



January 5, 2014

Sent via email.

Howard Levenson, Deputy Director
Materials Management and Local Assistance Division
Department of Resources Recycling and Recovery
1001 I Street
Sacramento, CA 95814

RE: PaintCare 2013 California Paint Stewardship Program Year 1 Annual Report

Dear Mr. Levenson:

PaintCare is in receipt of your letter dated December 6, 2013 regarding our 2013 California Annual Report. Attached, please find a copy of the revised Annual Report addressing information needed for CalRecycle's completeness review and including additional edits and corrections.

Below, please find additional information regarding the issues of completeness and compliance (those marked "required" and "must") in CalRecycle's December 6, 2013 letter to PaintCare.

COMPLETENESS REVIEW

CalRecycle Comment

1. The baseline is necessary for the Department to evaluate program performance. Please include the following regarding the baseline for program goals and methodology for baseline.

A statement that PaintCare will use the collection data from the second year reporting period of July 1, 2013, through June 30, 2014, as the baseline for the California Program. The baseline will be provided to CalRecycle in PaintCare's Year 2 Annual Report, due no later than September 1, 2014, regardless of the status of HHW programs contracting with PaintCare.

PaintCare Response

Please see edits to page 11 of the Revised Annual Report to satisfy this request.

CalRecycle Comment

2. The volume of architectural paint sales for latex and oil-based paint is required for the Department to accurately evaluate the recovery rates of oil-based and latex paints. Reporting paint sales data by container size is welcome, but not required. Please include the following information regarding the total volume of architectural paint sold, by type:

The total volume of architectural paint sales for latex paint;

The total volume of architectural paint sales for oil-based paint.

PaintCare Response

As noted in PaintCare previous response to CalRecycle regarding this matter, neither the regulations (Title 14, Division 7, Chapter 11, Article 2), nor the underlying statute (Chapter 420, Statutes of 2010, Huffman, AB 1343) define “type.” Thus, this information cannot be required for completeness. However, to address this lack of clarity, PaintCare specified in the Program Plan that it would report architectural paint sales by container type (see Section 11.c. of the Program Plan, top of page 38), which was approved by the Department. PaintCare has therefore provided in the Annual Report to the Department what was required for total volume of paint sales by type.

Furthermore, PaintCare does not require manufacturers to make a distinction between latex and oil-based paint when reporting their data to PaintCare, so this information is simply not available to provide.

Lastly, as discussed extensively in the Program Plan, application of a Recovery Rate (called Collection Rate in the Program Plan) is for all practical purposes, meaningless with regard to paint stewardship because, among other reasons, paint is meant and encouraged to be used up (resulting in a lower Recovery Rate) and because paint is rarely returned in the same year that is it purchased.

CalRecycle Comment

3. CalRecycle appreciates PaintCare's effort to provide estimated costs for each disposition method. Information on the cost for each disposition method is necessary to ensure program funds are effectively utilized to properly manage collected products. Staff reviewed the cost information that you provided and then calculated the percent of total program cost for each disposition method (based on the reported total expenses of \$9,314,296). Please include the percentage of total program cost for each disposition method.

As part of this, please confirm the percentages in the table below are accurate and include both the estimated costs and percent of total program cost in the revised report, as well as an explanation of the specific disposition methods that were reported as beneficial use.

Disposition Method	Derived Cost	% Total Program Cost
Fuel Incineration (oil-based paint)	\$ 539,560	5.8%
Reuse (latex and oil-based paint)	\$ 3,369	0.04%
Paint to Paint Recycling (latex paint)	\$ 2,322,066	24.9%
Beneficial Use* (latex paint)	\$ 439,017	4.7%
Landfill (latex paint)	\$ 134,684	1.4%
Total	\$ 3,438,696	37%

PaintCare Response

PaintCare confirms that the percentages derived by CalRecycle in the above table are accurate. However, after further consideration, we do not believe this data should be included in the Annual Report. As explained in detail in the last letter to CalRecycle on this issue, cost broken down by disposition is not available to PaintCare due to the format of contract pricing with our transportation and processing vendors. However, for CalRecycle's benefit, PaintCare conducted an extensive exercise that included separating cost and volume by each vendor, and then applying each vendor's specific per pound cost to their share of the total paint reported, and further separating that cost by latex paint versus oil-based paint and into each vendors latex disposition methods in order to provide gross approximates of cost for each disposition method. As PaintCare noted, this process results in an overstatement of the dollar amount spent on the lower-value disposition methods

(beneficial reuse and landfill). In addition, 7% of paint collected was not yet processed at the time of the Annual Report, yet the cost associated with it was artificially applied across the 93% of paint collected and processed. For these reasons, although we are willing to undergo this exercise and provide this information annually to CalRecycle, we have not included it in the Annual Report as it is inaccurate and misleading.

