STATEMENT OF PHILIPS ELECTRONICS
DRAFT MODEL ELECTRONIC WASTE RECYCLING LEGISLATION FOR THE GREAT LAKES STATES
February 8, 2006

Philips Electronics North America is providing comments on the draft model bill for the Great Lakes. Unfortunately the draft is based on flawed assumptions and will result in making products more costly to consumers, without providing any additional benefits that can be achieved with less costly alternatives while harming existing consumer electronic companies with excellent records of environmental progress to the benefit of newer manufacturers, many of them Chinese, without any record of environmental improvements.

Background

Philips Electronics is one of the world's largest global electronics company in the world. Philips Electronics North America employs 20,000 people in the US and sells medical equipment, consumer electronics, lighting, domestic appliances and semiconductors.

Philips Electronics takes its corporate responsibility very seriously. We have a significant company-wide sustainability program in which environment is only one element. Philips has publicly reported on its yearly environmental performance since 1998. For the last two years Philips electronics has been the top company in our market sector in the Dow Jones Sustainability Index. Philips Electronics has a long-standing environmental record of accomplishment that is documented in our 2004 report, "Dedicated to Sustainability." This report was externally verified by KPMG. We have developed numerous "Green flagship" products, 21 in 2004, which are our top EcoDesigned products. Just two weeks ago an independent third party, Global 100, listed Philips as well as two of our coalition partners, Panasonic and Canon, as being in the top 100 sustainable companies in the world (www.global100.org).

Philips Electronics supports the recycling of spent products with video screens. Recycling can increase resource recovery and reduce disposal costs for local communities. We have supported a number of pilot projects and currently are providing funding for the Northwest Third Party organization projected together with other manufacturers and EPA to work on developing a strategy to have a third party organization operate the electronics recycling effort. Philips also supports the Consumer Education Initiative at www.eiae.org, the industry-wide, web-based recycling information system that helps consumers locate recycling programs for end-of-life electronic products. Any recycling program, however, must be designed to provide the lowest cost to the consumer, be easy to administer and be fair to all manufacturers. The proposed model fails in all these areas.

The Process for Developing the Model Bill Is Flawed by Failing to Provide Any Rationale for the Proposed Model

While we appreciate the opportunity that you have provided to offer comments, the drafters have issued proposals without any explanation for the choices that they have made or how they have responded to the earlier round of comments. This means we are reduced to repeating comments already made without knowing the drafters' views on the comments. While we understand the goal of the drafters to develop a model in time for this year's legislatures, the failure of the drafters to publish their assessment of the comments received to date reduces the value of the comment process. We would urge the drafters to respond to comments before issuing a final draft to promote the development of a workable model.

Incorporation of Previous Comments

Philips Electronics submitted comments on the original proposal to the drafters by email on November 16, 2005. Those comments specifically addressed the manufacturer fee option then being considered both by NERC and the Great Lakes. These comments were not included in the list of comments received because the comments "…didn't directly address the model and options we were presenting for discussion…" (Cynthia Moore email on February 2, 2006). Philips Electronics respectfully disagrees. The comments were based on the exact same manufacturer fee concept being considered as one of the options by the Great Lakes task force that was being considered by NERC.

Philips Electronics is incorporating those comments into these comments and expects that both sets of comments will be in the public record.

Philips Electronics Supports An ARF or First Sale Approach

Philips Electronics is a member of the Electronics Manufacturers Coalition for Responsible Recycling. Our Coalition supports either the Advance Recycling Fee approach being successfully implemented in California in 2005 and either currently being implemented or about to be implemented in France, Spain, Belgium and the Netherlands. We also can support the fee on first sale in state being implemented in two Canadian Provinces.

Either of these mechanisms provide consistent and adequate source of funds to local governments and recyclers for recycling end of life electronics in most cost-effective manner possible while maintaining level playing field in market. We support the comments submitted by the EMCRR.

We do not understand why the Great Lakes Task Force did not propose one of these existing models.

Philips Electronics wants to amplify on three issues raised by the proposed model: 1. The proposed model is not necessary to encourage environmental design improvements, 2.

Philips Electronics does not know its sales in any particular state, and 3. The proposed model does not establish an economically viable system.

The Proposed Model Is not needed to Encourage Environmental Design Improvements

The preamble to the draft bill says a purpose of the bill is to encourage designs that use less toxic materials and are more recyclable. Presumably then, one of the underlying bases of the draft model is that a manufacturer fee is necessary to require producers to internalize these costs and give them a market incentive to design products that are durable, less toxic and more recyclable. If this statement were true, then there would have been no environmental improvement in products because there would have been no incentive without such a fee. This statement, as demonstrated by the record of Philips Electronics, is demonstrably false. Philips has had an extensive record of environmental performance starting long before anyone even started talking about manufacturer fees. That is because at Philips Electronics has for a long-time been a cornerstone of our corporate strategy because we believe sustainability offers competitive opportunities in the market place. Philips televisions are significantly more energy efficient and use far fewer toxic materials than televisions manufactured a decade ago. In fact we are aware of no evidence that shows that such a fee is necessary to achieve the goals the drafters' have laid out in the preamble.

While we are quite proud of our accomplishments, we acknowledge that many of our historic competitors have similar interests in environmental improvement.

The notion that a manufacturer fee is necessary or even useful to improve design is simply not supported by the facts.

Finally, for the reasons discussed below, such an additional cost on manufacturers that have higher cost structures in part because of their environmental design efforts, that cannot be recovered through the marketplace, will increase the competitive disadvantage these companies, like Philips, face with new Chinese manufacturers who are not making environmental design improvement efforts. Ironically, such a fee, therefore, acts to weaken the very manufacturers who are leaders in the environmental design that the preamble says is a goal at the expense of Chinese manufacturers who are not making such efforts. Rather than provide an incentive for environmental design this approach actually will reduce environmental design efforts.

