

REPORT OF
THE DEPARTMENTS OF LAW AND PUBLIC SAFETY
and
ENVIRONMENTAL PROTECTION
and
THE BOARD OF PUBLIC UTILITIES
TASK FORCE
TO STUDY SOLID WASTE REGULATION

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OF ENVIRONMENTAL PROTECTION

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News



JAMES R. ZAZZALI
ATTORNEY GENERAL

ADVISORY TO THE STATE HOUSE PRESS

September 15, 1981

Attached is a copy of a statement by Attorney General James R. Zazzali to be delivered before a public hearing of the Assembly Solid Waste Subcommittee chaired by Assemblyman Raymond Lesniak.

T.W.C.

Attachment

TODAY YOUR SUBCOMMITTEE HAS BEEN PROVIDED A REPORT OF A TASK FORCE COMPRISED OF MYSELF AND THE COMMISSIONERS OF THE BOARD OF PUBLIC UTILITIES AND THE DEPARTMENT OF ENVIRONMENTAL PROTECTION THAT CONTAINS RECOMMENDATIONS FOR REFORMING THE EXISTING SYSTEM OF SOLID WASTE REGULATION. I WOULD LIKE TO TAKE A FEW MINUTES TO PROVIDE SOME BACKGROUND FOR THE REPORT.

AS THE SUBCOMMITTEE KNOWS, FOR THE PAST THREE AND ONE-HALF YEARS, MY OFFICE HAS BEEN CONDUCTING A STATEWIDE INVESTIGATION OF ILLEGAL PRACTICES IN THE SOLID WASTE INDUSTRY. THE INDUSTRY HAD BEEN THE FOCUS OF EARLIER INVESTIGATIONS INCLUDING ONE CONDUCTED BY THE SCI IN 1969. AS A RESULT OF THAT PARTICULAR INVESTIGATION, THE SCI MADE RECOMMENDATIONS TO THE LEGISLATURE WHICH LED TO THE REGULATION OF THE SOLID WASTE INDUSTRY BY THE BOARD OF PUBLIC UTILITIES IN 1970.

DESPITE THE REGULATION OF THE INDUSTRY, THERE CONTINUED TO BE, DURING THE EARLY 1970s, ALLEGATIONS BY VARIOUS CUSTOMERS OF SOLID WASTE SERVICES AND PEOPLE IN THE INDUSTRY ITSELF OF CRIMINAL ACTIVITIES WITH RESPECT TO SOLID WASTE COLLECTION AND DISPOSAL. THUS, THE DIVISION OF CRIMINAL JUSTICE AND NEW JERSEY STATE POLICE IN COOPERATION WITH THE FBI AND THE UNITED STATES ATTORNEY'S OFFICE, BEGAN A COMPREHENSIVE INVESTIGATION OF THE SOLID WASTE INDUSTRY IN 1978.

THE FOCUS OF OUR INVESTIGATION HAS BEEN TWO-FOLD; TO INVESTIGATE AND PROSECUTE CRIMINALLY AND/OR CIVILLY UNLAWFUL PRACTICES INCLUDING ANTITRUST VIOLATIONS WITHIN THE SOLID WASTE INDUSTRY AND SECONDLY TO RE-EVALUATE THE PRESENT SYSTEM OF SOLID WASTE REGULATION WITH

A VIEW TOWARD RECOMMENDING AN ALTERNATIVE SYSTEM THAT WOULD BETTER CONFRONT POTENTIAL PROBLEMS WITHIN THE INDUSTRY.

WITH RESPECT TO THE FIRST GOAL, WE HAVE THREE PENDING INDICTMENTS AND ARE CONTINUING OUR INVESTIGATION. AS THE SUBCOMMITTEE IS AWARE, WE ARE UNDER A COURT ORDER TO REFRAIN FROM PUBLICLY DISCUSSING THE MAJOR CONSPIRACY INDICTMENT BROUGHT TO DATE AND THUS MY TESTIMONY TODAY MUST BE SEVERELY RESTRICTED.

WE HAVE ALSO MADE PROGRESS WITH RESPECT TO OUR SECOND OBJECTIVE. AS A RESULT OF OUR INVESTIGATION, WE HAVE ACQUIRED AN UNDERSTANDING OF THE SOLID WASTE INDUSTRY THAT HAS ENABLED US TO RECENTLY JOIN WITH THE BOARD OF PUBLIC UTILITIES AND THE DEPARTMENT OF ENVIRONMENTAL PROTECTION IN A TASK FORCE TO DEVELOP A REGULATORY APPROACH THAT WILL BETTER ADDRESS POTENTIAL PROBLEMS IN THE SOLID WASTE INDUSTRY THAN DOES THE PRESENT SYSTEM AND ELIMINATE WHAT ARE PERCEIVED TO BE PROBLEMS WITH THE EXISTING SCHEME OF REGULATION. I WOULD NOW LIKE TO BRIEFLY OUTLINE FOR THE COMMITTEE THOSE RECOMMENDATIONS.

1. REGULATION OF ECONOMIC AND ENVIRONMENTAL ASPECTS OF SOLID WASTE COLLECTION AND DISPOSAL BE VESTED IN THE DEPARTMENT OF ENVIRONMENTAL PROTECTION. THIS RECOMMENDATION RECOGNIZES THAT THE IMPETUS OF SOLID WASTE REGULATION IN RECENT YEARS HAS BEEN WITH THE DEPARTMENT OF ENVIRONMENTAL PROTECTION AND THAT DEP'S INCREASED INVOLVEMENT IN ECONOMIC CONCERNS OF SOLID WASTE COLLECTION AND DISPOSAL WARRANT IT BEING VESTED WITH COMPLETE JURISDICTION.

2. ECONOMIC REGULATION OF COLLECTORS BE CONVERTED FROM THE PRESENT RATE BASE, RATE OF RETURN APPROACH TO AN ALTERNATIVE SYSTEM TO BE DEVELOPED BY DEP OVER THE SOURCE OF A ONE-YEAR TRANSITION PERIOD. THIS RECOGNIZES THAT THE PRESENT SYSTEM OF RATE REGULATION REQUIRES SOLID WASTE COLLECTORS, MANY OF WHOM ARE SMALL FAMILY BUSINESSES, TO INCUR CONSIDERABLE EXPENSE IN OBTAINING APPROVAL FOR PRICE INCREASES. THIS SYSTEM WOULD ALSO ALLOW THE MONITORING OR REGULATION OF MUNICIPAL SOLID WASTE CONTRACT PRICES.

3. A THREE MEMBER BOARD COMPRISED OF REPRESENTATIVES OF DEP, BPU AND THE PUBLIC ADVOCATE BE CREATED TO PERIODICALLY REVIEW THE NEW SYSTEM OF RATE REGULATION. THIS PROVIDES A CHECKS AND BALANCES SYSTEM THAT FURTHER INSURES PROTECTION OF THE PUBLIC INTEREST IN REASONABLE PRICES FOR SOLID WASTE SERVICES.

4. THE DEPARTMENT OF LAW AND PUBLIC SAFETY BE EMPOWERED TO INVESTIGATE THE BACKGROUND OF EXISTING AND PROSPECTIVE LICENSEES TO DETERMINE WHETHER THEY SATISFY LICENSING CRITERIA RELATING TO CHARACTER AND MORAL FITNESS.

THE REPORT ALSO MAKES FURTHER RECOMMENDATIONS CONCERNING SECONDARY ISSUES BUT WHAT I HAVE ATTEMPTED TO DO BY THESE REMARKS IS HIGHLIGHT FOR THE SUBCOMMITTEE WHAT THE TASK FORCE PERCEIVES TO BE THE MAJOR CONCERNS IN THIS AREA. THANK YOU.

News

FOR IMMEDIATE RELEASE

September 15, 1981



JAMES R. ZAZZALI
ATTORNEY GENERAL

Attorney General James R. Zazzali today released a report recommending major changes in the manner in which the solid waste industry is regulated by State Government.

The report was prepared by a task force composed of representatives from the Division of Criminal Justice in the Department of Law and Public Safety, the Department of Environmental Protection and the Board of Public Utilities.

The report recommends that the regulation of the solid waste industry be vested entirely in the Department of Environmental Protection rather than being split as it now is between DEP and the Board of Public Utilities.

The report also recommends that economic regulation of collectors of solid waste be converted from the present "rate base-rate of return" approach to an alternative system to be developed by DEP during the course of a one year transition period. A three-member board composed of representatives of DEP, BPU and the Public Advocate would be created to periodically review the new regulatory system.

Finally, the report recommends that the Department of Law and Public Safety be empowered to investigate the background of solid waste collectors in order to determine the financial and moral integrity of collectors.

