

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 28, 1996

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 0-19621

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

MINNESOTA

41-1454591

(I.R.S. Employer
Identification No.)

(State or other jurisdiction of
incorporation or organization)
7400 Excelsior Blvd.

Minneapolis, Minnesota 55426-4517
(Address of principal executive offices)

(612) 930-9000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

YES NO

As of November 12, 1996, the number of shares outstanding of the registrant's no par value common stock was 4,546,917 shares.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

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<TABLE>
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Appliance Recycling Centers of America, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 28, 1996	December 30, 1995

ASSETS		
Current Assets		
<S>	<C>	<C>
Cash and cash equivalents	\$ 206,000	\$ 4,605,000
Accounts receivable	1,596,000	1,382,000
Inventories	808,000	426,000
Other current assets	293,000	325,000
Income taxes receivable	4,000	106,000
Deferred tax assets	248,000	277,000

Total current assets	\$ 3,155,000	\$ 7,121,000

Property and Equipment, at cost		
Land	\$ 2,103,000	\$ 2,101,000
Buildings and improvements	4,564,000	3,677,000
Equipment	6,155,000	6,483,000

	\$ 12,822,000	\$ 12,261,000
Less accumulated depreciation	4,517,000	3,973,000

Net property and equipment	\$ 8,305,000	\$ 8,288,000
Other Assets	562,000	108,000
Deferred Tax Assets	373,000	373,000

Total assets	\$12,395,000	\$ 15,890,000
=====		
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Note payable to bank	\$ 1,169,000	\$ -
Current maturities of long-term obligations	243,000	1,041,000
Accounts payable	1,437,000	1,536,000
Accrued expenses	649,000	1,041,000

Total current liabilities	\$ 3,498,000	\$ 3,618,000
Long-Term Obligations, less current maturities	1,758,000	2,084,000

Total liabilities	\$ 5,256,000	\$ 5,702,000

Shareholders' Equity		
Common Stock, no par value; authorized 20,000,000 shares; issued and outstanding 4,547,000 as of September 28, 1996 and 4,227,000 as of December 30, 1995	\$ 10,350,000	\$ 9,177,000
Retained earnings (deficit)	(3,211,000)	1,032,000
Foreign currency translation adjustment	-	(21,000)

Total shareholders' equity	\$ 7,139,000	\$ 10,188,000

Total liabilities and shareholders' equity	\$ 12,395,000	\$ 15,890,000
=====		

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See Notes to Consolidated Financial Statements.

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Appliance Recycling Centers of America, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

Months Ended	Three Months Ended		Nine	
	September 28, September 30,	September 30,	September 28,	
	1996	1995	1996	
1995				

<S>	<C>	<C>	<C>	
<C>				
Revenues				
Recycling revenues	\$ 1,834,000	\$ 3,496,000	\$ 5,000,000	\$
9,293,000				
Appliance sales	1,666,000	510,000	3,851,000	
1,288,000				

Byproduct revenues 1,639,000	701,000	534,000	1,682,000	

Net revenues 12,220,000	\$ 4,201,000	\$ 4,540,000	\$ 10,533,000	\$
Cost of Revenues 7,757,000	2,772,000	2,873,000	8,314,000	

Gross profit \$ 4,463,000	\$ 1,429,000	\$ 1,667,000	\$ 2,219,000	
Selling, General and Administrative Expenses 4,291,000	2,130,000	1,537,000	6,385,000	

Operating income (loss) 172,000	\$ (701,000)	\$ 130,000	\$ (4,166,000)	\$
Other Income (Expense):				
Other income 44,000	21,000	7,000	92,000	
Interest income 160,000	2,000	53,000	34,000	
Interest expense (198,000)	(67,000)	(60,000)	(203,000)	

Income (loss) before provision for income taxes 178,000	\$ (745,000)	\$ 130,000	\$ (4,243,000)	\$
Provision for (Benefit of) Income Taxes 74,000	--	49,000	--	

Net income (loss) \$ 104,000	\$ (745,000)	\$ 81,000	\$ (4,243,000)	
=====				
Net Earnings (Loss) per Common and Common Equivalent Share \$ 0.02	\$ (0.16)	\$ 0.02	\$ (0.96)	
=====				
Weighted Average Number of Common and Common Equivalent Shares 4,257,000	4,547,000	4,282,000	4,425,000	
=====				

</TABLE>

See Notes to Consolidated Financial Statements

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Appliance Recycling Centers of America, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended	
	September 28, 1996	September 30, 1995
	<C>	<C>
Cash Flows from Operating Activities		
Net income (loss)	\$ (4,243,000)	\$ 104,000
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,148,000	1,133,000
Common Stock issued for services	30,000	-
(Gain) loss on sale of equipment	(76,000)	32,000
Deferred income taxes	29,000	(27,000)
Change in assets and liabilities, net of effects from acquisition of Universal Appliance Company, Inc. and Universal Appliance Recycling, Inc.:		
(Increase) decrease in:		
Receivables	41,000	1,934,000
Inventories	(327,000)	(67,000)
Other current assets	41,000	(47,000)
Income taxes receivable	106,000	(71,000)
(Increase) decrease in:		
Accounts payable	(270,000)	255,000
Accrued expenses	(424,000)	(482,000)

Income taxes payable	(28,000)	(429,000)
Net cash provided by (used in) operating activities	\$ (3,973,000)	\$ 2,335,000
Cash Flows from Investing Activities		
Purchase of equipment	\$ (1,226,000)	\$ (1,273,000)
Cash acquired for acquisition of Universal Appliance Company, Inc. and Universal Appliance Recycling, Inc.	26,000	-
Payments for noncompete agreements	(110,000)	-
Proceeds from disposal of equipment	272,000	151,000
Net cash provided by (used in) investing activities	\$ (1,038,000)	\$ (1,122,000)
Cash Flows from Financing Activities		
Increase (decrease) in note payable to bank	\$ 1,169,000	-
Payments on long-term obligations	(1,332,000)	(591,000)
Proceeds from long-term debt borrowing	-	712,000
Proceeds from placement of Common Stock	700,000	-
Proceeds and tax benefit from stock options	54,000	180,000
Net cash provided by (used in) financing activities	\$ 591,000	\$ 301,000
Effect of foreign currency exchange rate changes on cash and cash equivalents	\$ 21,000	\$ 21,000
Increase (decrease) in cash and cash equivalents	\$ (4,399,000)	\$ 1,535,000
Cash and Cash Equivalents		
Beginning	4,605,000	2,860,000
Ending	\$ 206,000	\$ 4,395,000