COMPLIANCE REVIEW

CalRecycle Comment

Program Outline

Per CCR §18954(a)(3)(B), the report should include the number and location of collection points, which includes "temporary events," held by PaintCare in the state during the reporting period.

PaintCare Response

Please see edits to page 6 of the Revised Annual Report and the new Appendix B to satisfy this request.

CalRecycle Comment

Program Outline

The report states that "Sites in urban areas receive pick-ups within five business days of a request, and sites in rural areas receive pick-ups within ten business days." While this may be PaintCare's expectation, it has been reported to CalRecycle that this is not always the case. The report should provide empirical information on what actually transpired, for example modifications to procedures and/or training of collection site staff done as a result of lessons learned, as well as how PaintCare intends to monitor and address issues regarding insufficient collection schedules in the future.

PaintCare Response

As to be expected with a new program as large as the California PaintCare Program, some service strains were experienced in the first year. The program started with over 300 sites and ended with more than 450 in the first reporting period. This rapid growth and the high public demand for the program required adjustments, both for the PaintCare Program, and its service providers. Service issues are continually being addressed with several approaches – public education to call ahead, site training on ordering pick-ups frequently enough to keep up with demand, implementation of automatic pick-ups for high-volume sites, and continual pressure on haulers to meet the terms of the transportation contracts. In addition, a significant number of drop-off sites were re-assigned among service providers, which resulted in significant service improvements.

CalRecycle Comment

Description of Goals and Activities Based on the Stewardship Plan

CCR §18954(a)(4)(B), requires PaintCare to provide quantitative information and discussion on the total volume of postconsumer architectural paint recovered, by type, in the state during the preceding reporting period.

Please describe the methodology used to determine the volumes reported (conversion factor, measurement methods, assumptions, etc.).

PaintCare Response

PaintCare was provided aggregate data by each service provider (transportation service providers and HHW programs with reuse or reprocessing programs) for total paint processed (and unprocessed).

For transporters, one of two methods was applied. (1) For data where the weight of paint processed was provided by recyclers to transporters, standard packaging weight assumptions were made by each transporter and removed from the total weights. Next, a conversion factor of 10 lbs per gallon was applied to weight data to obtain volume. (2) For data where actual volume was provided by recyclers to transporters, no conversions were applied and the volume data was reported as-is to PaintCare.

For HHW programs with reprocessing programs, data provided to PaintCare was the volume processed and then given out to the public. For reuse programs, data was provided as weights converted to gallons (using their own standards), or an estimate of gallons based on visual inspection.

CalRecycle Comment

Description of Goals and Activities Based on the Stewardship Plan

CCR §18954(a)(4)(B), requires PaintCare to provide quantitative information and discussion on the total volume of postconsumer architectural paint recovered, by type, in the state during the preceding reporting period.

PaintCare reported 632,652 gallons as the total volume of paint processed on Page 10, and 617,035 gallons was reported immediately following in Table 3. Please explain the discrepancy on Page 10 of the report in the total volume of paint processed. Define the term "processed," as used in the text under "B. Architectural Paint Recovered" and in Table 3.

Please explain the discrepancy in the total volumes of latex and oil-based paint in "Table 3. Paint Processed" (542,611 gallons of latex paint and 74,424 of oil-based paint) and Table 4. Summary of Paint Disposition Method by Volume and Percentage (541,449 gallons of latex paint and 77,138 gallons of oil-based paint).

PaintCare Response

The total volume of paint reported in the Executive Summary and in the narrative of Section 4B (632,652 gallons) is correct. However, the data in the table in Section 4B was not updated to reflect the final data. The correct volume of oil-based paint is 77,138 gallons. The correct volume of latex paint is 555,514 gallons. The correct total volume is 632,652 gallons. Corrections have been made to page 10 of the Revised Annual Report to address this.