In releasing the report, Attorney General Zazzali said, "The purpose of this aspect of the proposed legislation would be to insure

that those who operate within this industry have the requisite integrity to render honest, efficient service in a comprehensive atmosphere."

Environmental Protection Commissioner Jerry F. English said of the report, "This proposed regulatory scheme will increase efficiency in government by eliminating the current dual regulation that exists between the BPU and the DEP. The consolidation of these two responsibilities will enable our Department to exercise greater control over New Jersey's solid waste disposal facilities, while also increasing the efficiency of protection of the environment for New Jersey residents."

George H. Barbour, President, Board of Public Utilities, said, "The philosophy of the solid waste regulation in New Jersey was built on the experiences gained since the present dual regulation system was established in 1970, and a need for realignment is now evident. Traditional utility regulation of the rates charged by garbage collection and disposal businesses -- which, unlike other utilities, are not franchized monopolies -- must make way for an alternative regulatory system more directly linked to the economic nature of the industry.

"Since the major concern of the State is that the industry be regulated in a way which brings about responsiveness to environment and health concerns in the most efficient manner, it is appropriate that both economic and environmental regulation be consolidated within the Department of Environmental Protection," Barbour said.

The report recommends that the Attorney General's Office assume the responsibility for determining whether prospective or existing licensees have the requisite character fitness since DEP does not have the wherewithal to investigate the backgrounds and associations of licensees. Zazzali indicated that, from a law enforcement point of

view, this recommendation is the most significant. Since the question of fitness is the potential Achilles heel of this industry. "However, my Department cannot discharge the function and the public interest cannot be adequately protected unless we are given the proper tools." Zazzali noted that the five tools he needed, identified by the report, are as follows:

1. The Department of Law and Public Safety be required to develop standards of prior conduct and associations for the issuance and continuance of a license.
2. Prospective and grandfathered licensees be required to complete a detailed questionnaire inquiring into said licensees' criminal records and business interests.
3. Said questionnaire be answered under oath with penalties provided for any misrepresentations or falsehood made therein.
4. The Department of Law and Public Safety be provided with broad subpoena powers with respect to the interviewing and examination under oath of licensees and their principals and employees and the production of licensees' books and records.
5. The Department of Law and Public Safety should have the burden of showing an impermissible association but upon such a showing the licensee be required to demonstrate that such associate did not influence the conduct of said licensee's business.

The report notes that the Attorney General "would not have the power to deny or revoke a license but would merely make recommendations to DEP." Zazzali stated that "this is as it should be. We should not be both prosecutor and judge in these circumstances."

A copy of the Task Force report is attached.

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INTRODUCTION

The present system of state economic regulation of the solid waste collection and disposal industry is currently being criticized for being unduly burdensome to the industry and ineffective in addressing the problems it was designed to correct. Various initiatives have been undertaken by the legislative and executive branches and representatives of the industry itself over the past two years to explore these problems and propose legislation that would reform the existing regulatory scheme.¹ This report is the result of a task force that was formed among representatives of the Board of Public Utilities, the Department of Environmental Protection and the Department of Law and Public Safety for the purpose of examining these problems and making legislative recommendations to the Governor.

I. STRUCTURE OF THE INDUSTRY

Presently, there are approximately 1282 collectors and 41 public utility disposal facilities in the State of New Jersey. Of the 1282 collection firms, over 1,000 could be described as "mom and pop" operations where a single family runs a very small firm, that is, one consisting of less than five trucks. On the other extreme, there are two publicly traded solid waste firms in New Jersey, to wit, Browning-Ferris Industries and SCA, each of which own a number of collection firms and disposal facilities within the State. Some of these subsidiaries alone have over 50 trucks. In addition, there are a number of collection firms that are closely held corporations that have in excess of 10 trucks.

Most of the solid waste disposed of in New Jersey is placed

¹See discussion of proposed legislation pp. 32-46, infra.

in sanitary landfills. Historically, many of these landfills were owned by municipalities. However, the majority have been closed leaving a small number of private landfills which for the most part are owned by individuals who also own collection companies.² It is anticipated that many landfills will be eventually replaced by resource recovery operations and bailers.³

There are three basic types of solid waste collection arrangements in the State of New Jersey, namely, municipal sanitation department collection, municipal solid waste contracts (under this arrangement, a municipality awards a contract for residential refuse collection to a single firm by competitive bid) and scavenger service (under this arrangement each residential commercial and industrial property owner is responsible for contracting to have garbage from that property collected by a private firm).

Of the 567 municipalities in New Jersey, approximately 130 are under public sanitation department arrangement, approximately 279 have their residential waste collected pursuant to municipal contracts, and 158 have their waste collected pursuant to scavenger service.⁴

²In 1967, there were 417 operating landfills in New Jersey and only 331 in 1972. County and Municipal Government Study Commission, Solid Waste, A Coordinated Approach 4, 5 (1972) (hereinafter Approach).

³See discussion concerning the future of solid waste disposal in New Jersey on pp. 24-27, infra.

⁴Approach at 8. These figures have not significantly changed since the date of the report.

Except for main street type commercial establishments, most commercial and industrial customers have their waste collected pursuant to scavenger service.

II. HISTORICAL PERSPECTIVE

The solid waste industry in New Jersey has undergone tremendous technological, financial and managerial changes over the course of the last forty years. Prior to 1940, solid waste businesses in urban and suburban north and south Jersey were exclusively small family-run operations with no more than a handful of wagons and/or trucks per firm. Landfills also tended to be small operations and, as noted, many were for the exclusive use of individual municipalities.

With respect to collection arrangements in urban and suburban areas, the majority of municipalities either did their own collection or they licensed firms to collect within their boundaries and bill individuals and businesses individually.⁵ In addition, there were some municipalities who awarded contracts for solid waste collection and these contracts tended to be tailored to favored collectors.⁶ In rural areas, most garbage collection was done by pig farmers who used the waste as fodder for their livestock.

⁵The source of this statement in addition to those made in the text accompanying notes 5-13 is an untitled report from Deputy Attorney General John J. Bergin to Attorney General David D. Furman, dated May 12, 1959, which was released to the public on May 17, 1959. Copies of this report are available in the Waste Investigation Task Force Unit of the Division of Criminal Justice.

⁶Id.

The 1940s and 1950s witnessed more sophisticated equipment, the unionization of many firms and a substantial increase in the number of municipalities awarding contracts for solid waste collection especially in the northeastern part of the State.⁷ Moreover, there was also substantial industrial development and the emergence of bedroom suburban communities and the migration of retail centers from downtown to highway malls. With the increase in the number of contracts came an increase in the number of firms. This in turn provided an incentive for the older firms to band together to keep the newcomers in their place.⁸ This solidarity was allegedly effected through the union for solid waste firms, Teamsters Local 945 and a new association formed in 1956 called the Municipal Contractors Association (MCA). Together and separately they purportedly used a variety of practices to maintain the 30 or so MCA members' stranglehold on the municipal contract market.⁹ These practices included denying dumping privileges to non-association members who bid on municipal contracts and tailoring bid specifications to incumbent collectors.¹⁰ The result of these practices were rapidly escalating prices for municipal contracts.¹¹ The non-association collectors who became known as "privates" were relegated to commercial and industrial work which itself was a rapidly growing market.¹²

⁷ Id. at 5.

⁸ Id. at 6, 7.

⁹ Id. at 8.

¹⁰ Id.

¹¹ Id. at 10-12.

¹² Id. at 14.

Complaints about these practices led to several investigations in the late 1950s. The main investigation was conducted by the Attorney General's Office which coordinated similar investigations with several New Jersey prosecutors' offices.¹³ This resulted in the return of two presentments¹⁴ and one indictment.¹⁵ The presentment concluded that the members of MCA in conjunction with Local 945 kept the small collector in its place¹⁶ by 1) denying access to the landfills which were owned by members of MCA, and 2) utilizing threats and intimidation. It was also determined that the union wage demands were used as an excuse by MCA collectors for higher contract prices. In other words, proposed wage increases rather than actual increases were offered as an excuse by collectors for boosting their contract prices to municipalities. The indictment which concerned the bid rigging of the 1956 Belleville solid waste contract was ultimately dismissed for lack of evidence.¹⁷

¹³Id. at 8.

¹⁴Bergen County Presentment, March 21, 1958; Union County Presentment, May 28, 1958.

¹⁵Indictment No. 1237-58, New Jersey v. John Serratelli, et al.

¹⁶It should be noted that the privates formed their own association at this time which was for the basic purpose of resolving disputes among themselves with respect to commercial and industrial stops. However, testimony was taken that indicated that if there was a dispute between a private and MCA member, and the private association resolved it in favor of the private, it would be appealed to Local 945 which would normally rule in favor of the municipal contractor. See Testimony of Frank Miele, Jr., January 30, 1959. See Public Hearing before Senate Committee Created Under Senate Resolution No. 4 (1958) and Reconstituted Under Senate Resolution No. 3 (1959) to Investigate the Cost of Garbage Collection and Disposal. (Hereinafter Public Hearing.)

