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Dear Heather

Exchange for Change would like to take this opportunity to submit a response to the IPART draft report on the NSW container deposit scheme. Our comments are centred around the recommended changes to trading terms for first suppliers.

IPART draft recommendations

The following are the IPART draft recommendations that impact Exchange for Change:

Draft recommendations on reducing cost volatility

1. *To reduce the volatility in scheme costs, the NSW Environment Protection Authority and Exchange for Change implement an arrears invoicing model arrangement for first supplier contributions to the CDS, with payment terms of 30 days.*
2. *The NSW Government provide the security for the overdraft required to implement an arrears invoicing model arrangement for first supplier contributions to the CDS. The cost of the overdraft should be included as a scheme cost to be recovered from participants.*
3. *Exchange for Change and TOMRA Cleanaway vary their payment terms such that the Network Operator invoices the Scheme Co-ordinator two weeks in advance with payment in seven days, rather than the current four weeks in advance with payment within 10 business days. This would reduce the size of the overdraft required to implement an arrears invoicing model arrangement for first supplier contributions to the CDS, whilst ensuring TOMRA Cleanaway continues to be able to provide refunds to consumers at collection points.*
4. *That quarterly true ups to beverage suppliers for container volumes returned via kerbside recycling to the MRFs be smoothed over three months based on the volume of containers returned to the MRFs in the previous three months.*

Exchange for Change response

Exchange for Change is supportive of moving from a forecast model to an arrears model for determining First Suppliers invoices. The critical aspect to determine is which is the optimum arrears model for the scheme. Our thinking around arrears models has evolved over the last few months as we have heard from more beverage suppliers on this issue and looked at container deposit schemes

that are being introduced in other jurisdictions. We believe the following are the critical aspects that should be considered when implementing an arrears model.

- **True Up**: True up's result in pricing that consumers pay for drinks not being in-line with the final CDS costs that beverage suppliers pay. Beverage suppliers receive/incur the true up and then it becomes difficult for this amount to be passed onto consumers. True ups are caused by there being differences between the forecasted inputs to the scheme cost model and the actual inputs. The inputs that cause true ups are:

    1. Network Operator
    2. MRF operators
    3. Beverage Suppliers
    4. Exporters

  An arrears model that removes all potential causes of true ups would be optimal. Still being left with a true up for a couple of inputs reduces the benefits of an arrears model.

  If operating in a full arrears model, (invoices are only generated once all costs and volumes are known) beverage suppliers will still require EFC to provide a forecast of expected pricing for the upcoming period. This is because the beverage supplier is not going to have knowledge of collection volumes and potential supply volumes. While the forecast is only for guidance, it still maybe used as a price setting to consumers. If the forecast is wrong once again there is a difference between costs to consumers and cost to beverage suppliers.

- **Price Stability**: Scheme price volatility can lead to an increase in drink prices as beverage suppliers may need to manage the risk of an increase in costs. Having a fixed price for a quarter or longer gives all scheme participants greater confidence in the pricing of the scheme.

- **Cashflow**: Forecast invoicing leads to difficulties with cashflow as Scheme invoices have to be paid prior to income from the sale of the beverage.

- **Administrative Burden**: A reduction in the administrative burden of the scheme would be beneficial in potentially keeping prices to consumers lower. Major contributors to administrative burden are:

    1. **Changes to Supply volumes:** The ability for any beverage supplier to change supply volumes for a previous period results in every supplier's invoice to be adjusted for that period. Reconciling this is very difficult for the beverage supplier. Also these changes are time unlimited and could result in suppliers who have left the scheme being due for a refund/additional payment dating back from potentially years ago (and which could be less than $1). Every time there is an adjustment, the suppliers see it as being a fault in the system rather than a deliberate system design.

    2. **Negotiating the impact of True Ups with Customers:** The tracking of EFC true ups and potential future true ups, allocating these by customer, and then negotiating the way these are shared with customers, is a material burden on suppliers including in finance, sales teams etc

3. **Jurisdictional differences:** Beverage suppliers are asking for a common approach to CDS schemes across Australia. This includes invoicing, reporting, contract bottlers, and container eligibility.