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Appliance Recycling Centers of America, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS - continued
(Unaudited)

	Nine Months Ended	
	September 28,	September 30,
	1996	1995
<S>		
<C>		
<C>		
Supplemental Disclosures of Cash Flow Information		
Cash payments (receipts) for:		
Interest	\$ 202,000	\$ 208,000
Income taxes net of refunds	\$ (103,000)	\$ 480,000
Supplemental Schedule of Noncash Investing and Financing Activities		
Long-term obligations incurred on purchase of equipment	-	\$ 712,000
Acquisition of Universal Appliance Company, Inc. and Universal Appliance Recycling, Inc.		
Working capital acquired, including cash and cash equivalents of \$26,000	\$ 118,000	-
Fair value of other assets acquired, principally property and equipment and a noncompete agreement	176,000	-
Value assigned to Goodwill	302,000	-
Long-term debt assumed	(207,000)	-
Total consideration, 84,000 shares of Common Stock	\$ 389,000	-

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See Notes to Consolidated Financial Statements.

Appliance Recycling Centers of America, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- Financial Statements - In the opinion of management of the Company, the accompanying unaudited consolidated financial statements contain all

adjustments (consisting of only normal, recurring accruals) necessary to present fairly the financial position of the Company and its subsidiaries as of September 28, 1996, and the results of operations for the three-month and nine-month periods and its cash flows for the nine-month periods ended September 28, 1996 and September 30, 1995. The results of operations for any interim period are not necessarily indicative of the results for the year. These interim consolidated financial statements should be read in conjunction with the Company's annual financial statements and related notes in the Company's Annual Report on Form 10-K for the year ended December 30, 1995.

2. Accrued Expenses

Accrued expenses were as follows:

	September 28, 1996	December 30, 1995
Vacation	\$ 167,000	\$ 171,000
Payroll	125,000	307,000
Customer Deposit	46,000	140,000
Other	311,000	423,000
	-----	-----
	\$ 649,000	\$ 1,041,000
	=====	=====

PART I: ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of the Company's level of operation and financial condition. This discussion should be read with the consolidated financial statements appearing in Item 1.

RESULTS OF OPERATIONS

Net revenues for the three and nine months ended September 28, 1996 were \$4,201,000 and \$10,533,000, respectively, compared to \$4,540,000 and \$12,220,000 for the same periods in the prior year. Recycling revenues for the three and nine months ended September 28, 1996 decreased by \$1,662,000 and \$4,293,000, respectively, from the same periods in the prior year. The decreases were primarily due to decreased revenues from contracts with electric utility programs. In mid-September 1996, the Company and Southern California Edison Company ("California Edison") entered into a contract to extend the refrigerator recycling program with the Company through 1997, subject to approval of funding for 1997 by the California Public Utilities Commission ("CPUC"). The CPUC is currently expected to act by the end of 1996. Under the terms of the new contract, California Edison has specified minimum refrigerator recycling volumes of approximately 25,000 units in 1996 and approximately 30,000 units in 1997, which are expected to generate revenues of approximately \$3 million in 1996 and \$3.5 million in 1997. Through the third quarter of 1996, the Company had realized approximately \$2.1 million in revenues pursuant to this agreement. The program is subject to cancellation by the CPUC if certain cost effectiveness ratios are not met by the California Edison program.

Appliance sales for the three and nine months ended September 28, 1996 increased by \$1,156,000 and \$2,563,000, respectively, over the same periods in the prior year. The increases were primarily due to the Company's expansion of its retail business through a new chain of stores under the name "Encore Recycled Appliances." As of September 28, 1996 the Company operated 26 retail locations and seven recycling centers compared to six retail locations and 11 recycling centers as of September 30, 1995. On October 31, 1996, the Company announced that it intended to withdraw from three under-performing markets during the fourth quarter of 1996. The Company currently anticipates closing 12 retail locations and three recycling centers. The Company is closing all of its retail locations and centers in Washington, D.C./Baltimore, Maryland; Hartford, Connecticut; and Oakland, California. In addition, the Company is closing its retail outlets in Southern California, but will continue to operate its Los Angeles recycling center, which will process the units from the California Edison program. No new stores are currently expected to be opened until after 1997.

Byproduct revenues for the three and nine months ended September 28, 1996 increased by \$167,000 and \$43,000 over the same periods in the prior year. The increase was primarily due to increased sales of reclaimed chlorofluorocarbons ("CFCs") and scrap metals. The Company expects a small increase in total byproduct revenues for 1996 when compared to the prior year.

Gross profit as a percentage of net revenues decreased to 34.0% for the three months and 21.1% for the nine months ended September 28, 1996 from 36.7% for the three months and 36.5% for the nine months ended September

30, 1995. The decrease between the three and nine months ended September 28, 1996 compared to the same periods in the prior year was primarily due to inefficiencies in the conversion to add appliance reconditioning capabilities to six of the Company's 11 then-operating recycling centers. Gross profit as a percentage of net revenues increased from 7.3% for the first quarter of 1996 to 17.7% for the second quarter of 1996 to 34.0% for the third quarter of 1996. Due to the expiration of utility contracts and the implementation of cost-cutting programs, four recycling centers were closed in the second quarter of 1996 leaving seven centers open as of September 28, 1996. On October 31, 1996, the Company announced that it intended to withdraw from three under-performing markets during the fourth quarter of 1996. The Company currently anticipates closing 12 retail stores and three recycling centers. The Company expects the gross margin rate will significantly decrease for the last three months of 1996 compared to the first nine months of 1996 due to write-offs and other significant expenses related to the closing of retail stores and recycling centers.

Selling, general and administrative expenses for the three and nine months ended September 28, 1996 increased to \$2,130,000 and \$6,385,000, respectively, from \$1,537,000 and \$4,291,000 in the same periods of 1995. The increases in the three and nine months ended September 28, 1996 were primarily due to costs associated with operating 26 retail stores at September 28, 1996 compared to operating six retail stores in the same period in the prior year, and by a small increase in general and administrative expenses. During the first nine months of 1996, 23 retail stores were opened and six retail stores were closed. During the fourth quarter of 1996, an additional 12 retail stores and three recycling centers are anticipated to be closed. The Company expects total selling, general and administrative expenses for the last three months of 1996 to be substantially higher than the total for the third quarter of 1996 due to expenses related to the closing of retail stores and recycling centers.