¹⁷One of the indicted individuals was John Serratelli, business agent for Teamsters Local 945, who disappeared shortly after the indictment was handed up.

Subsequent to the Attorney General's investigation, a State Senate investigation was conducted which basically elicited the same testimony and evidence taken before the Grand Juries.¹⁸

The effect of these investigations, apart from drawing the public's attention to the solid waste industry, appear to have had no apparent impact on the industry conditions that prompted the investigation. Municipal contract prices continued to escalate. Moreover, municipal contractors would generally successfully bid the same towns leading to suspicions of some territorial or customer allocation agreements among the members of MCA. It took ten years, however, before any further investigation into the garbage industry was initiated. The focus of this investigation, conducted by the State Commission of Investigation (SCI), was on the privates in central New Jersey rather than the municipal contractors in northeastern New Jersey.¹⁹ The investigation was prompted by some truck arsons and allegations of intimidation of various collectors by organized crime individuals.²⁰ Moreover, since the 1950s investigations, there had been a proliferation of small associations of the privates, some pertaining to as small a geographic area as a municipality while others pertained to one or more counties. These associations were very open about their purpose,

¹⁸Public Hearing.

¹⁹See, generally, testimony taken in State Commission of Investigation, "In the Matter of the Investigation of Waste Disposal and the Garbage Industry in New Jersey."

²⁰Id.

namely to police members. Thus, the SCI hearings served a four-fold purpose: 1) to investigate the anti-competitive practices of these associations, 2) to allow the privates to air their complaints about the multifarious licensing requirements to which they were subjected, 3) to determine the extent, if any, of organized crime's infiltration into the solid waste industry, and 4) to determine whether landfills were still being utilized by their owners to gain a competitive advantage in solid waste collection over smaller collectors.

With respect to anti-competitive practices, it was the collectors' opinion that their customers were basically assets that provided them with the majority of their business equity.²¹ With respect to licensing requirements, the collectors complained of having to post separate bonds and pay separate licensing fees in every town they collected.²² With respect to landfills, the Commission did not elicit the dramatic testimony elicited in the earlier investigations. Finally, the hearings elicited little testimony concerning organized crime's presence in the solid waste industry.²³

As a result of the investigation, the SCI issued a report on October 7, 1969 which made the following recommendations to the 1970 legislature:

²¹See Testimony of Harry Kay, September 23, 1969.

²²See Testimony of Charles Capozzolo, September 23, 1969.

²³See Testimony of John B. Filiberto, September 23, 1969.

1) Enact legislation which will prohibit customer and territorial allocations in the garbage industry. This legislation should also prohibit price fixing arrangements and collusive bidding among waste collection contractors and make unlawful present trade association constitutions, by-laws and resolutions which prohibit or discourage one waste collector from taking a customer from another.

2) Enact legislation providing for the licensing by the State (to the exclusion of municipal licensing) of all waste collectors throughout the State. The licensing law should provide for the availability to the public of the names of the real persons of interest of each waste collection and waste disposal company.

3) Enact legislation prohibiting the discrimination either as to the availability or as to the price in the use of privately owned waste disposal areas. New Jersey State Commission of Investigations, A Report Relating to the Garbage Industry of New Jersey, (1969)

III. PRESENT REGULATORY SCHEME

A. STRUCTURE

The legislature acted upon the SCI's recommendations and in 1970 passed the Solid Waste Utility Control Act, N.J.S.A. 48:13A-1, et seq., which vested economic jurisdiction of the solid waste industry in the Public Utilities Commission, now the Board of Public Utilities (hereinafter BPU).²⁴

The system, besides providing for a uniform licensing procedure,²⁵ also regulated rates by requiring each collector and landfill to file a tariff setting forth the prices they charged to residential, commercial and industrial customers, and in the case of landfills, the solid waste collector.²⁶ These rates would be periodically adjusted

²⁴The environmental aspects of solid waste collection are controlled by the Solid Waste Management Act, N.J.S.A. 13A:1, et seq. The enforcement of this Act is the responsibility of the Department of Environmental Protection (DEP).

²⁵N.J.S.A. 48:13A-3.

²⁶Id. § 4.

through rate cases where the collector or landfill would have to establish a rate base and request a tariff increase that would provide it with an adequate rate of return.²⁷ The Act also gave the BPU the power to grant franchises although no indication is given in the statute for the circumstances which would warrant the granting of the franchise.²⁸

B. IMPLEMENTATION

The BPU in implementing the statutory scheme it was handed by the legislature was confronted with a formidable task. First of all, the industry was no small one, consisting of 2,000 separate firms generating approximately \$104 million per year in revenue. Of this \$104 million in revenues, \$49 million was spent by municipalities and some \$55 million by the private sector.²⁹ This indicates that the privates collectively had achieved equal footing with the municipal contractors at least in total dollar volume of business. Of course, the municipal contractors were considerably fewer in number relegating most mom and pop operations to the private commercial and industrial market. Secondly, the regulatory scheme described by the legislation did not necessarily follow from the SCI recommendations. Basically, as indicated above, those recommendations called for simple antitrust provisions. In response, the legislature created a complex scheme designed to promote competition through market interference, almost a contradiction in terms. Moreover, the industry, being atomistic

²⁷ Id.

²⁸ Id. § 5.

²⁹ New Jersey BPU, The Solid Waste System, 1972, page IX.

in nature, especially on the collection end, was unlike the industries the BPU was experienced in regulating, i.e., natural monopolies such as gas, electricity and water companies.³⁰

In addition, there was an inherent anomaly within the act itself. On one hand, it was intended to promote competition while at the same time it empowered the BPU to grant franchises which would eliminate competition. Finally, the Act did not specifically address the municipal contract market and whether that market would be subjected to any form of regulation beyond the licensing of solid waste collectors who would bid on such contracts.³¹

³⁰ There is substantial literature analyzing the characteristics of solid waste collection with respect to those of natural monopolies. See, generally, Stevens and Edwards, "The Provision of Municipal Sanitation Services by Private Firms: An Empirical Analysis of the Efficiency of Alternative Market Structures and Regulatory Arrangements," Journal of Industrial Economics (December, 1978); Stevens and Savas, "Cost of Residential Refuse Collection and the Effect of Service Arrangement," 1977 Municipal Yearbook; Collins and Downes, "The Effects of Size on the Provision of Public Services, The Case of Solid Waste Collection in Smaller Cities," Urban Affairs Quarterly, (March, 1977).

Natural monopolies are characterized by large initial investments and a minimal optional scale that enables them to saturate market demand in the area they service. The aforementioned studies indicate that economies of scale in the solid waste industry extend to a relatively small market size of approximately a population of 15,000 to 20,000, i.e., a small percentage of the market capable of being reached by the firm. These economies of scale pertain to an homogenous solid waste service, i.e., residential pick up. Commercial and industrial solid waste collection often calls for different types of vehicles, e.g., roll-offs versus rear-loaders.

³¹ There is, however, a provision in the Act, specifically, N.J.S.A. 48:13A- 7, which does provide the BPU with the authority to review the reasonableness of any solid waste contract. This would presumably include municipal contracts. Moreover, this provision has almost never been utilized by the BPU. The reason given by the BPU staff is lack of manpower. That the municipal contract market was left unregulated is not surprising considering the SCI's hearings orientation to the non-public residential, commercial and industrial market.

Given this complicated and somewhat contradictory regulatory scheme, the BPU seized upon that aspect of the Act with which it was most comfortable, to wit, rate regulation. All collectors and disposal facilities, once licensed, were required to file tariffs setting forth the various prices they were charging for the various classifications of service provided.³²

The BPU clearly recognized its obligation as two-fold. By requiring the filing of tariffs that were to be strictly adhered to, the BPU sought to protect the consumer from price gouging and protect the solid waste firm from predatory pricing practices by other firms. These are certainly laudable objectives and it is arguable that the BPU has basically accomplished them. Assuming that this is true, the question then becomes

- 1) whether these objectives have been achieved at the expense of other important considerations
- 2) whether there are alternative regulatory approaches that can also achieve these objectives while still accommodating those other considerations.

This report will now address the first question and further on address the second question in the section outlining regulatory proposals.