The following table outlines three different types of arrears models and the subsequent table then details how each of these models performs against the critical aspects, detailed above, on how to improve the scheme finances.

	Description
Option 1 Full Arrears Model, no forecast price	• At the end of each financial cycle total scheme costs are divided by number of containers supplied • Suppliers report actual containers sold at the end of month • Monthly Network Operator, EPA & EFC costs are divided by monthly supplied volumes • Quarterly MRF costs are divided by quarterly supplied volumes • This model results in two smaller invoice months and one larger invoice month
Option 2 Hybrid Model	• Arrears pricing is used for Network Operator, EPA & EFC costs. Actual costs for these components divided by total containers supplied. (These costs treated the same as option 1.) • Forecast pricing with true up is used for MRF. • Financial cycle for Network Operator **costs** would be monthly and MRF quarterly (with monthly forecast)
Option 3 Revenue & Costs	• EFC would forecast a price at start of each quarter based on predicted costs. This price held constant throughout quarter unless unpredicted higher costs incurred. • At end of each month suppliers report containers supplied • Invoice generated by multiplying containers supplied by price for that quarter • No true up • If revenue does not cover cost then adjust price for following quarter, or vice a versa • Cap & collar targets need to be set for what the balance of the account should be. Staying within these band would become a KPI with EPA. • This model is similar to Queensland, South Australia & Northern Territory

	True up	*Price Stability*	*Cashflow*	*Administrative Burden*	*Comment*
Option 1 Full Arrears Model,	True up removed	No improvement and major price spike once per quarter	CDS paid after supply, significant improvement	Improved	3rd month price spike a major disadvantage of this option.
Option 2 Hybrid Model	Required for MRF, & supplier volume adjustments	No Improvement	CDS paid after supply, significant improvement	No improvement	While reducing the size of true-ups they remain
Option 3 Revenue & Costs	True up removed	Stable price	CDS paid after supply, significant improvement	Improved	Simple and in-line with other jurisdictions

Preferred Solution

Exchange for Change believes option 3, Revenue & Cost model is the preferred solution.   This is because it is the only solution that addresses all of the critical requirements.

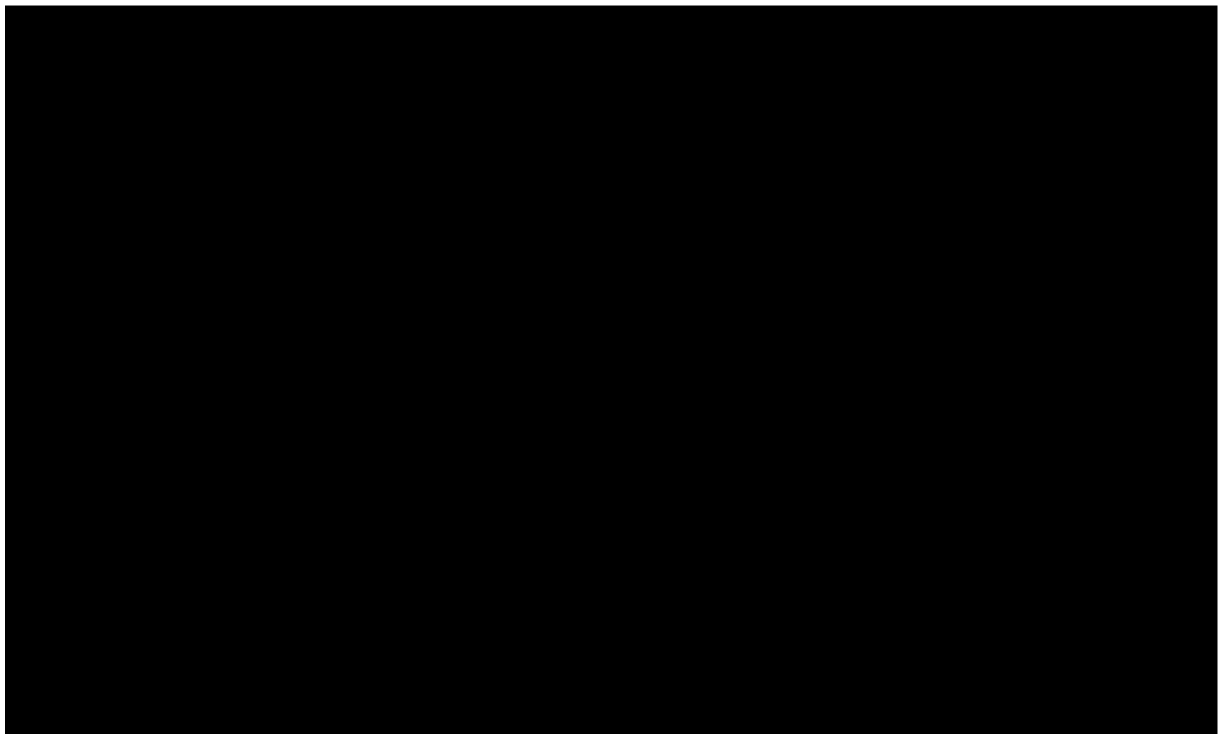
An issue with this option is that revenue will not necessary match costs at the end of each quarter, however this is addressed by price adjustments occuring in subsequent quarters to address any mismatch in revenue and costs. This approach results in beverage suppliers only incurring the true costs of the scheme over the long term without the negative impacts of a monthly or quarterly true up.