Similarly, the total latex data in the table in Section 4C was not updated. Corrections have been made to page 12 of the Revised Annual Report to address this.

The term "processed" is the general term used throughout the Report to mean that in addition to being collected, the paint was managed for end-of-life treatment during the reporting period through one of the approved methods noted in the Program Plan and Annual Report. Specifically, for latex paint, it was reused, recycled back into paint, recycled into an alternative product, treated for beneficial use, or disposed of appropriately, and for oil-based paint, it was reused or treated for energy recovery.

CalRecycle Comment

Description of Goals and Activities Based on the Stewardship Plan

The various disposition methods of program products are not clearly defined in the report.

The term "beneficial use" is not adequately explained. What specific disposition methods were categorized as "beneficial use" in the report?

PaintCare Response

Revisions were made to Section 3A (bottom of page 5) and Section 4C (top of page 12) to address this.

CalRecycle Comment

Description of Goals and Activities Based on the Stewardship Plan

The various disposition methods of program products are not clearly defined in the report.

Page 12 of the report lists "Reprocessed back into paint or into another product," as a disposition category for latex paint. However, immediately following, Table 4 illustrates paint disposition where this category is absent (seemingly replaced with a "Paint to Paint" category) and a footnote explains that "the volume of paint processed into nonpoint materials is combined with the category of beneficial use." It is unclear where the volume and percentage of latex paint recycled into alternative products was reported. Please clarify the difference between reprocessing into "another product" and processing into "non-paint materials," or correct this discrepancy and use consistent terms throughout the report.

PaintCare Response

Revisions were made to Section 3A (bottom of page 5) and the text and table in Section 4C (top half of page 12) to address this.

CalRecycle Comment

Financing Mechanism

Explain the error on Page 26 of the approved plan, where the projected expenses related to transportation and processing were reversed.

PaintCare Response

This was a simple error where the transportation and processing costs were transposed when being moved from our budget worksheet into the Program Plan. The \$9,717,725 figure on the Transportation line should have been entered on the Processing line, and conversely, the \$1,865,904 figure on the Processing line should have been entered on the Transportation line.

CalRecycle Comment

Financing Mechanism

PaintCare reported the cost per gallon processed during the reporting period as \$14.72. Please provide discussion on what factors may have contributed to the high cost, and whether and how costs are projected to decrease over time.

PaintCare Response

There are many program expenses that are independent of the paint volume collected and processed (e.g. staffing, outreach and education, California's share of corporate costs).

These costs will remain fixed from year to year. As a result, as collection volumes grow in future years, while the total cost of the Program will increase, the cost per gallon will decrease.

In addition, the total expenses figure used to calculate the cost per gallon included significant pre-program expenses for the period of fiscal year 2013 prior to the Program launch (July 1, 2012 - October 18, 2012), including, personnel, communications, legal fees and CalRecycle administrative fees covering the previous fiscal year. Subsequent years of the PaintCare program will not include pre-program costs that contribute to a higher cost per gallon.

CalRecycle Comment

Financing Mechanism

PaintCare accumulated a surplus of \$9,892,568 in the reporting period, which well exceeded the targeted balance. Per CCR §18954 (a)(5)(I), please provide discussion on how surplus funding will be applied over the next reporting period to reduce program costs.

PaintCare Response

As described on page 17 of the Annual Report, at the end of the reporting period, the California program had exceeded its budgeted surplus. However, as awareness about the program grows, additional HHW programs and retail stores join the program, and collection volumes increase, the cost of the program will also increase. In time this will lead to a reduction in the growth of the surplus, and eventual use of some (or all) of the surplus to pay for expenses.

PaintCare anticipates reaching a program maturity with consistent collection levels by about the end of year four of the Program, at which time it will determine if a reduction in the assessment is warranted.

CalRecycle Comment

Financing Mechanism

CCR §18954(a)(5) requires PaintCare to provide documentation on how the collection and expenditure of assessment funds for the implementation and management of the California paint stewardship program are kept separate from other activities and the methodology for distribution of shared costs. Provide documentation that California assessment funds were used only for the California program.

PaintCare Response

PaintCare utilizes program codes within its chart of accounts to allocate revenue and expenses. The California Program has its own program code different from the other PaintCare state programs. For revenue, PaintCare's funding mechanism allows for manufacturer participants to report paint sales and the related PaintCare Recovery Fees based on the state where the paint was sold. This allows PaintCare to record and allocate the reported fees on behalf of the California Program. For expenses, each invoice paid is identifiable to a state program and allocated accordingly using the assigned program code.