C. PROBLEMS

As stated, the practice of requiring filed tariffs that must be strictly adhered to by collectors and disposal facilities presumably

³²Some collectors filed tariffs that reflected prices higher than those being charged at the time of filing, the rationale being that said collectors would increase their prices over time to their tariff rates eliminating the need for frequent rate increase application in the first few years of regulation. This practice is referred to in the industry as the historical tariff and its existence is borne out by the failure of most collectors to apply for rate increases until 1977.

protects the consumer from price gouging and protects the solid waste firm from predatory pricing practices by other firms. However, it also impedes competition. Clearly, a collector cannot under the present system legally compete with another collector unless that second collector has a higher tariff than he does. The same holds true for disposal facilities but the problem is less pronounced. That is because disposal facilities are more akin to natural monopolies than solid waste collection firms. They are far fewer in number and tend to have a captive market based on geographical proximity to collection routes. Though in some sections of the State there are still landfills in close proximity that are in competition with one another, the prospect of fewer disposal facilities will minimize the problems created by rigid tariffs with respect to said facilities.³³

Thus, the present system of solid waste regulation had had its most dilatorious effect on the collectors and the collection end of the industry. By imposing rigid tariffs schedules on the collector, the BPU has impeded the collectors' ability to compete contrary to the concerns expressed by the SCI. Conceivably, the utilization of the tariff could be merely a tacit acknowledgement by the BPU that this is not an industry prone to competition, at least of the non-predatory nature, and that the public interest would be better served by price controls than attempts by the BPU to foster competition, a task better left to antitrust law enforcement. The question then becomes whether the tariff system imposed by the BPU

³³ See discussion concerning resource recovery facilities, pp. 24-27 infra.

has been successful in keeping solid waste collection and disposal prices reasonable.

Presumably, the tariff increases granted by the BPU are justified. Such increases are granted only after public hearings where the firm requesting the increase must present cost and revenue data sufficient to justify the increase requested.³⁴ Moreover, these public hearings are participated in by the Public Advocate in addition to the BPU and the petitioning firm.

If there is a weakness in the solid waste tariff system in insuring reasonable prices to the public, it is on the enforcement end. Manpower allotted the BPU for solid waste regulation is inadequate to monitor all 1,282 licensed solid waste collectors to determine whether tariff prices are in fact being charged. However, manpower is not the only problem. And if manpower will always be a problem because of budgetary constraints, there are other problems that are more easily solved and, if eliminated, would greatly ease enforcement.

The first is consumer awareness. There is presently no procedure for educating commercial, industrial and residential customers to the existence of tariffs and solid waste collectors' obligations under the Solid Waste Utility Control Act and the Solid Waste Management Act. This explains in part why tariff enforcement is not a problem with disposal facilities. There the customers are the collectors themselves who are fully aware of the price that must be charged by the disposal facility. Therefore,

³⁴N.J.S.A. 48:2-21.

collectors are more likely to complain to the BPU if they are being overcharged. There would be no similar conduct expected on the part of residential, commercial and industrial solid waste customers because of ignorance of their rights under the present solid waste regulatory scheme.

The second problem is the lack of uniformity in the way tariffs are designed. At the outset of regulation in 1971, each collector was allowed to file his own individual tariff which often described types of service particular to the individual collector. Moreover, the tariff often provided for many variables that made it difficult for the BPU to determine whether tariffs were actually being adhered to by that collector.

A third problem lies in the exception from the tariff system granted municipal solid waste contracts. Said contracts are controlled only by the competitive bid process which in the solid waste industry is, to a very great extent, ineffective in insuring reasonable prices. This ineffectiveness is demonstrated by the frequency with which municipalities only receive single bids for the municipal solid waste contracts that they let. Furthermore, in the opinion of the staff of the BPU municipal contract prices on a per household basis tend to be higher than residential tariffs.

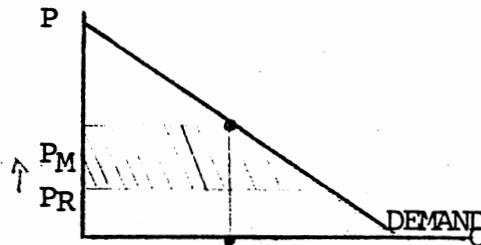
From an economic viewpoint, it is also questionable whether a rate base, rate of return approach ensures a fair price to the public. As long as the regulated price is less than the profit maximizing monopoly price, the regulated firm has an incentive to

let its rate base grow.³⁵ This can be accomplished through manipulation of books or in a more ethical manner by making bigger annual capital investments.

In addition to these problems, the present tariff system produces one other negative effect that should be noted. As stated above, the rate base, rate of return approach taken with respect to solid waste collection and disposal tariffs is identical to that taken with respect to natural monopolies, that is, extensive public hearings and examination of profitability. These characteristics produce considerable expense that is far more easily absorbed by a large publicly traded corporation than the mom and pop type operation that more typically characterizes the solid waste collector in New Jersey.³⁶

In sum, the BPU has foresaken promotion of competition in the solid waste industry for price controls. Although this may be a valid and justifiable approach to solid waste regulation, it has operated in a manner that brings into question its efficacy with respect to the goal of protecting the consumer against unreasonable prices.

³⁵ As rate base grows, the regulated price P_R is adjusted upward toward P_M , thus shrinking the savings to the public (represented by the shaded area). This incentive to let rate base rise will not be eliminated until $P_R = P_M$ at which time a higher price would cause a decrease in total revenues.



³⁶ One speculates whether the expense of regulation, a major component of which is the cost incurred by the solid waste firm in filing a rate case, at least in part explains the substantial decrease in collectors from the time regulation took effect in 1971 to the present, i.e., 2,000 to approximately 1,300.

Although price control serves as the major component of solid waste regulation, there are two other aspects of solid waste regulation, derivative of the utility approach of the BPU toward solid waste firms, that warrant discussion.

The first aspect is the approval of customer sales by the BPU. There is a practice in the solid waste industry in New Jersey³⁷ that was part of the focus of the SCI investigation of 1969, namely the sale of customer or customer routes by one collector to another. These customers are sold usually at a multiple of monthly billing. Thus, if the customer is charged \$50 a month, he might be sold at \$500 if the multiple were ten to one. In northern New Jersey, multiples tend to be in a range of 15 to 30 to one. These customer sales can be one of three types:

1. Customer sales incident to the sale of a business. Such sales accompanied by a restrictive covenant against the seller competing for said customer or in the relevant geographic area for a reasonable period of time, usually two to five years, are normally considered legal and enforced by the Courts. Such sales are legal because the seller has left the market and is no longer in competition with the buyer.
2. A sale of a portion of a solid waste collector's business, e.g., his roll-off work. These sales are also legal and for the same reason as stated in number 1.
3. Customer sales that constitute only a portion of the seller's customers and where the seller remains as a competitor of the buyer in the geographic area in which the sold customers are located. This type of customer sale is nothing more than an allocation of customers between two firms who should be in competition with one another.

³⁷In other jurisdictions, also, for example, New York City and its immediate environs.

The BPU, as a matter of course, approves all three of these types of customer sales. Its rationale is that such customer sales, even category number 3, would take place regardless of the BPU's review of same. Through requiring a formal petition by the seller, the BPU is able to monitor levels of concentration in the industry. Of course, the BPU could still require the formal petitions and deny those category 3 type sales. Conceivably, there could be a legal problem with such a denial of a sale on the basis of a constitutional argument, that is, the seller had bought the customers in the first instance and now he is being prevented from selling them, thereby amounting to an unjust taking of his property. Of course, the counter argument to that is the recognition that the initial purchase by the seller was an illegal contract and unenforceable, thereby removing any constitutional argument. These are unresolved legal issues that the BPU has chosen not to confront. Such sales tend not to involve sizeable numbers of customers. Therefore, the BPU's view that the effect on competition is negligible may be justified. However, although the direct effect of one sale of the category 3 type on competition may be marginal, the overall and indirect impact of approving many of these types of sales is probably considerable since it promotes an understanding or ethic in the solid waste industry that customers are assets and not subject to competition by other collectors. Moreover, the sale of such customers at high multiples increases the invested capital of the company presumably leading to a need for higher prices.

In summary, the sale of solid waste customers is a practice that needs further examination and must be made a part of any reform of the regulation of the solid waste industry.

Another practice in the solid waste industry that impacts on regulation is subcontracting. Subcontracting normally arises where a collector has a customer that operates chain stores usually in close proximity to one another. A customer opens up a new store in a geographic area inaccessible to the collector. If the customer is insistent on the collector servicing the new location for purposes of ease of billing, the collector will subcontract the work to another collector but bill the new location under its name rather than the subcontractor's. This would appear to be a reasonable practice with no obvious anti-competitive purposes or effects. However, sub-contracting often takes place where the foregoing justification is absent. BPU has not done an indepth examination of this phenomenon nor does it question it except in occasional instances where they are performing a broad analysis of a particular company's activities.³⁸ However, it may be advisable to consider a systematic examination of sub-contracting as part of the solid waste regulatory reforms. What form that examination might take is discussed more fully in Section VII, Proposals for Reform.