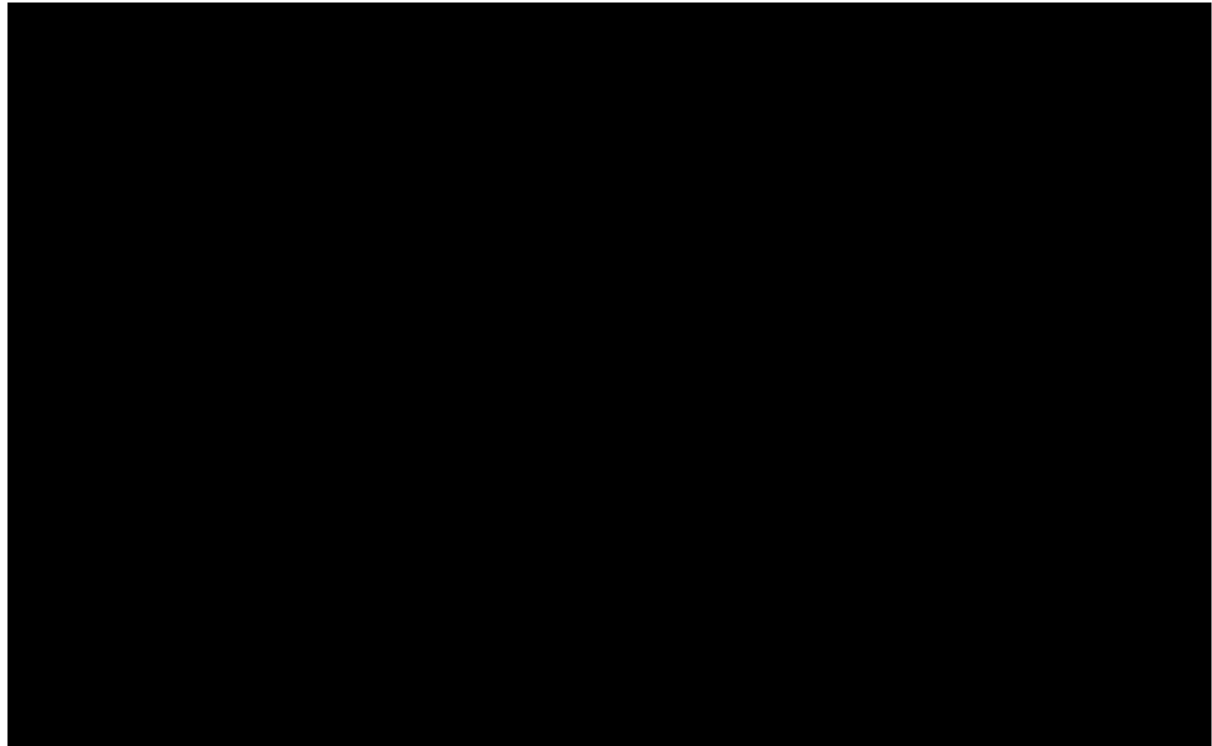
To deal with any misunderstandings related to this mismatch EFC believes this can be addressed by having a cap and collar benchmark set on the scheme account. We will be required to keep the account balance within this band and report to the EPA quarterly on our performance. Providing a high level of transparency to all stakeholders around the account balance, inflows and outflows will help to address this concern.