Philips Electronics Does Not Know Its Sales in Any Particular State and Cannot Report Such Sales to the State As Required by the Draft.

Section 6 of the bill requires manufacturers to report on their sales in the state on a quarterly basis. Manufacturers do not, however, sell products in any state. Manufacturers mostly sell products to national retailers and distributors. Once a sale is made to a retailer or distributor, the manufacturer has no control over the distribution of the product. The manufacturer does not know to what state the product is sent and when a sale is actually made.

There are two options for addressing this problem. The first is to do what the last NERC draft proposed to require retailers, who have the data, to report quarterly sales. The Great Lakes draft fails to provide for such reporting. The other option is for manufacturer fees to be based on national sales data prorated based on the population of a particular state. This will estimate total current sales (commercial and consumer) for the largest manufacturers, but currently this national sales data does not include smaller manufacturers who make up an estimated 20-30% of covered electronic product sales. This methodology also fails to create any opportunity for manufacturers to recover costs. This estimated volume will result in inequitable fee collection and pricing for products.

Philips believes that the requirement in section 6 does not reflect economic reality.

<u>The Proposed Draft Establishes an Economic System that is not viable</u>

While there appears to be recognition that costs should be passed along to final consumers, other than the ARF or a first sale fee, there is no mechanism proposed to date for manufacturers to recover these costs. Since manufacturers sell products in a national market, manufacturers would not be able to pass on the cost of the fee in the price of the product sold in any particular state. Again, because the drafters have not provided any rationale for the draft proposal we have no idea whether the drafters dispute this claim or simply do not care about its implications.

The question arises, then, why don't the manufacturers just absorb the costs of this fee as a cost of doing business?

The Merrill Lynch analysis of the third quarter results of Philips Electronics (provided in our earlier comments and incorporated by reference into these comments) show that the margin (revenues minus costs) for our consumer electronics division is only 1%, far below the margins for our four other businesses and well below any reasonable industry standard. This narrow margin shows the sharp competition in the industry. The report goes on to assess a value for each of the five major businesses of Philips Electronics including the Consumer Electronics division. The Merrill Lynch analysis reached the following conclusion:

"We continue to believe that substantial value creation will be very difficult as the industry characteristics remain tough. **Consequently we don't ascribe any value to the mainstream consumer electronics business**."

So an independent third party financial analysis of our business assessed the business as valueless. Our earlier comments provide numerous other stories showing that Philips is hardly unique among electronics manufacturers.

More recently, a story from the January 3rd edition of *Business Week Online*, discussing the sharp decline in television prices contains the following statement:

"What's behind the steep drop in prices? Strong consumer demand for low-end plasmas and LCDs give the decline health momentum, and aggressive pricing by Chinese and Taiwanese manufacturers only go further in shredding margins and creating a ruthlessly competitive environment for TV manufacturer. "I don't think anybody is making any money other than the retailers, really" says (Riddhi) Patel (analyst with ISuppli)."

If manufacturers could simply add the cost of the fee into the price, why would manufacturers currently be selling products with such low margins? We simply do not understand what economic data the task force would use to come to a different conclusion.

It is simply indisputable that a system that requires manufacturers to pay a fee recycling of the product that they sell cannot recover in the price of the product is not economically viable. And ironically, as described above, by adding costs that are not recoverable, the task force provides an economic advantage to lower cost Chinese manufacturers who sell only on low price and do not invest in the environmental design improvements the model draft preamble says its wants to encourage.

<u>Assuming a Manufacturer Fee Could Be Recovered it would Result in Higher Costs for the Consumer than would an ARF</u>

Even if you believe that manufacturers could recover the cost of the fee in the price of the product, the nature of the distribution system guarantees that such a system would result in higher costs for Great Lakes consumers than would under an ARF. Under the manufacturer fee scenario the costs would be reflected in the price of the product that the manufacturer sells. But as the product moves through the distribution chain, each participant in the chain marks up the product for its profit based on the higher price. So at each subsequent step in the distribution chain, markups are increasing based on the higher initial price and then the higher markup. The more steps in the distribution chain the greater the markup. And then the state imposes a sales tax on the now higher cost end product increasing the cost of the product to the purchaser.

Let us demonstrate this problem that the task force appears to have ignored. While the task force could adjust either the price or the margin, the example demonstrates that under any scenario the proposed model results in higher consumer costs.

ARF Approach

Manufacturer sells product to retailer or distributor at $1,000.
Inventory Markup (Costs of holding product in inventory) of 20% -- Price $1,200
Retailer or distributor takes 50% markup ($600) resulting in sale price of $1,800.
Sales tax of 5% added to final cost (lowest of the six participating states) $90.
ARF of $10 added to final price (Fee proposed in model bill).

Total Price = $1,900.

Manufacturer Fee Approach

Manufacturer sells product to retailer or distributor at $1,010. (Sales price plus fee).
Inventory markup of 20% ($202) – Price $1,212
Retailer or distributor takes 50% ($606) markup resulting in sales price of $1,818.
Sales tax of 5% added to final cost (lowest of the six participating states) $90.9.

Total Sales Price $1908.9.

This assumes that there is only an inventory markup and one markup in the distribution chain. If there is more than one markup the price differential increases because the markup now includes the higher price because of the inclusion of the fee. But using virtually any set of assumptions a manufacturer fee will result in a higher cost to consumers because of the markups and the sales tax. Philips believes that it is clear that the consumer would pay a higher price for recycling than under an ARF or first sale system.

The least costly system to the consumer will be one where the consumer pays the cost either at the point of sale or point of disposal where there are no distribution system markups and no additional third parties.