Another aspect of regulation that warrants extended discussion is franchising. As noted above, N.J.S.A. 48:13A-5 requires the BPU to designate "any municipality as a franchise area to be served by

³⁸ It would take an investigative effort beyond the resources of the BPU to examine this phenomenon on a broad scale.

one or more persons engaged in solid waste disposal . . . when it finds that the public interest requires."

Once again, a distinction is drawn between collection and disposal. Disposal franchises have virtually become de facto realities and will be discussed in the broader context of section 5 of the report dealing with solid waste master plans. However, collection franchises have never been granted and in fact, to date, only three applications for such franchises have been made to the BPU.³⁹ These applications with respect to purely economic considerations were properly denied for the following reasons.

Normally, franchises are granted in industries consisting of either 1) natural monopolies, e.g., gas, electric or water; or 2) route oriented industries where only one firm can operate, e.g., buses and the solid waste collection industry for the most part fits neither of these two categories. It is certainly not akin to a natural monopoly.⁴⁰ The solid waste industry is one which has economic characteristics of competition under a free and open market. It is not a capital intensive industry. In fact, "the advancement of

³⁹BPU docket nos. 744-253; 753-218; 814-187.

⁴⁰A natural monopoly as discussed in n. 30, supra, has a minimal optimal scale of production so large that there is room in a given market for only one or at most a very few firms realizing all production and distribution economies of scale. In other words, the long run unit cost function declines continuously out to a scale of output which saturates potential market demand. Monopolists can therefore, enjoy lower unit cost than a group of small scale competitors could. See, generally, F. Scherer, Industrial Market Structure and Economic Performance, 519 (Rand McNally and Co., 1970).

solid waste technology has notoriously lagged. Practices continue to be labor intensive"41 Despite this, certain economic arguments can be advanced such as eliminating competition in order to realize economies of contiguity (elimination of overlapping of routes) or reducing the number of firms in a given geographic area in order to realize economies of scale. The discussion will now turn to an analysis of these arguments and others.

One argument advanced is that franchising of solid waste collection firms results in economies of contiguity. There are economies that result in consolidation of routes. They have been found to be as high as 10 percent.⁴² These economies for the most part apply, however, to urban residential collection and curbside commercial collection. The volume of waste generated by shopping centers, manufacturing plants, etc. would normally warrant the overlapping of territories by collection firms.

With respect to all types of accounts, the overlapping of routes can be minimized through the encouragement of route consolidation that would eliminate gross inefficiencies that fall short of granting a collector an exclusive territory for an indefinite period of time. Such exclusivity would remove the incentive for realizing any efficiencies that the franchise could achieve. Consolidation of routes on the other hand would achieve those same

⁴¹Rimberg, Municipal Solid Waste Management, 24 (Noyes Data Corporation 1975).

⁴²Edward and Stevens, Research Paper No. 151, Relative Efficiency of Alternative Institutional Arrangements for Collecting Refuse: Collective Action versus the Free Market (Graduate School of Business, Columbia University, N.Y., N.Y. 1976).

efficiencies yet keep the collector honest by allowing another collector to solicit his customers.

Another major argument for franchising is that it protects a firm from predatory entry by another firm. Most solid waste rates reflect average per capita service cost; some customers in a market areas cost more to service, and others less. This exposes the firm to the entry of a new firm which only takes over the more profitable accounts, a practice known as cream skimming. This forces the first firm to seek a rate increase for its remaining customers. A franchise would, of course, alleviate this problem since new entrants would be precluded. Thus, the collector could continue to charge customers the same rate regardless of relative cost of service. This in turn would result in an administrative efficiency.

There are other potential solutions to the problem of cream skimming. First of all, the problem is somewhat exaggerated. Most municipalities do not vary substantially in cost of service. Other solutions will be discussed in Section VII, Proposals for Reform.

Probably the strongest argument for franchising is that such procedures can oftentimes effect economies of scale. For example, it has been determined that for urban residential collection there is up to a 41 percent increase in efficiency of scale for populations up to 40,000.⁴³ Thus, arguably, franchising for areas with a population of approximately 40,000 would result in the lowest

⁴³Id.

per capita cost. This presumes, however, that the firm has an incentive for achieving such economies. It is a well-documented economic fact that competition is more likely to produce increased productivity, efficiency and technological innovation than a monopoly situation. Moreover, many firms already serve areas of that size in New Jersey either through scavenger service or municipal contract collection. Furthermore, a large part of the State consists of municipalities whose populations are considerably smaller than 40,000. In the end, such efficiencies may be achieved through route consolidation without the need for franchising.

In short, the economic arguments for franchising of solid waste collectors are not strong ones. If franchising of solid waste collectors is to be allowed it would be for other non-economic reasons that will be discussed in a subsequent section.

IV. THE INDICTMENT

The last section has attempted to analyze the effectiveness of the regulatory scheme brought about by the Solid Waste Utility Control Act of 1970. Possibly the most interesting comment on its effectiveness was the recent indictments that were returned against some 56 individuals and corporations engaged in solid waste collection in northern and central New Jersey. The indictment, New Jersey v. New Jersey Trade Waste Association, et al., returned by a State Grand Jury on October 17, 1980, describes a business ethic among the defendants and possibly others in the solid waste industry that replaces free market forces with an anti-competitive concept known

as "property rights." Under this concept, a solid waste collector, once it services a particular commercial, industrial or residential scavenger account, becomes entitled to service that account for life. In the event that another collector solicits said account, the collector who has the property right can have, what is referred to in the indictment as a grievance against the soliciting collector before either the New Jersey Trade Waste Association or the Hudson County Association depending on the Association in which he is a member. The indictment also describes specific instances where the resolution of these grievances led to increases in prices to particular customers that possibly were not in line with the defendants' tariffs.

This case is not expected to go to trial until sometime in 1982, so it should not be used as a basis for regulatory reform. However, if it paints an accurate picture of the solid waste industry in New Jersey, the need for more effective regulation becomes ever the more obvious.

V. ENVIRONMENTAL ASPECTS OF SOLID WASTE REGULATION

Section III of this report described the major aspects of solid waste economic regulation since its inception. Over the course of the last few years, there have been other developments under the environmental solid waste statute that are having an increasing impact on the effectiveness of the existing economic regulatory scheme.

In 1975, amendments were made to the Solid Waste Management Act which provides the regulatory scheme for the environmental aspects of the solid waste industry.⁴⁴ That Act mandated that a regional planning approach be the basis for solid waste collection and disposal throughout the State.⁴⁵ The core of the 1975 amendments can be found in their directives concerning district control of solid waste flow. This control is effected through the development of district management of solid waste plans. For the purposes of development and implementation of these plans, each county plus the Hackensack Meadowlands Development District is considered a district within the meaning of the Act. The amendments set out a very detailed time schedule for the development of these plans including review and final approval by DEP. The main concern of said master plans would be the disposal of solid waste, specifically the State policy of phasing out sanitary landfills as the chief type of disposal facility in the State and replacing them with higher technology facilities. Moreover, it was anticipated that in order to accomplish this transition in the industry, each district would be able to direct the future course of solid waste disposal within its borders. In other words, if a district anticipated a shortage of disposal facilities, it could direct that the shortage be alleviated by the construction of a resource recovery facility rather than a new landfill. Moreover, where a district plan

⁴⁴N.J.S.A. 13:1E-1, et seq.

⁴⁵N.J.S.A. 13:1E-2, 4, 5, 15, 20.

called for a resource recovery or similarly high technology disposal facility, the district would be empowered to direct an adequate flow of waste to such a facility to ensure its operation.⁴⁶

Most district master plans are now in a period of implementation. This has caused certain disruptions on the collection end because collection routes are of course not always intra-county or according to waste flow directives. In some cases they have resulted in higher costs. For example, Waste Disposal has a contract with the City of Elizabeth that provides for a higher price to compensate Waste Disposal's having to utilize the Middlesex Landfill rather than the Municipal Sanitary Landfill in the Hackensack Meadowlands District.⁴⁷ Moreover, several collectors in Middlesex County have applied to the DEP for variances from the Middlesex County plan.

In anticipation of these types of diseconomies, the 1975 amendments also allow districts to analyze collection districts and transportation routes.⁴⁸ Although economic strategy is within the purview of these district plans, actual approval of such strategies is still vested in the BPU. These strategies would include franchising of either collectors or disposal facilities,⁴⁹ route consolidation,⁵⁰ and rate averaging.⁵¹ Franchising and route

⁴⁶Attorney General's Formal Opinion No. 12-80.

⁴⁷The City of Elizabeth is in Union County which has no disposal facilities within its borders. Therefore, Union County entered into an agreement with Middlesex County to have all collectors and municipalities in Union County transport their waste to Middlesex County facilities pending the development of disposal facilities within the borders of Union County.