Interest income decreased to \$2,000 from \$53,000 for the three months and to \$34,000 from \$160,000 for the nine months ended September 28, 1996 compared to the same periods in 1995. The decrease in interest income for the three and nine months ended September 28, 1996 resulted from lower cash balances when compared to the same periods in the prior year.

Interest expense was \$67,000 for the three months and \$203,000 for the nine months ended September 28, 1996 compared to \$60,000 and \$198,000 for the same periods in 1995.

During the first nine months of 1996, the Company recorded a valuation allowance of approximately \$1,700,000, and accordingly, no tax benefit was recorded for the first nine months of 1996. \$400,000 of the deferred tax assets as of September 28, 1996 will be realized by carrybacks to prior taxable years and the realization of the remaining deferred tax assets is dependent upon future taxable income.

The Company recorded a net loss of \$745,000 for the three months and \$4,243,000 for the nine months ended September 28, 1996 compared to a net income of \$81,000 and \$104,000 in the same periods of 1995. The increase in loss was primarily due to the increased operational expenses and increased selling, general and administrative expenses associated with the development of the Company's retail business. The Company expects the loss for the remaining three months of 1996 to be significantly larger than initially expected due primarily to additional write-offs and other significant expenses related to the closing of retail stores and recycling centers.

LIQUIDITY AND CAPITAL RESOURCES

At September 28, 1996, the Company had a working capital deficit of \$343,000 compared to a working capital surplus of \$3,503,000 at December 30, 1995. Cash and cash equivalents decreased to \$206,000 at September 28, 1996 from \$4,605,000 at December 30, 1995. Net cash used in operating activities was \$3,973,000 for the nine months ended September 28, 1996 compared to net cash provided by operating activities of \$2,335,000 in the same period of 1995. The decrease in cash provided by operating activities was primarily due to the net loss from operations and an increase in inventory offset by depreciation and a decrease in accounts receivable.

The Company's capital expenditures were approximately \$1,226,000 and \$1,273,000 for the nine months ended September 28, 1996 and September 30, 1995, respectively. The 1996 capital expenditures were primarily related to leasehold improvements to the Company's recycling centers and additional retail stores. The Company had no material purchase commitments for assets as of September 28, 1996. The announced closing of certain retail stores will result in a loss of the capital investments in these leasehold improvements, which could be significant. The Company doesn't plan any major purchase commitments for the next 12

months.

The Company had a bank line of credit of \$2,500,000 which expired in April 1996. The Company had no borrowings under the line. The Company negotiated a revised bank line of credit in the amount of \$400,000 which was to expire October 1, 1996. In August 1996, the Company entered into a \$1.5 million line of credit with Spectrum Commercial Services, a division of Lyons Financial Services, Inc. ("Spectrum"), which replaced the existing \$400,000 bank line of credit. On November 8, 1996, the line of credit was amended to increase the line to \$2.0 million, of which approximately \$1.4 million is currently drawn. The amended line of credit is secured by the receivables, inventory, equipment, real estate and other assets of the Company and a portion is guaranteed by the President of the Company. The line of credit provides for a stated maturity date of August 30, 1999, and provides that the lender may demand payment in full of the entire outstanding balance of the loan at any time. The amended loan provides for a rate of interest equal to 5 percentage points over the prime lending rate per annum, but never less than 10% per annum (the current rate is 13-1/4%), and minimum monthly interest payments of \$10,000 regardless of the outstanding principal balance. Upon an event of default, the interest may increase by 6% per annum. The loan also requires that the Company meet certain financial covenants, provides payment penalties for noncompliance, contains certain prepayment penalties, provides for annual fees for administration of the loan and for maintenance of the line of credit, limits the amount of other debt the Company can incur, and limits the amount of spending on fixed assets. As of September 28, 1996 the Company was not in compliance with certain financial covenants under the current line of credit. As of November 8, 1996, Spectrum has waived the noncompliance with certain financial covenants.

In May 1996, \$700,000 was raised in a private placement of Common Stock to an institutional investor that currently holds approximately 15% of the outstanding shares. These proceeds were used to pay off an equipment loan of \$480,000 and for additional working capital. The proceeds were raised from selling 200,000 shares at \$3.50 each.

The Company filed a registration statement on Form S-3 to register for resale, pursuant to certain registration rights agreements, 319,355 shares of Common Stock held by certain shareholders, including the 200,000 shares referred to above. The registration statement became effective on November 8, 1996.

On March 26, 1996 the Company announced it signed a letter of intent to acquire the assets of Appliance Distributors of Texas, Inc., a reconditioned appliance retailer and recycler based in Austin, Texas, subject to the Company's due diligence and negotiation of definitive agreements. The Company has decided not to go forward with this acquisition.

The Company anticipates that its current cash balance, existing and anticipated equipment financing, and current line of credit will be sufficient to finance its operations and capital expenditures through December 1997. The Company's total capital requirements will depend, among other things as discussed below, on the number of recycling centers operated and the number and size of retail stores operating during the fiscal year. Currently, the Company has seven centers and 26 stores in operation and expects to close three centers and 12 retail stores by year end. If revenues are lower than anticipated, or expenses (including expenses associated with store closings) are higher than anticipated, the Company may require additional capital to finance operations and expansion. Sources of additional financing, if needed in the future, may include further debt financing or the sale of equity or other securities. There can be no assurance that such additional sources of financing will be available or available on terms satisfactory to the Company or permitted by the Company's current lender.

Statements regarding the Company's operations, performance and results and anticipated liquidity, discussed herein are forward-looking and therefore are subject to certain risks and uncertainties, including those discussed herein. In addition, any forward-looking information regarding the operations of the Company will be subject to the amount of the write-offs and costs associated with the closing of retail stores and centers discussed previously, whether planned revenue levels are attained by individual stores, the speed at which Encore stores reach profitability, whether costs and expenses are realized at higher than expected levels (including continued costs of conversion of existing recycling centers to support the appliance resale aspect of the Company's business), the Company's ability to secure an adequate supply of used appliances for resale, the continued availability of the Company's current line of credit, and the ability of California Edison to deliver units under its contract with the Company and the timing of such delivery.