When expenses are incurred that apply to PaintCare as whole (administrative expenses), they are allocated using the methodology for distribution of shared costs described in Section 5H (page 16) of the Annual Report.

The independent audited financial statements of the Program included in Appendix E of the Annual Report provided adequate documentation that California funds were used for the California Program only. In addition, please refer to the Independent Accountants' Report under the Supplemental Reports section (page 13 of the Appendix E). The third paragraph states "In our opinion, PaintCare complied, in all material respects, with the financial aspects of the Public Resources Code §48700, and Title 14, Division 7, Chapter 11, Article 2 of the California Code of Regulations during the year ended June 30, 2013."

CalRecycle Comment

Audits

Provide more detailed explanation of the various expense categories outlined in the report and the audit including "Legal fees, "Collection support," "Other program expenses," and "General and administrative,".

Discuss the services and activities that were included in the expenses of \$1,154,644 listed as "General and administrative."

Please provide a detailed statement of which expense categories are being paid in-full by the California assessment, and which expenses are being shared by PaintCare programs in other states.

PaintCare Response

Below is a description of each line items outlined in the Program audit included in Appendix E of the Annual Report.

Transportation and processing. Paint transportation costs include per-tote transportation and/or minimum stop charges. Paint processing costs are paid by the pound for paint collected (includes packaging weight), and per container for reuse programs.

Communications expenses include marketing, advertising and promotional materials to increase Program visibility through education and outreach.

Legal fees include developing and negotiating contracts for municipalities, retailers, hazardous waste service providers and other Program partners. Legal fees also include legal opinions, consultation and representation, and litigation costs.

State agency administrative fee is the fee paid to CalRecycle for Program oversight.

Collection support includes the costs of site materials and supplies such as collection bins and liners, spill kits and any miscellaneous supplies needed by drop-off to maintain safe and clean operations.

Other program expenses includes personnel costs of staff dedicated to the California program, travel, professional fees, printing, supplies, etc.

The above, in-state related expenses are all paid in full by the California Program.

General and administrative represent cost shared by all PaintCare states. It was described in Section 5H (page 16) of the Annual Report as:

"PaintCare's administrative costs (also called indirect costs) are shared by all PaintCare states. Administrative expenses are costs that do not directly benefit the California program,

but rather are indirectly beneficial to the California program. PaintCare incurs costs that benefit the organization as a whole, and each state program bears a proportionate share of those costs. The basis of this allocation is the relative population size of each participating state. California's share of the administrative expenses was 81% in the reporting period.

Elements of the administrative costs include personnel cost of corporate staff, administrative support from the American Coatings Association, auditing fees, corporate legal fees, and insurance. California's share of PaintCare's total administrative expenses in the reporting period was \$1,154,644. This represents 12% of total program cost."

CalRecycle Comment

Audits

During PaintCare's October 17th Webinar, Ms. Keane indicated that the "Legal fees" reported in the independently audited financial statements cover all corporate legal fees, including expenses related to the Lawsuit filed against CalRecycle. Please provide the specific amount that was charged for the Lawsuit. Provide a breakdown of the services and activities that accounted for the \$333,852 in expenses listed under "Legal fees."

PaintCare Response

The following table provides a breakdown of the \$333,852 reported as Legal fees.

Description	Amount
Legal services rendered from July 2012 through June 2013 related to contracts, consultations and opinions.	\$ 252,132
Legal services rendered from September 2012 through June 2013 related to CalRecycle/California regulations lawsuit.	\$ 56,694
Legal services rendered in December 2012 in connection with Public Record Requests.	\$ 25,026
Total	\$ 333,852

PaintCare questions how this detailed breakdown of legal expenses, including expenses related to the Lawsuit filed against CalRecycle, is relevant to the compliance aspect of the program.

CalRecycle Comment

Audits

Per the report, "total administrative fees charged by ACA to PaintCare were \$390,988, of this amount, \$316,518 related to the Program."

Describe the specific administrative support services provided by ACA to PaintCare that were charged to the California program.

Explain whether the consumer assessment on paint purchases in California was used by PaintCare to reimburse costs to the American Coatings Association (ACA) related to the Lawsuit filed against CalRecycle. If so, please provide the specific amount that was charged by ACA for the Lawsuit and explain where that amount was included in the Statement of Activities.