⁴⁸N.J.S.A. 13:1E-21a(4).

⁴⁹Attorney General's Formal Opinion No. 3-1980, N.J.S.A. 48:13-5.

⁵⁰N.J.S.A. 48:13-5.

⁵¹Attorney General's Formal Opinion No. 12-80.

consolidation have been discussed previously. Rate averaging is a mechanism by which rates for the various disposal facilities within a district are equalized. The purpose is to insure that higher technology facilities have a sufficient waste stream to insure operation. Since such facilities tend to be more expensive than sanitary landfills, it is difficult to insure an adequate flow of waste to such facilities. Under such a scheme each disposal facility would have a different rate schedule as they do now pursuant to BPU rate case procedures. These individualized rate schedules would be weighed according to the anticipated waste received by each facility. Each facility would then charge the same price with the higher cost facility subsidized by the lower cost facilities.

Presently, there is one rate averaging scheme in operation.⁵² This scheme operates in the Hackensack Meadowlands District with respect to the disposal facilities located therein, namely, the Hackensack Meadowlands Bailer and two landfills. Each landfill charges its own individual tariff rate which is below the average rate. However, a collector, in addition to paying that individual tariff rate to the landfills, must also obtain a ticket from the Hackensack Meadowlands Development Commission, which equals the differential between the landfill price and the average rate, and present that ticket at the gate of the landfill. To monitor collector compliance with this procedure, the HMDC has employees stationed at the gate of each landfill.

⁵² PUC Docket No. 814-429.

Although the purpose behind rate averaging, that is, to insure an adequate flow of waste to higher technology landfills, could be accomplished through franchising,⁵³ rate averaging is far less inequitable to the customer. Under franchising, disposal costs to those ordered to higher cost facilities could be as much as 200 percent higher than those ordered to landfills.

There is a third option available to encourage the introduction of resource recovery facilities, i.e., long term contracts between the facility and municipalities. The price might be a fixed price geared to the facilities' costs thus being far more expensive than landfills in the short term but possibly less expensive in the long term if there are no landfills operating and the facility's costs have risen significantly. The price could also be simply whatever the going average rate is, although there would be no apparent advantage to the municipality in such an arrangement other than a guaranteed disposal facility for its waste.⁵⁴

Another economic consideration that comes within the planning authority of solid waste management districts is recycling. Earlier this year, the State Legislature called for a \$50,000,000 recycling program⁵⁵ that encourages source separation, resource recovery

⁵³Originally, the HMDC had petitioned the BPU for a franchise for its proposed bailer. PUC Docket No. 814-187. After a few weeks of hearings and much industry opposition, the petition was withdrawn.

⁵⁴Wheelabrator Frye is presently planning a resource recovery facility in Middlesex County and may offer municipalities this option.

⁵⁵Assembly Bill No. 2283.

and other methods of recovering some of the costs of solid waste collection and disposal. The economies of recycling are beyond the purview of this report. However, this clearly is an increasingly important factor in agency determination of reasonable solid waste collection rates and it will increase the frequency of collectors' need for access to the appropriate regulatory body for rate adjustments.

Finally, the ever increasing cost of disposal has precipitated an increase in the number of transfer stations. Transfer stations, although not final disposal facilities, must comply with the waste flow directives of district master plans. In other words, the district will advise the transfer station owner of the final disposal facilities he is to transfer waste to and the respective amounts of waste for each facility.

One would expect transfer stations to become more popular where waste flow directives force a collector to change disposal facilities thereby causing route diseconomies.⁵⁶ However, since new transfer stations now have to be compatible with district master plans, it is likely that approvals of new transfer stations will decline,

⁵⁶ In other words, the transfer station would be closer to the collector's route than the designated final disposal facility. It is also clear that the use of transfer stations causes technical deviations from waste flow directives in the case where waste from town A and town B is brought to a transfer station at the same time and is transferred to the same final disposal facility even if waste from one of the towns was designated under a waste flow directive for a different disposal facility. Presumably, in that case the transfer station would have to even the score on a subsequent load.

conceivably leading to competitive advantages to those collectors already owning such facilities.

It is clear that the 1975 amendments to the Solid Waste Management Act have brought with them an increasing involvement of DEP with economic aspects of solid waste collection and disposal. In light of the increasing complexity of the solid waste industry, these involvements will only become greater in the future. In fact, a strong contrast can be drawn between DEP's and BPU's experience in solid waste regulation over the past ten years. BPU's responsibility in this area has basically remained the same during that period of time. DEP's responsibility on the other hand has increased at least ten-fold.⁵⁷ Put simply, DEP has the impetus in the area of solid waste regulation while BPU is still attempting to adopt utility style regulation to an industry without utility characteristics.

It is also clear that it is the intention of the Legislature that solid waste collection and disposal be more strictly managed in a planned environmentally and economically sound manner. Planning is made more difficult when approval of other agencies is not within the planning agency's control. For example, a district awards a contract to a firm to build a resource recovery facility based on.

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Primarily, as a result of the 1975 amendments to the Solid Waste Management Act.

cost estimates that anticipate the facility receiving a certain price per ton. However, the price counted on by the firm is subsequently turned down by the BPU preventing the firm to abide by its contract. To avoid this problem, DEP and BPU are planning joint hearings during the proposal phase of future resource recovery facilities. Such a procedure although beneficial to solid waste planning also requires duplication of effort on the part of DEP and BPU that would be unnecessary if both planning and approval authority were in one agency.

In summary, the solid waste industry is not the same as it was in 1970 when the two major pieces of solid waste legislation became law. Despite the evolving nature of the solid waste industry, we believe two observations can be made with conviction. Those are 1) the present system of economic regulation is in need of an overall; and 2) economic regulation needs to be coordinated more smoothly with the solid waste planning process created by 1975 amendments to the Solid Waste Management Act. With that said, we now turn to an examination of the legislation that has been proposed with respect to the solid waste industry and the issues with which said legislation is concerned.

VI. PROPOSED LEGISLATION

To date, three pieces of legislation have been sponsored that concern the economic aspects of solid waste regulation.⁵⁸ The first is Senate bill 215 introduced by Senator Matthew Feldman in 1979. Said legislation solely addresses the problems previously discussed which are created by having regulation by two separate agencies. Therefore, the legislation merely transfers complete regulatory authority from one agency to another, namely BPU to DEP while keeping the present regulatory scheme in tact.

More recently, Assemblyman Lesniak has called for legislation that would require a more stringent screening process of the licensing of solid waste firms and would prevent organized crime from having ownership interests in the industry and has introduced a⁵⁹ bill requiring the BPU to analyze the reasonableness of municipal solid waste contracts, a power, as noted above, the BPU presently has but fails to exercise for lack of sufficient resources.

Recently, the New Jersey Trade Waste Association has submitted to Senator Dodd whose Agriculture and Environmental Committee has the Feldman bill under consideration, a revised version of the bill that would accomplish the following:

1. Provide for the regulation and oversight of solid waste disposal services by a single State agency namely DEP. With respect to such regulation, DEP is required to license facilities, set disposal rates and designate

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There have literally been scores of proposed bills dealing with the environmental aspects of solid waste disposal. See, e.g. Assembly Bills Nos. 1210, 1392, 1593 and 2283.

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Assembly Bill No. 2247.

franchise areas.

2. Keep economic regulation of solid waste collection services in the BPU. With respect to such regulation, the Board will, in setting future rates, no longer utilize rate base, rate of return calculations but shall within six months adopt rules and regulations for the economic regulation of the solid waste collection. Within one year the Board shall also establish minimum maximum rates in each solid waste collection area it shall designate in the State. Moreover, the legislation would eliminate the franchising of collectors and would not encourage consolidation of customers, routes and facilities of persons engaged in solid waste collection.

The foregoing proposed legislation basically presents two issues.

1. Should any form of regulatory consolidation take place? and
2. Should there be substantial changes in the form of regulation itself?

This report will now analyze these issues in light of the problems discussed in earlier sections and make recommendations for reforming the existing system of solid waste regulation in New Jersey.

VII. Proposals

Having examined the proposed legislation and having analyzed the effects regulation by both BPU and DEP have had on the solid waste industry in light of the issues and problems discussed in the foregoing section, we make the following recommendations.

1. Regulation of economic and environmental aspects of solid waste collection and disposal be vested in DEP.
2. The Department of Law and Public Safety be empowered to investigate the background of existing and prospective licensees to determine whether they satisfy licensing criteria relating to character and moral fitness.
3. The economic regulation of disposal should continue to consist of each disposal facility having to individually justify increases in rates. Franchising of disposal facilities and for rate averaging would still be permitted as integral parts of district master plans and subject to review and approval by DEP.

4. Economic regulation of collectors convert from the present rate base, rate of return approach to an alternative system to be developed by DEP over the course of a one-year transition period.