ITEM 1 - LEGAL PROCEEDINGS - None

ITEM 2 - CHANGES IN SECURITIES - None

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES - None

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5 - OTHER INFORMATION - None

ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibit 10.14:
Agreement between Southern California Edison Company and Appliance Recycling Centers of America, Inc. for Refrigerator Recycling and Hazardous Materials Disposal dated May 7, 1996.
- Exhibit 10.15:
Line of credit between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, a division of Lyons Financial Services, Inc., dated August 30, 1996.
- Exhibit 10.16
Amended line of credit between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, a division of Lyons Financial Services, Inc. dated November 8, 1996.
- Exhibit 27 - Financial Data Schedule
- (b) The Company did not file any reports on Form 8-K during the three months ended September 28, 1996.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Appliance Recycling Centers of America, Inc.
Registrant

Date: November 12, 1996

/s/Edward R. Cameron

Edward R. Cameron
President

Date: November 12, 1996

/s/Kent S. McCoy

Kent S. McCoy
Vice President of Finance,
Treasurer

Southern California Edison Company

Rosemead, California

Refrigerator Recycling and Hazardous Materials Disposal Agreement

1. PARTIES

The parties to the Agreement are Appliance Recycling Centers of America, Inc., the entity responsible for the performance of the Work as one Party (hereinafter referred to as "Contractor"), and Southern California Edison Company, a California Corporation (hereinafter referred to as "Edison") as the other Party.

2. RECITALS

The Agreement is entered into with reference to the following facts, among others:

- 2.1 Edison and Contractor are currently parties to a contract dated August 19, 1993 for Contractor's performance of refrigerator recycling and hazardous materials disposal, which contract has been modified to date by Purchase Order K1113911, dated November 23, 1993, and by numerous change orders (said contract, Purchase Order, and change orders hereinafter referred to as the "Initial Contract".)
- 2.2 Said Initial Contract implements a Refrigerator Recycling Program ("Program") for the removal of older, inefficient second refrigerators and freezers ("Refrigerators and Freezers") from Edison Customer residences thereby reducing the load demand on the electrical system.
- 2.3 Edison desires to continue and increase its efforts to reduce the load demand on the electrical system through the further removal of older inefficient second Refrigerators and Freezers.
- 2.4 Edison desires to ensure the safe, lawful recovery and recycling or lawful disposal, as necessary, of CFCs, PCBs, and Hazardous Materials.
- 2.5 In furtherance thereof, Edison desires to increase and extend the Program by contracting with Contractor for the comprehensive management of the Program.
- 2.6 Contractor desires to contract with Edison for the continued comprehensive management of the Program, said management to include collection and dismantling of second Refrigerators and Freezers; removal of CFCs, PCBs and other Hazardous Materials from collected Refrigerators and Freezers; handling storage and legal disposal of compressor oil, PCBs and other Hazardous Materials; recycling of metal, sulfur dioxide, and CFCs; providing incentives to participating Edison Customers who relinquish second Refrigerators and Freezers; and performance of a customer survey.
- 2.7 Contractor represents (i) that it has knowledge of the Metallic Discard Act, effective January 1, 1994, which prohibits the disposal of Refrigerators and Freezers in landfills and requires that Refrigerators and Freezers be shredded for metal recovery following removal of CFCs, PCBs, and other Hazardous Materials contained in discarded Refrigerators and Freezers, (ii) that it has knowledge of the hazards associated with the removal, handling, storage, recycling, and legal disposal of Hazardous Materials, (iii) that it has experience and expertise in such removal, handling, storage, recycling, and legal disposal, (iv) that it uses only qualified personnel, (including subcontractor's and agent's personnel) who have been instructed and certified in the proper safety procedures to be used in such removal, handling, storage, recycling, or legal disposal, and (v) that it has purchased property and has established and will continue to operate and maintain its recycling center on said purchased property in the City of Compton or other area acceptable to Contractor and Edison.
- 2.8 Contractor has entered into a similar agreement with the Los

Angeles Department of Water and Power ("DWP") which contract is due to expire on or before November 30, 1996, and may be entering into agreements with other utilities or agencies.

2.9 The Parties hereto desire to set forth terms and conditions under which the aforesaid management services shall be performed and which shall constitute the Parties' agreement.

3. AGREEMENT

3.1 In consideration of the aforesaid Recitals, the mutual covenants contained herein, the payments and agreement to be made and performed by Edison as set forth in the pricing schedules, attached hereto as Exhibits A and B incorporated by reference herein, Contractor shall perform the Work and its associated obligations as an independent contractor.

3.2 This Agreement shall be incorporated in a Purchase Order as the terms and conditions for performing the work.

4. DEFINITIONS

- 4.1 Agreement: This document, the terms and conditions contained in this Agreement as amended from time to time.
- 4.2 Basic Recycling Charge: Per-unit price for services performed by Contractor under scope of work except for CFC-11 recovery services and bond purchasing, incentive and financing services.
- 4.3 CFCs: Chlorofluorocarbons
- 4.4 CFC-11: Chlorofluorocarbons contained in refrigerator and freezer insulating foam.
- 4.5 CFC-11 Recovery Charge: Per-unit price for removal and recycling of CFC-11 from refrigerator and freezer insulating foam.
- 4.6 Change Order: Document issued by Edison to Contractor to change a Purchase Order.
- 4.7 Combined Volume: Edison's Specified Volume combined with DWP's Specified Volume for each or any Contract Year; provided, however, that if DWP chooses not to participate in the Program in the Second Contract Year, its Specified Volume for said year shall be deemed to be zero.
DWP's Specified Volume for the First Contract Year is 10,000.
- 4.8 Comparable Programs: Utility sponsored Recycling Programs similar to scope of work described in this Agreement.
- 4.9 Contract Year: The First Contract Year or the Second Contract Year, as applicable, and/or each successive 12 month period thereafter.
- 4.10 Documentation: Specifications, procedures, instructions, reports, test results, analyses, calculations, manuals, and other data specified in the Purchase Order, Change Order, this Agreement, and any amendment to this Agreement, as required by any legal entity having jurisdiction over the Work.
- 4.11 Edison's Specified Volume: The number of units to which Edison commits for each or any Contract Year.
- 4.12 Eligible Customers: Residential customers in Edison service territory who meet the customer eligibility criteria in Section 7.
- 4.13 Eligible Freezers: Freezers that meet the Program appliance eligibility criteria as set forth in Section 7.
- 4.14 Eligible Refrigerators: Second refrigerators that meet the Program appliance eligibility criteria as set forth in Section 7.
- 4.15 First Contract Year: The period beginning on October 20, 1995 and ending on December 31, 1996.
- 4.16 Freezer: A freezer which provides supplementary cold storage to a primary freezer or to the freezer section located within the primary refrigerator in a residential household.
- 4.17 Hazardous Materials: Any substance or material which has been designated as hazardous or toxic by the U.S. Environmental

Protection Agency, the California Department of Toxic Substances Control and/or any other governmental agency now or hereinafter authorized to regulate materials in the environment, including, but not limited to "Materials which require special handling" as defined in California Public Resources Code Section 42167, which is contained in or is derived from the Refrigerators or Freezers.