It is critical that all stakeholders are aware that EFC cannot profiteer from payments into the CDS as the funds are held in the Scheme Account which is held on trust for the suppliers and returned in the future including interest.

Costs & Implementation

Option 3 still has the Network Operator being paid in advance however at a reduced period, namely 7 days instead of the current 14 days. As revenue is in arrears and costs of Network Operator is prior, then an additional source of liquidity is required to keep the scheme a float. The size of the additional source of liquidity is dependent upon the trading terms of the beverage suppliers. In the financial models it has been assumed that suppliers will have 14 days to report their supplied volumes, EFC will then have 7 days to generate invoices and then we have created two models, one with 7 days payment terms (aligned to other jurisdictions) and the other with 28 days payment terms (IPART recommendation for alignment with other State trading terms).





These two models show the following additional source of liquidity required are:

- 7 days supply trading terms - $53.5 Million
- 28 days supplier trading terms - $76 Million

IPART has recommended that the NSW Government should be providing the security to enable EFC to get an overdraft for this liquidity fund. Westpac, who EFC currently utilise, has advised the following:

As discussed, indicatively we would have no issue with supporting any of the amounts below if the state was going to step in as guarantor, but it would be dependent on how that state would be open to structuring the documentation.

From our perspective we would be seeking a form of guarantee and indemnity covering unconditional indemnity for Westpac specific to the loan/facility and inclusive of fess, costs or interest. Typically we would structure this deed inclusive of a limitation on guarantors liability clause, which would specify the value of the loan/facility. Under the deed Westpac would have the right to request the guarantor make payment on demand via written notice.

Implementation Date

EFC has modelled various start dates of an arrears model to see if this had an impact on the size of the liquidity required. The modelling shows that the last month in a quarter results in the lowest cost and this is around payment dates to MRF operators. The highest month was December at $53.5 million and the lowest month was march at $49.5million. The difference between December and March is due to higher collection volumes over the summer period. **These calculations are based on a large number of assumptions and should only be used as a guide.**

Cost to the Scheme

Previous advice from Westpac that the interest rate on a secured loan would be 3.32%. (This is currently being confirmed.) Using this interest rate, a loan of $53 million, and an annual supply volume of 3.5 billion containers would result in a cost per container of 0.05 cents to fund the loan.

Payment terms, 7 days versus 28 days

IPART recommended payment terms for beverage suppliers should be moved to 28 days instead of the current 7 days. For a forecast model cashflow is major concern for a beverage supplier. The reason is as follows:

Assume supply of container is 15th of the month.

Current forecast model has invoices being issued on 1st of month and payable 7 days later. This effectively means that beverage supplier is paying for the CDS 38 days prior to supply to retailer.

For an arrears model based on the following assumptions of:

- reporting supply volume on day 15 of following month
- EFC invoice being generated 7 days later and
- Beverage supplier having 7 days trading terms with EfC

This model results in CDS being payable 44 days after supply to the Retailer.

In the opinion of EFC, moving to an arrears model addresses the cashflow issue for beverage suppliers without having to extend the payment terms from 7 days to 28 days.

Payment terms of 7 days is also in alignment with other jurisdictions CDS schemes.

As the loan facility would need to be increased to 76 million for 28 days trading terms, this would result in the cost of servicing the loan being 0.07cents per container an increase of 0.02 cents per container.

Exchange for Change thanks you for the opportunity to submit this paper and is happy to clarify any issue raised.

Yours sincerely,

P A Bruce

Peter Bruce

Chief Executive Officer