5. A three member board comprised of representative of DEP, BPU and The Public Advocate be created to periodically review the new systems of rate regulation created pursuant to recommendations 3 and 4.

6. Increased resources be made available for solid waste regulation and the option of funding these resources through a tax on disposal facilities be explored.

A. CONSOLIDATION

We do not see a strong reason for separating economic regulatory responsibility between collection and disposal as recommended by the Trade Waste Association's proposed legislation.

It is the Trade Waste Association's premise that disposal of solid waste has increasingly become the responsibility of DEP to the point where the economic regulation of such facilities should also be within its jurisdiction. We agree. However, we feel that economic regulation of collectors should also be transferred. It is clear that the operation of district master plans, presently the responsibility of DEP's, will increasingly involve that agency in matters impacting on the collector. For example, the de facto franchising of disposal facilities which takes place through waste flow directives has obvious impact on solid waste collection cost through the potential diseconomies it creates.⁶⁰ This situation presently has the potential for inter-agency conflict where the rate setting agency, in this case BPU, does not expeditiously allow the collector to pass on the costs incurred by district plan directives approved by DEP. Vesting complete

regulatory authority in DEP would not only eliminate this potential for inter-agency conflict but more importantly present an opportunity for reducing the potential for diseconomies. In other words, the DEP, through district master plans, could coordinate the consolidation of routes and otherwise examine collection routes so as to avoid diseconomies in its waste flow directives.

The future of solid waste regulation is in the implementation of district master plans. Once this is recognized it becomes clear that DEP must receive complete regulatory responsibility. The impetus is with DEP. To transfer all responsibility to BPU is inappropriate because of the several years of experience of DEP with district master plans, experience that cannot be acquired by BPU overnight. On the other hand, the years of economic regulatory experience acquired by the BPU is not so invaluable if the method of economic regulation is to be radically changed. In other words, with respect to such economic regulation, BPU and DEP would be on almost equal footing.

There are other practical advantages of consolidation in one agency, for example, economies through minimizing duplication of effort with respect to registration of collectors and disposal facilities, investigations and regulatory compliance. Moreover, the conversion of the type of economic regulation recommended by this report would be more easily effected if done by DEP rather than BPU. In other words, until the new system is in place, the the present system must continue to operate. We believe the transition would be easier if the BPU did not have to divide its energy between the two tasks.

Finally we note that the economic regulation of solid waste collection and disposal does not have to be placed in the existing Solid Waste Administration but could be a separate unit within DEP. As long as all regulation is in the same agency, we feel proper coordination can be effected.

B. LICENSING

The actual issuance and revocation of licenses for collectors and disposal facilities should be performed by DEP. Existing licensees should be grandfathered in until new licenses are issued, approximately six months after the effective date of the new legislation on solid waste regulation. With respect to the licensing process, DEP's responsibilities should include:

1. developing financial and professional criteria for the issuance of a license.
2. determining whether existing and prospective licensees meet said criteria.
3. Issuing new licenses to those firms which qualify.
4. Promulgating rules and regulations pursuant to the new legislation.
5. determining whether licensees are conducting their businesses in compliance with the legislation and all rules and regulations promulgated thereunder.
6. developing criteria for license revocation or other penalties for violation of the legislation and rules and regulations promulgated thereunder.
7. Instituting license revocation and penalty proceedings for violations of the legislation and rules and regulations promulgated thereunder.
8. Revoking licenses and/or imposing penalties where called for by the legislation, and rules and regulations promulgated thereunder.

It is recognized, however, that DEP does not have the wherewithal to investigate the backgrounds and associations of licensees. Therefore, in addition, it is recommended that the Department of Law & Public Safety assume the responsibility for determining whether prospective or existing licensees have requisite character fitness. In order for the Department of Law & Public Safety to properly perform this function, new legislation should provide for the following:

1. The Department of Law & Public Safety be required to develop standards of prior conduct and associations for the issuance and continuance of a license.
2. Prospective and grandfathered licensees be required to complete a detailed questionnaire inquiring into said licensees' criminal records and business interests.
3. Said questionnaire be answered under oath with penalties provided for any misrepresentations or falsehood made therein.
4. The Department of Law & Public Safety be provided with broad subpoena powers with respect to the interviewing and examination under oath of licensees and their principals and employees and the production of licensees' books and records.
5. The Department of Law & Public Safety should have the burden of showing an impermissible association but upon such a showing the licensee be required to demonstrate that such associate did not influence the conduct of said licensee's business.

The above provisions are meant as a minimum and the legislation should provide sufficient flexibility to the Department of Law & Public Safety to refine and expand upon them. It is anticipated that in the exercise of these responsibilities the Department of Law & Public Safety would not have the power to deny or revoke a license but would merely make recommendations to DEP concerning same.

Finally the new legislation would not contain any antitrust provisions as does the Solid Waste Utility Control Act. Rather all antitrust enforcement power would be in the Department of Law & Public Safety. However, DEP would have an affirmative

obligation to notify the Department of Law & Public Safety of any activities warranting said department's investigation.

C. REFORM OF ECONOMIC REGULATION

It would appear that there are two basic options for reforming the present system of solid waste regulation 1) deregulation and 2) some alternative form of rate regulation. This report will now focus on the reasons why it is recommended that the solid waste industry not be deregulated but rather continue under rate regulation pursuant to something other than a rate base, rate of return approach.

We are familiar with the standard arguments against government regulation. These include the following:

1. Regulation is rigid and inflexible,
2. The advantages of decentralized decision making are lost,
3. Controls are cumbersome to administer,
4. The administration of controls demands a high level of information, and
5. Regulations usually achieve only the grossest controls⁶¹.

In addition to the above arguments there are economic arguments that militate against rate regulation in this industry. Simply put, in a free market, decision making of individual firms will be based on marginal costs. This, in turn, should result in the

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E. Mills, "Economic Incentives in Air Pollution Control," Urban Economics: Readings and Analysis (Grieson Ed. 1973).

optimal allocation of productive resources because goods will be produced up to the point where the marginal costs of production equal marginal prices.⁶² Any means of regulation that directs or interferes with a firm's decision making would presumably preclude the firm from setting prices at a point where marginal cost equals marginal price thus leading to inefficiency.

Despite these managerial and economic arguments against regulation we feel that regulation is still the correct approach with respect to the solid waste industry. For example, the minimum maximum approach discussed later in this section circumvent the rigidity argument that applies to most regulatory mechanisms.

Admittedly any detailed form of regulation is cumbersome. However, it is suggested that placing the rate setting function in the regulatory agency itself is far less cumbersome than the existing system that requires each firm to bear the burden of justifying an increase in rates.

With respect to economic arguments, it must be remembered that such arguments assume a market unfettered by anticompetitive conduct. It would be unfair to attribute such conduct to the industry based on an indictment that has not come to trial. However, there are other characteristics of the solid waste industry that question the viability of competition even in an unregulated market. For example, many municipalities, school

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J. Quirk, Intermediate Microeconomics (1976).

boards and other public entities receive only one bid for solid waste contracts. Whether this is the result of conspiracy or some economic phenomenon indigenous to the industry, it still casts doubt on the effectiveness of free market forces in the solid waste industry ensuring fair prices to the public.⁶³

In short, we are not convinced that the market place is a sufficient guarantee of fair prices to the public. Reasonable prices to the consumer should be a goal of any economic system whether it be a free system or a regulated one. If in the solid waste industry this goal can only be achieved through strict regulation, so be it.⁶⁴

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We are also not persuaded that the recent deregulation of the milk and liquor industries provides arguments for deregulating the solid waste industry. Many of the problems in those industries were a result of regulation. Here regulation has been ineffective in dealing with problems that predated regulation. See Report of Division of Criminal Justice Antitrust Task Force to Study the Alcoholic Beverage Industry.

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There are a few other states that regulate or have regulated solid waste collection rates. For example, in Colorado, the solid waste industry was deregulated on July 1, 1980. While under regulation, however, solid waste collectors were subjected to a rather involved system of rate regulation. Each solid waste collector in Colorado was required to file a tariff with the Public Utilities Commission (PUC). Rather than formal public hearings, rate petitions were reviewed in an open meeting before the PUC commissioners. Normally, there was a thirty-day lag between the filing of a new tariff and its effective date. Each collector was required to perform a cost of service study before applying for an increase in rates. This requirement was sometimes relaxed with respect to mom and pop operations. The cost of service study was a time study conducted over the course of a week which measured three functions performed by the solid waste collector, to wit, loading, traveling and dumping. The time study was done in order to establish a cost figure for labor which would then be allocated among the three functions. Costs were also calculated for containers, vehicles and overhead. Deregulation was a result of lobbying by the larger firms and was opposed by mom and pop firms.