- 4.18 Other Specified Volumes: The number of units collected by Contractor from other utilities pursuant to Comparable Programs for any applicable year.
- 4.19 PCB: Polychlorinated Biphenyl
- 4.20 Participation Percentage: The percentage of the applicable Specified Volume as reflected by the number of units actually collected or paid for by either Edison or DWP.
- 4.21 Program: Refrigerator Recycling Program defined by this Agreement.
- 4.22 Program Participants: Eligible customers who turn in qualifying Refrigerators or Freezers.
- 4.23 Purchase Order: Document issued by Edison to Contractor and executed by the Parties, which incorporates, by reference, this Agreement.
- 4.24 Recycling Center: The site at which Contractor will process Refrigerators and Freezers, remove CFCs, PCBs and other Hazardous Materials, and recycle or legally dispose of Hazardous Materials.
- 4.25 Second Contract Year: The period beginning on January 1, 1997 and ending December 31, 1997.
- 4.26 Second refrigerator: Surplus refrigerator utilized by customer concurrently with primary refrigerator.
- 4.27 Specified Volume: The number of units to which Edison or DWP commits for each or any Contract Year.
- 4.28 Subcontractor: Either an entity contracting directly with Contractor to furnish services or materials as part of or directly related to, the Work; or an entity contracting with Subcontractor of any tier to furnish services or materials as a part of, or directly related to, the Work.
- 4.29 Work: Any and all obligations of Contractor to be performed pursuant to this Agreement or a Purchase Order incorporating this Agreement, such as Refrigerator and Freezer collection, Refrigerator and Freezer processing, handling, storing, recycling, and legal disposal, of Hazardous Materials and Documentation preparation.

5. CONTRACT DOCUMENTS

- 5.1 The contract between the Parties shall consist of the following documents: Change Orders, Purchase Order, this Agreement, and any amendments to this Agreement. In the event of conflicting provisions within the contract, the provisions of the contract shall govern in the following order:
 - 5.1.1 Amendments to the Agreement in chronological order from the most recent to the earliest;
 - 5.1.2 Change Orders incorporating and reflecting any Amendments to the Agreement in chronological order from the most recent to the earliest.
 - 5.1.3 This Agreement.
 - 5.1.4 Purchase Order incorporating this Agreement.
- 5.2 Each party shall notify the other immediately upon the determination of any such conflict or inconsistency.

6. SCOPE OF WORK

- 6.1 Contractor shall be responsible for customer services including provision of inbound 800 telephone numbers for Customers' use and all communication services, scheduling of Refrigerator and Freezer collection appointments, verification of customer and appliance eligibility, and documentation of customer data.

- 6.2 Contractor shall (i) collect all Eligible Refrigerators and Eligible Freezers from Customers' residences within 10 to 15 working days from the date of initial customer contact (unless otherwise requested by the customer, in remote areas of the service territory, or approved by Edison's program manager because of program response in excess of the Edison's Specified Volume for which approval shall not be unnecessarily withheld, and collection shall be no later than 25 working days from the date of the initial customer contract, unless otherwise requested by customer), (ii) ensure Refrigerator or Freezer is an operating unit before removal from residence, (iii) disable the unit prior to leaving pick-up location, and (iv) process unit at its Recycling Center.
- 6.3 Contractor shall be solely responsible for all methods, techniques, sequences, and procedures for the dismantling of Refrigerators and Freezers, processing of metal panels and components, recycling of recovered scrap metal, removal, recycling, or lawful disposal of Hazardous Materials.
- 6.4 Contractor shall be solely responsible for all methods, techniques, sequences, and procedures for the removal and management of all capacitors found in Refrigerators and Freezers, and the removal and disposal of compressor oil, PCBs, and other Hazardous Materials from the time Contractor collects Refrigerators and Freezers pursuant to this Agreement.
- 6.5 Contractor shall document and maintain records for services under this Agreement, or the Purchase Order, incorporating this Agreement, as follows:
- 6.5.1 A Customer Comment Tracking System for recording customer inquiries, complaints, and positive feedback.
- 6.5.2 Appliance Turn-in Order Form to collect data such as customer name, address, home and work phone numbers; utility account number, Refrigerator or Freezer manufacturer's name; Refrigerator or Freezer model and style; defrost type; color, size, and estimated age of unit; location of Refrigerator or Freezer within the residence; amperage, final disposition code (which indicates operating condition of Refrigerator or Freezer), identification of units containing CFC-11; special pick-up instructions (if applicable); and signature of customer following customer certification that the unit is a Second Refrigerator or Freezer in continuous use for a minimum of six months and that in the event refrigerator or freezer is discovered not to be an Eligible Refrigerator or Freezer as certified, customer acknowledges liability to Edison for recycling costs.
- 6.5.3 Compilation of data in paragraphs 6.5.1 and 6.5.2 in electronic mode, employing the Microsoft XCEL software program.
- 6.6 Contractor shall conduct a customer survey, comparable to Exhibit C, attached and incorporated by reference herein, using a stratified purposeful sample of 5 to 20% of the Program Participants. The stratification and frequency of the survey may be modified periodically by Edison, provided that an Amendment to this Agreement or a separate agreement shall be entered into if any such modification necessitates unreasonable labor, as substantiated by Contractor, requiring the negotiation of a charge separate from the Basic Recycling Charge. The purpose of the survey shall be to elicit information such as appliance use, customer demographics and customer satisfaction. Stratification and frequency of survey shall be modified periodically as determined by Edison provided modified survey is comparable to Exhibit C.
- 6.7 Contractor and Edison shall establish and implement a financial incentive service as follows:
- 6.7.1 The incentive will be a savings bond with a face value of Fifty dollars (\$50.00) or, in the alternative, a check in the amount of Twenty Five Dollars (\$25.00).
- 6.7.2 Contractor shall provide Edison with a weekly listing for approval of Customers qualifying for bonds or

checks. Customers qualifying for the incentive are Program Participants who turn in an Eligible Refrigerator or Freezer for which Edison will pay a per-unit price as set forth in paragraph 10.1.