Describe the services and activities that account for ACA's administrative expenses of \$74,470 unrelated to the program that were charged to the program.

PaintCare Response

The specific administrative support services provided by ACA to PaintCare include 1) the allocation of time incurred by the following persons: Andy Doyle, PaintCare President and CEO; Alison Keane, PaintCare General Counsel and Corporate Secretary; Jeff Wasikowski, Counsel; and Nathan Perrine, PaintCare CFO, 2) the allocation of building and office expenses, and 3) the allocation of other back office support such as payroll, HR and IT services including computers and telephones.

As already discussed, California's share of the administrative expenses was 81% during this reporting period. This percentage applied to the total of \$390,988 equals \$316,518. The remaining \$74,470 unrelated to the program was allocated to the other PaintCare state programs, not to California.

Absent administrative support, which is included in the costs allocated above, there were no ACA funds expended on the lawsuit, and no reimbursement of costs was made to ACA from PaintCare in this regard.

CalRecycle Comment

Audits

Provide a statement explaining what is meant by "PaintCare owed the Program \$7,914,659 related to paint recovery fees that are being held on behalf of the Program ... " Specifically, explain why program money is "being held," where it is "being held," and when it will be reimbursed.

PaintCare Response

No PaintCare state program has its own bank account; all financial transactions generated by all state programs flow through one bank account maintained by the corporate headquarters of PaintCare. All the surpluses generated by the state programs are held in the corporate bank account. Programs that have generated surpluses, including the California Program, have a claim on the cash sitting in the corporate bank account. That claim is an asset for that state program described as Due from PaintCare Inc. As such, there are no plans for reimbursement.

CalRecycle Comment

Audits

Per PRC §48703(b), retailers, distributors, and manufacturers are required to add an assessment fee to the purchase price of paint sold in CA and the fee must be remitted to the stewardship organization. Provide more information on the allowance for bad debts of \$18,409. How was the allowance determined? Please describe the steps that are in place and taken by PaintCare to ensure complete collection of the fees assessed. At what point will PaintCare consider its collection efforts "exhausted" and drop an entity as a registered manufacturer and/or provide a list of entities and the amounts uncollected to CalRecycle thereby enabling potential enforcement actions and timely imposition of applicable penalties.

PaintCare Response

The PaintCare organization prepares its financial statements in accordance with accounting principles generally accepted in the United States of America or otherwise known as U.S. GAAP. Under GAAP, a company must evaluate its outstanding accounts receivable from

time to time and calculate an estimate of how much of the total will become uncollectible. PaintCare believes that the monthly PaintCare Recovery Fees being reported are collectible as the terms and conditions of participation in the PaintCare Program require that participants file monthly reports and the Fees are paid by the end of the following month. Here is how the allowance of \$18,409 was calculated:

CA - Accounts Receivable balance as of June 30, 2013	\$	3,562,721.00
Less: A/R portion related June 2013 fees	\$	(2,429,265.00)
Less: A/R portion related May 2013 fees	\$	<u>(1,041,408.00)</u>
CA - Accounts Receivable balance 61 days or older	\$	92,047.00
Estimate: 20% applied to the older A/R of \$92,047	\$	18,409.00

To ensure complete collection of the fees assessed, PaintCare periodically reviews the accounts receivable detailed listing and observes which is the oldest reporting period/month shown as unpaid. This information is then compared to a separate report generated from the reporting system which shows the submitted reports by month with the participants listed. If

it is observed that payment has not been received for an outstanding amount, either a phone call will be made or an email is sent to the primary contact shown in the participant's record, and payment will be requested.

PaintCare understands the complexity of many of the issues raised by CalRecycle's review of the PaintCare Annual Report and is pleased to be offered the opportunity by Director Mortensen to meet in person to discuss any outstanding issues following your review of this letter and Revised Annual Report. In the meantime, if you have any questions, please do not hesitate to contact us.

Sincerely,



Marjaneh Zarrehparvar
Executive Director

Cc: Caroll Mortensen, CalRecycle
Allyson Willsey, CalRecycle
Ty Moore, CalRecycle
Alison Keane, PaintCare
Caitlin Sanders, PaintCare
Valerie Bernardo, PaintCare