The State of Washington also regulates the rates of collectors through the use of operating ratios, specifically 93 percent, which was the ratio utilized by the ICC with respect to the trucking industry prior to that industry's deregulation.

Finally, West Virginia regulates rates through a rate base approach. Telephone interviews of Robert Cordova, Rate Analyst for the PUC of Colorado, Anthony Cook of the Utilities & Transportation Commission of Washington and Lance Oblinger of the Public Service Commission of West Virginia by Deputy Attorney General John K. Enright, September 28, 1980.

It is admitted that devising a system of rate regulation for the solid waste industry is a difficult and complex undertaking. We agree with the New Jersey Trade Waste Association's recommendation that rate base, rate of return regulation be eliminated with respect to solid waste collectors for reasons discussed below. We also agree that the rate setting mechanism not be the same for collection and disposal. For example, it is possible that the rate base approach or some comparable alternative is still appropriate for disposal facilities. Disposal facilities are becoming increasingly diversified in the make-up of their operations, and their respective costs. It will still be necessary to consider each facility separately through individual rate increase applications. Since disposal facilities are becoming more capital intensive in nature, a rate base, rate of return approach may be suitable. However, the legislation should permit DEP during the transition period to explore alternative approaches to rate setting for disposal facilities such as operating ratios. Moreover, the transition period for disposal facilities should be six months rather than a year.

With respect to rate regulation of collectors, this report does not recommend any specific alternative to the rate base, rate of return approach. We feel that the year transition period will place DEP in a better position to devise an alternative. During the year transition period, it is expected that DEP will have the option of performing cost studies of the industry, hiring economic consultants, auditing selected companies' books and records or whatever approach DEP feels will obtain the best method of

regulating collector rates.⁶⁵

It is felt, however, that the minimum-maximum approach suggested by the New Jersey Trade Waste Association has merit and should be examined closely by DEP during the transition period. In any event, the system to be developed should meet these objectives:

1. Eliminate the onerous expense to the collector imposed by the current system.
2. Eliminate the rigidity of the present system which impedes competition by requiring the collector to adhere to a single rate.
3. Bring municipal contracts for solid waste collection in line with residential tariffs and require that there be uniform bid specifications and minimum contracts of three or possibly five years.
4. Provide DEP with the authority to order a collector or collectors to service a municipality if said municipality cannot obtain a bid in line with residential tariffs.
5. Develop a program of consumer awareness of their rights under the new system with respect to service, freedom of choice of collectors and price in conformity with established rates.
6. The performance bond provision of the Solid Waste Utility Control Act should be eliminated. Moreover, efforts should be made by DEP to encourage municipalities to reduce the amount of performance bonds required with respect to solid waste municipal contracts.⁶⁶
7. Take into account the effects of recycling programs on the cost of solid waste collection.

⁶⁵In an attempt to determine the comparative efficiencies of different market structures in the solid waste industry, Columbia University faculty Barbara Stevens and Franklin Edwards did an extensive study into the costs of garbage collection in 77 cities nationwide. Based on information derived from that study, Stevens and Edwards developed an econometric model which could calculate normal prices for residential solid waste collection given certain variables for a particular municipality. See, B. Stevens, An Econometric Model of Residential Refuse Collection: Specification of the Model and Review of the Literature (Center for Government Studies, Columbia University, March 1975).

⁶⁶Presently, most municipalities require 100 percent of the contract price. This should be eliminated and replaced by a requirement of 10 or 15 percent of the contract price which should cover the differential

It is also suggested that DEP consider the possibility of bifurcating the overall rate of solid waste collection into a collection and disposal component. The reason for this is the acknowledgement that disposal rates will probably rise more frequently and more dramatically than any other solid waste component. In order to make the system more flexible, a disposal cost might be separately identified in the tariffs established by DEP.

Finally, it is acknowledged that providing flexibility to the agency in devising a new rate system rather than specifying the system in the legislation itself can result in the same problems experienced to date. Therefore, we suggest that the legislation set out in some form the seven criteria described on the preceding page so as to narrow the focus of DEP in devising a new system during the year transition period.⁶⁷

D. REVIEW BOARD

As a means of creating a system of checks and balances for the rate setting mechanism that will be developed by DEP during the year transition period it is recommended that a three member board be created comprised of a representative of DEP, BPU and the Public Advocate's office respectively.

Said review board will serve two purposes:

1. To review the rate setting system developed by DEP prior to implementation.

⁶⁷We also realize that making BPU a lame duck agency with respect to solid waste collection and disposal for a period of a year might cause administrative problems in retaining staff. Therefore, consideration should be given to transferring some of the current regulatory responsibility over to DEP during the year transition period.

2. Periodically review the effectiveness of said rate setting system.

To carry out these responsibilities, the board would be empowered to conduct public hearings and make recommendations to DEP based on its findings. DEP would be required to adopt these recommendations. The Board would be akin to the Coastal Review Board⁶⁸ although the members of the Board need not be on the Commissioner or department head level. Furthermore, the Board would only act on its own initiative and not be an appeal board for DEP administrative action.

E. SECONDARY ISSUES

There are other aspects of the current system of regulation that were discussed in earlier sections of the report that should also be addressed in new legislation. These aspects include 1) franchising, 2) sale of customers and 3) subcontracting.

With respect to franchising, we would suggest that it remain an option. As stated, Solid Waste Management Act encourages counties in the implementation of their master plans to promote the consolidation of routes, impliedly for the purpose of achieving maximum efficiencies. As stated above, route consolidation makes far greater sense with respect to residential collection than it does for commercial and industrial collection. We think that DEP should encourage the exchange or sale of stops where it promotes efficiency. Although, as discussed above, exchanges or sales of stops not incident to the sale of a business, are inherently anti-competitive, such considerations may be put aside if the result of

⁶⁸N.J.S.A. 13:19-13.

the exchange or sale is a lower price to the public. We would suggest that each county be required to do a route analysis of each collector (if financially feasible) to determine where such efficiencies can be achieved. Collectors often go far out of their way to service a particular stop. It would seem advisable to analyze the extent of this phenomenon and the inefficiencies it creates. Moreover, if particular areas of collection are assigned to specific disposal facilities pursuant to district master plans, many collectors may try to concentrate their routes so that they will only have to use one disposal facility. As stated, DEP is being besieged by collectors applying for variances for master plans which direct them to disposal facilities other than the ones they currently utilize. It may be preferable to have the collector conform to the master plan rather than vice a versa.

The route consolidation suggested above should not be confused with franchising. In the commercial and industrial solid waste collection market, there should be several collectors in the same geographic area. Route consolidations still allow for this but precludes the collector from having commercial and industrial stops widely and thinly dispersed leading to gross inefficiencies that are simply passed on to the consumer. Franchising of residential customers does make sense and should be encouraged even as a potential replacement for municipal contracts. Municipalities under strict cap requirements may very much want to wash their hands of solid waste contract collection and leave the responsibility for said collection to the individual resident.⁶⁹

⁶⁹In fact, recently one municipality, Keansburg, has attempted to convert from contract solid waste collection to having the municipality residents individually billed by solid waste collectors pursuant to tariff.

Franchising of commercial and industrial customers, even though economically unjustifiable, may have one very positive advantage. There have been allegations over the past several years that organized crime serves a function in the solid waste industry, to wit, the arbitration of disputes among collectors over customer accounts. If collectors are given franchise rights to do their accounts, a major if not the major reason for organized crime's alleged presence in the New Jersey solid waste industry would be eliminated.

If the regulatory agency were to grant franchises, it should franchise specific stops rather than large geographic areas. Of course, this would probably result in collectors charging the maximum of the range. It may also result in minimizing the alleged influence of organized crime in the solid waste industry, but in light of the lack of proven evidence of this phenomenon such considerations should await proof of such influence.

F.. RESOURCES

If there were one conclusion to draw from this report, it is that proper solid waste management requires a substantial commitment of resources. One must also conclude that the existing system of economic regulation has suffered because of inadequate resources. Clearly, there is no point in increasing the jurisdiction of a regulatory agency without also providing the wherewithal for the exercise of that jurisdiction. It is, therefore, suggested that the BPU be consulted concerning current budgetary shortcomings so as to avoid the repeat of such resource problems in the future. Moreover, it is also suggested that the option of a tax on disposal

facilities be explored for purposes of partially funding the proposals made herein. For example, the State Assembly has recently made a similar proposal with respect to recycling.⁷⁰

CONCLUSION

The solid waste industry has become increasingly complex and no one report could ever pretend to be exhaustive of the regulatory problems the industry presents. However, we believe that the foregoing presents a very solid framework upon which the legislature can draft new legislation and regulations which will more directly confront the issues raised herein and insure that New Jersey consumers pay a fair price for solid waste collection and disposal in the future.

⁷⁰Assembly Bill No. 2283.