- 6.7.3 Contractor shall send customer list to Minneapolis Federal Reserve District and purchase bonds, obtain Edison's approval for listed customers and send bonds to customers. If the customer requests a check as an incentive, then Contractor shall issue a check to customer and Edison shall reimburse Contractor for such incentives in accordance with Section 9.5.1.
 - 6.7.4 Upon reimbursement by Edison to Contractor of the incentives under Section 9.5.1 of this Agreement, Edison shall be under no further obligation with respect to reimbursement of such amounts and such reimbursement shall constitute full payment to Contractor on behalf of the program Participants entitled to incentives. Moreover, upon Edison's payment to Contractor of the amounts described above, Contractor shall be deemed the holder of such property as far as the interests of the Program Participants entitled thereto are concerned for any and all purposes, including, but not limited to, complying with the unclaimed property laws of California and any and all other applicable states. At no time after such reimbursement to Contractor is Edison to assume any responsibility for other disposition of such amounts and shall not be entitled to the reversion of any amounts so paid.
 - 6.7.5 Customers eligible for the Program pursuant to Section 7.3.4, below, shall not be entitled to receive the bond or check incentive provided for by this Agreement for any units otherwise eligible for the Program.
- 6.8 Contractor shall provide Edison with reports for the services performed under this Agreement as follows:
- 6.8.1 A monthly report, provided no later than the 15th day of the month, listing the number of Refrigerators and Freezers processed through the Recycling Center during the previous month and containing size in cubic feet, year of manufacture, style, and defrost type.
 - 6.8.2 A quarterly report, presented within 15 days of the new quarter, summarizing the monthly report information from the previous quarter and containing environmental data such as an estimated breakdown of amount of refrigerants recovered; number of pounds of capacitors removed; number and size of CFC-11 units and amount of CFC-11 recovered; amount of sulfur dioxide recovered, amount of compressor oil recycled, and weight of metals and nonrecyclable materials sold for shredding.
 - 6.8.3 A quarterly report presented within fifteen (15) days of the new quarter summarizing the monthly Customer Comment Tracking System information in Section 6.5.1.
 - 6.8.4 By the 15th day of January, April, July and October of each calendar year during the term of this Agreement, Contractor shall provide Edison with quarterly aging reports indicating the number of Refrigerators and Freezers that were collected during the preceding quarter and that were scheduled for collection from customers during that quarter, the date of the initial contact with the Customer, the date or dates the appliance was scheduled for collection, and the actual collection date.
 - 6.8.5 Annual summary reports covering all activity requested in quarterly reports plus information from any incomplete quarter.
 - 6.8.6 An annual report by January 31 of each year of all amounts paid by Contractor in compliance with any unclaimed property laws pursuant to Section 6.7.4, hereof.
 - 6.8.7 Upon reasonable written request from an authorized representative of Edison, special and nonrecurring

reports during course of program. Such report content will be developed by the parties in anticipation of requests from the CPUC, Edison internal audits, or compilation of data relevant to Rebuild LA activities. An amendment to this Agreement or a separate agreement shall be entered into only if any such report necessitates unreasonable labor, as substantiated by Contractor, requiring the negotiation of a charge separate from the Basic Recycling Charge.

7. Customer and Refrigerator Eligibility

- 7.1 Customer eligibility for the Program shall depend on the following:
- 7.1.1 Customer is a resident in the Edison service territory and occupies a single-family residential (Domestic Rate) or multi-unit dwelling or mobile home.
 - 7.1.2 Customer owns the Eligible Refrigerator or Freezer or possesses written consent from the Refrigerator or Freezer owner to turn in Eligible Refrigerator or Freezer.
 - 7.1.3 Customer turns in no more than two Eligible Refrigerators and two Eligible Freezers per year unless written Edison approval is obtained for any additional Refrigerator or Freezer.
- 7.2 Commercial customers do not qualify for the Program.
- 7.3 Refrigerator and Freezer eligibility for the Program shall depend on the following:
- 7.3.1 Refrigerator or Freezer must be capable of cooling or freezing, or both, as applicable, at time of collection.
 - 7.3.2 Refrigerator or Freezer minimum size is 10 cubic feet and maximum size is 25 cubic feet.
 - 7.3.3 Refrigerator or Freezer is certified by the customer to have been in use for a minimum of six months as a Second Refrigerator or Freezer, as the case may be.
 - 7.3.4 Subcontractors who provide new refrigerators to participants in Edison's Direct Assistance Refrigerator Replacement Program may turn in the working refrigerator that was replaced by an energy efficient model to Contractor. The limit imposed above under Section 7.1.3 shall not apply to such subcontractors. No freezers may be accepted by Contractor from such subcontractors. Subcontractors shall be allowed to deliver replaced refrigerators to Contractor's facilities for recycling. Refrigerators collected pursuant to this Section 7.3.4 shall count towards Edison's Specified Volume at a ratio of three refrigerators collected for one Specified Volume unit. For example, if 300 units are collected by Contractor pursuant to this Section 7.3.4, Edison shall receive credit for 100 units against its Specified Volume. Contractor shall not be responsible for determining the eligibility requirements for said units. Contractor's record keeping requirements for purposes of units collected pursuant to this Section 7.3.4 shall be adjusted to reflect the scope of Contractor's work pursuant to this Section 7.3.4. All costs associated with the Direct Assistance Refrigerator Replacement Program, whether said costs are Edison's costs or Contractor's costs, and whether said costs are direct or indirect, shall not be included for purposes of determining the TRC and UC ratios for the Refrigerator Recycling Program addressed and defined below in Section 19.3.
- 7.4 Commercial refrigerators, ammonia-containing gas refrigerators, commercial freezers, and room air conditioners do not qualify for the Program.

