expect it to facilitate the addition of such diversion programs as food scrap composting. Indeed, wet/dry systems (one strategy for diverting the organic fraction of the waste stream) are already said to be against WMI's corporate policy. Compounding this expected bias in general is the company's corporate policy concerning any recycling which is not as profitable as its waste hauling operations. As a condition of keeping recycling and not spinning it off, Steve Ragiel, Vice President of Recycling at WMI stated the company will cut back collection efforts when market conditions are unfavorable. "You'll see a renewed focus on turning the spigot off when prices go down," he said.[15]

In the Twin Cities, the cost to preserve public control over processing recyclables has an estimated capital expense of $4.9 million, with an annual debt service cost of approximately $550,000.[16] Recent history of the waste industry indicates that that amount is far lower than the overcharges that the county's residents and businesses would be subjected to were there no escape route from a monopoly power for waste services in the area.

Conclusions

Past experience strongly suggests that domination of a local market by one or two waste industry consolidators will lead to significant price increases.

Many regions of the country may currently appear competitive, when in fact competition is about to vanish. Until the endgame is completed, market power does not arise. Price increases in the waste industry is not something that builds slowly, heralding its coming arrival with an uptick or swell on the price curve. Rather, pricing behavior is something like the super-saturated solution of sugar that remains liquid until the last granule turns it solid. WMI's aborted attempt to raise tip fees in the Northeast in advance of achieving total control illustrates this fact. This characteristic of the market also means that regions at risk (such as the Twin Cities) do not have the luxury to wait-and-see what happens. After the lockdown occurs, the options to restore competition will be extremely limited and unwieldy.

Local governments often view their decision to provide MRF services in traditional privatization terms. The imminent existence of a waste monopoly in the private sector turns all those considerations on their head. The primary purpose of privatization is to realize the advantages flowing out of competition that do not always exist in the public sector. But, in those distinct market segments where competition may soon disappear, public sector facilities can protect a competitive market from monopoly or duopoly control by private companies.

Communities that decide to build, own, and operate new public sector MRF capacity are taking a step in the right direction, as are those that contract with local nonprofit organizations or local independent firms to provide such services. One consideration is whether new MRF capacity will be great enough to absorb the amount of materials the region must divert in order to maintain competitive fees at consolidators' disposal facilities.

Communities would do well to weigh this factor in developing additional processing capacity for recycling and composting. In the Twin Cities, just a six-tenths of one-percent undue increase in waste fees would exceed the estimated $550,000 carrying charges for a $4.9 million regional MRF. Communities at risk of losing competition may want to assess whether higher overcharges for waste services would dwarf the dollars associated with the cost of maintaining public or independent processing capacity.

Endnotes

[1] The march to consolidate may be temporarily halted. As a result of recent accounting scandals, Wall Street is demanding that the industry first clean up its act before it will agree to resume financing of acquisitions. After WMI's 7/6/99 $1.8 billion accounting restatement, investors pulled back and acquisitions were forced to cease for the moment.

[2] "Waste Management to Buy East Coast Hauler," *Wall Street Journal*, August 18, 1998.

[3] Bob Brown, "WMI Raises Tip Fees," *Waste News* (March 1, 1999).

[4] J. Bailey, "Slump at Hazardous-Waste Dumps Raises Concerns: As Fat Profits Fizzle, Fund for Future Monitoring May Fail to Keep Pace," *Wall Street Journal* (Aug 5 '94).

[5] B. Richards, Waste Haulers Face Charges of Nationwide Price Fixing," *Wall Street Journal* (Feb 17 '88); S. Daniels and K. Paul, "Waste giants settle in antitrust probe," *Waste News* (Feb 19 '96).

[6] A. Briloff, "Recycled Accounting: It Enhances Waste Management's Earnings," *Barrons* (Aug 6 '90); "Burying Trash in Big Holes — On the Balance Sheet," *Business Week* (May 11 '92); Gabriella Stern, "Polluted Numbers: Audit Report Shows How Far Chambers Would Go for Profits," *Wall Street Journal* (Oct 21 '92); Deutsche Morgan Grenfell, *The Solid Waste Industry* (Oct '97), at p. 11.

[7] Deutsche Morgan Grenfell, *The Solid Waste Industry* (Oct '97), at p. 11, and SECURITIES AND EXCHANGE COMMISSION v. BUNTROCK, (District Court Northern District of Illinois, Case 02C-2180) Complaint filed March 26, 2002.

[8] Phillip Lentz, "Small, New York hauler feels pinch: Mob-controlled cartels gone, but influx of national firms hurts Crown Waste," *Waste News* (Aug 3 '98).

[9] E. Lowe, "Competitors aim to trash area landfills," *The Post-Crescent* (Apr 16 '00).

[10] USDOJ Press Release, "Justice Department Settles Merger Lawsuit with Waste Management and Eastern Environmental Services (Dec 31 '98). B. Brown, "WMI raises tip fees," *Waste News* (Mar 1 '99).

[11] D. Hofstader, "Metamagical Themas: Computer Tournaments of the Prisoner's Dilemma Suggest How Cooperation Evolves," *Scientific American* (May '85), at p. 16. The prisoner's dilemma is part of the annals of game theory. It postulates two suspects accused of a crime being grilled in separate rooms by the police who do not yet have enough evidence to charge them with a crime unless one or the other confesses. Each one has to decide whether to cop a plea, knowing at the same time that if either both or just the other does so, he will go down.

[12] Personal communication, Eileen Berenyi, Government Advisory Associates, New York, New York, October 26, 2000.

[13] Mari Bari, *The Solid Waste Industry* (New York: Deutsche Morgan Grenfell, October 1, 1997), p. 79. Also see Neil Seldman and David Morris, "Who's Behind the Attack on Recycling?" *Greenpeace Quarterly* Vol. 1 No. 3 (Winter 1996), p. 20.

[14] "U.S. Investment Research," *Environmental Services* (December 10, 1997), p. 1; and "Solid-Waste Pricing Debate Intensifies," *Environmental Services* (March 2, 1998), p. 1.

[15] J. Johnson, "Waste giant sticks with recycling," *Waste News* (July 10, 2000).

[16] Resource Recycling Systems, *An Evaluation of Recycling Options for the Neighborhood Energy Center* (Jun '00), at APPENDIX B, at p. 4.

About the Authors

Peter Anderson is the President of Recycle Worlds Consulting, 4513 Vernon Blvd., #15, Madison, WI 53705-4964, (608) 231-1100.

Brenda Platt is the Director of Materials Recovery for the Institute for Local Self-Reliance.

Neil Seldman is the President of the Institute for Local Self-Reliance