8. OWNERSHIP AND CONFIDENTIALITY

- 8.1 All information disclosed by Edison during meetings or negotiations with regard to the Program, and any information

- contained in drawings, specifications, technical reports, and data provided by Edison to Contractor during performance of this Agreement shall be held in confidence by Contractor and used only for the performance of the Work pursuant to this Agreement.
- 8.2 Contractor, its employees, and any subcontractors shall not disclose any Program or customer information to any person other than Edison's personnel either during the term of this Agreement or after its completion, without Contractor having obtained the prior written consent of Edison, except as provided by lawful court order or subpoena and provided Contractor gives Edison advance written notice of such order or subpoena. Prior to any approved disclosure, persons receiving said information, including Contractor, its employees, or third parties, must enter into a nondisclosure agreement with Edison. Contractor agrees to require its employees and subcontractors to execute a nondisclosure agreement prior to performing any services under this Agreement.
- 8.3 All material provided by Edison to the Contractor during the performance of this Agreement shall be returned to Edison after this Agreement is terminated or at the request of Edison. The Contractor shall not duplicate any material furnished by Edison without prior written approval from Edison.
- 8.4 All information, material, and documents prepared or caused to be prepared under this Agreement by Contractor shall become the property of Edison. Such information, or derivative information, materials, and documents, shall be used by the Contractor only for work done directly for Edison, shall not be used in Contractor's general course of business, and shall neither be disclosed nor revealed in any way to a third party without the prior express written consent of Edison.
- 8.5 All information disclosed by Contractor to Edison during meetings or negotiations with regard to the Program, and any information contained in drawings, specifications, technical reports, and data provided by Contractor to Edison during performance of this Agreement, shall be held in confidence by Edison, and used only in relation to the Work pursuant to this Agreement.
- 8.6 Except as required by the CPUC, Edison, its employees and any subcontractors of Edison shall not disclose any confidential or proprietary information of Contractor ("Contractor's Confidential Information") to any person other than Contractor's personnel, either during the term of the Agreement, or after its completion, without having obtained the prior written consent of Contractor. By way of example, Contractor's Confidential Information shall include, without limitation, Contractor's systems for oil degassing, CFC recovery, CFC-11 recovery and Contractor's computer software. Prior to any approved disclosure, persons to receive Contractor's Confidential Information, including Edison, its employees or any third-party, must enter into a nondisclosure agreement with Contractor. Edison agrees to require its employees to execute appropriate nondisclosure agreements prior to any contact with, or evaluation of Contractor's Confidential Information.
- 8.7 Edison agrees that, without the prior written consent of Contractor, it will not, during the term or after termination of this Agreement, directly or indirectly, disclose to any individual, corporation, or other entity, or use for its own or such other's benefit, any of Contractor's Confidential Information, whether reduced to written or other tangible form, which:
- 8.7.1 Is not generally known to the public or in the industry;
- 8.7.2 Has been treated by the Contractor or any of its subsidiaries as confidential or proprietary; and
- 8.7.3 Is of a competitive advantage to Contractor or any of its subsidiaries and in the confidentiality of which the Contractor or any of its subsidiaries has a legally protectable interest.
- 8.8 Contractor's Confidential Information which becomes generally known to the public or in the industry, or, in the confidentiality of which, the Contractor and its subsidiaries

cease to have a legally protectable interest, shall cease to be subject to the restrictions of this Paragraph 8.

9. COMMERCIAL TERMS

9.1 Payment

No payment shall be made under this Agreement until Edison has received a signed "Acceptance Copy" of the Purchase Order from Contractor. Edison shall pay to Contractor, as full compensation for completing the Work, the prices set forth in Exhibits A and B in accordance with the payment provisions set forth in paragraphs 9.2 through 9.7.

9.2 Summary of Charges

9.2.1 Basic Recycling Charge Edison shall pay to Contractor a per-unit Basic Recycling Charge for the greater of the number of units collected, or specified per section 9.3.2 below, pursuant to this Agreement at the price or prices set forth in Section 9.3 below. The Basic Recycling Charge covers the scope of work described in paragraph 6.1 through 6.9 excluding CFC-11 Recovery and Bond or incentive purchasing and financing services.

9.2.2 CFC-11 Recovery Charge Edison shall pay to Contractor a per-unit CFC-11 Recovery Charge for the greater of the number of units collected, or specified in section 9.3.2 below, pursuant to this Agreement at the price or prices set forth in Section 9.4, below.

9.2.3 Bond or Incentive Cost and Finance Charges. Edison shall pay to Contractor bond and incentive costs and finance charges as specified in Section 9.5, below.

9.2.4 Other Charges. All other costs for services shall be negotiated between the parties and implemented by an amendment to the Agreement.

9.3 Pricing - Basic Recycling Charge

9.3.1 The per-unit Basic Recycling Charge to be paid by Edison for the First Contract Year and the Second Contract Year shall be as set forth on Exhibit A and is based upon the Combined Volume of units specified by Edison and DWP prior to the commencement of each such Contract Year. If DWP enters into an agreement with Contractor to extend its agreement, or enters into a new agreement, for a Comparable Program, for the Second Contract Year, then the per-unit Basic Recycling Charge to be paid by Edison for the Second Contract Year shall be as set forth on Exhibit "A" and shall be based upon the Combined Volume of units specified by Edison and DWP.

9.3.2 On or prior to the commencement of each Contract Year, Edison shall commit to, and notify Contractor of the number of units it wishes Contractor to collect for the ensuing year ("Edison's Specified Volume"). Contractor shall obtain a similar number from DWP each such year ("DWP's Specified Volume"), provided that DWP has decided to participate that year. The combination of Edison's Specified Volume and DWP's Specified Volume shall be defined as the Combined Volume. The price column on Exhibit A applicable for such Contract Year shall be identified by that number of units most closely approximating and equal to or less than the Combined Volume chosen by Edison and DWP.

9.3.3 Units collected from Edison's customers or paid for by Edison and units collected from DWP's customers or paid for by DWP and Other Specified Volumes shall all be counted toward the Combined Volume and as units collected on Exhibit A within the pricing column determined in subsection 9.3.2, above, applicable for said year.

9.3.4 Edison's Specified Volume for each of the First and Second Contract Years for purposes of subsection 9.3.2 shall be 30,000 units. Units collected in connection with Edison's Direct Assistance Refrigerator Replacement Program under Subsection 7.3.4 shall be counted towards Edison's Specified

Volume at the rate of three units collected pursuant to Subsection 7.3.4 to equal one unit counted towards Edison's Specified Volume.

- 9.3.5 Edison shall receive a \$5.00 per unit credit against the Basic Recycling Charge for the first 15,271 units collected after July 31, 1996, excluding units collected pursuant to Subsection 7.3.4.

9.4 Pricing - CFC-11 Recovery Charge

9.4.1 The per-unit CFC-11 Recovery Charge to be paid by Edison shall be as set forth on Exhibit B, assuming an initial experience rate of 48%. The price column on Exhibit B, applicable for such Contract Year, shall be identified by that number most closely approximating, and equal to or less than, the Combined Volume chosen for such Contract Year. If the DWP enters into an agreement with Contractor to extend its agreement, or enter into a new agreement, for a Comparable Program, then the per unit CFC-11 Recovery Charge to be paid by Edison for the Second Contract Year shall be as set forth on Exhibit B and shall be based upon the Combined Volume of units specified by Edison and DWP. Edison and Contractor are exploring other methods of cost recovery of the per-unit CFC-11 Recovery Charge from that provided in this Subsection. If other methods are identified which are reasonably agreeable to Edison and Contractor, then the parties hereto agree to participate in good faith negotiations to further amend this Agreement to provide for such alternative method or methods of cost recovery of the CFC-11 Recovery Charge. In no event shall such alternative cost recovery method result in an increase in the per-unit fee of CFC-11 Recovery Charge paid to Contractor.

- 9.4.2 At the end of each quarter, Contractor shall adjust its pricing for such quarter to reflect the difference between the actual number of units processed containing CFC-11 foam and the estimated number of such units. Contractor shall immediately invoice or credit Edison accordingly.

9.5 Pricing - Bond or Incentive Costs and Finance Charges

- 9.5.1 Edison shall reimburse Contractor for the cost of each bond or incentive payment distributed to Program Participants.
- 9.5.2 Edison shall pay to Contractor monthly interest at the rate of three-quarter of one percent (0.75%) on the average monthly balance of the outstanding bond or incentive costs.

9.6 Combined Volume Commitment

In any Contract Year in which the Combined Volume is not achieved, and if Edison has not met its Specified Volume for such year, Edison shall pay to Contractor a Basic Recycling Charge and CFC-11 Recovery Charge on its proportionate share of the shortfall with said share determined by the process described in 9.6.2.

- 9.6.1 The shortfall shall be determined by subtracting from the Combined Volume all units collected from Edison and DWP for said year and further subtracting Other Specified Volumes.
- 9.6.2 In any year in which DWP has decided to participate in the Program, the shortfall shall be paid by Edison and/or DWP in full in accordance with the following:
- 9.6.2.1 The utility (Edison or DWP) with the lower Participation Percentage will contribute to said shortfall until its Participation Percentage equals the higher Participation Percentage of the other utility.
- 9.6.2.2 The Participation Percentage shall be determined by dividing either Edison's or DWP's actual units collected or paid for by Edison's or DWP's Specified

Volume respectively.

Actual Units

Specified Volume

9.6.2.3 The remaining shortfall, if any, after application of 9.6.2.1 and 9.6.2.2 will be paid by Edison and/or DWP on a pro rata basis consistent with the ratio of the Specified Volume to the Combined Volume.

Specified Volume

Combined Volume

9.6.2.4 In any year in which DWP has decided not to participate in the Program, the shortfall as determined pursuant to Section 9.6 shall be paid by Edison.

9.6.3 In no Contract Year shall Edison's payment pursuant to this Section 9.6 exceed its Specified Volume.

9.6.4 For purposes of this Section 9.6 the CFC-11 Recovery Charge shall be calculated upon actual percentage results achieved from the most recent quarter applicable to said year (or in absence thereof, 20%) at the pricing column in Exhibit B.

EXAMPLE:

9.6.4.1 Edison's Specified Volume for year 1 is 60,000

9.6.4.2 DWP's Specified Volume for year 1 is 15,000

9.6.4.3 Combined Volume = 75,000

9.6.4.4 Other Specified Volume = 6,000

9.6.4.5 Units actually collected for Edison = 30,000

9.6.4.6 Units actually collected for DWP = 9,000

9.6.4.7 Shortfall = Combined Volume (75,000) - Other Specified Volume (6,000) - Units collected for Edison (30,000) - Units collected for DWP (9,000) = 30,000

$$75,000 - 6,000 - 30,000 - 9,000 = 30,000$$

9.6.4.8 Contractor is entitled to 30,000 from Edison and/or DWP

9.6.4.9 Edison's Participation Percentage =

Actual Units Collected or Paid For

Specified Volume

$$\begin{array}{r} = 30.000 \\ \text{-----} \\ 60,000 = 50\% \end{array}$$

Edison has achieved half of its Participation Percentage.

9.6.4.10 DWP's Participation Percentage =
9,000 = 60%

15,000

DWP has achieved 60% of its Participation Percentage.

9.6.4.11 Edison must first contribute to the shortfall until its Participation Percentage reaches DWP's Participation Percentage or until Edison reaches its Specified Volume. For Edison to reach DWP's Participation Percentage of 60%, Edison must add 6000 units to the units actually collected for Edison.

30,000 (actually collected) + 6000 units = 60%

 60,000

9.6.4.12 A shortfall of 24,000 still remains (30,000 less 6000 paid for by Edison) and is divided between Edison and DWP:

Edison's Specified Volume (60,000) = 80%

 Combined Volume (75,000)

DWP's Specified Volume (15,000) = 20%

 Combined Volume (75,000)

Thus: Edison pays 80% of 24,000 = 19,200
 DWP pays 20% of 24,000 = 4,800

Edison has paid for 55,200 units (30,000 + 6,000 + 19,200) and Edison's final contribution, as a percentage of its Specified Volume, is equal to

55,200 = 92%

 60,000

DWP has paid for 13,800 units (9,000 + 4,800) and DWP's final contribution, as a percentage of its Specified Volume, is equal to 13,800 = 92%

 15,000

9.7 Miscellaneous

9.7.1 Contractor agrees that any agreement it has, or in which it may enter with other utilities or agencies for a recycling program, shall not detrimentally affect Contractor's services under this Agreement.

9.7.2 Edison and Contractor agree that the number of units collected for Edison between October 20, 1995 and December 31, 1995 equals 5,207 units (the "1995 Units"), and that the 1995 Units shall be counted towards Edison's Specified Volume for the First Contract Year. The per-unit Basic Recycling Charge to be paid by Edison for the 1995 Units shall be \$110.00 per-unit, less a \$5.00 per unit credit.

9.8 Pricing - Direct Assistance Refrigerator Replacement Program

Contractor shall be paid by Edison for residential refrigerators delivered to Contractor for recycling as part of Edison's Direct Assistance Refrigerator Replacement Program for the 1996 and 1997 program year as follows:

Description -----	Fixed Unit Price -----
Basic Recycling Charge for 1996 and 1997 program years	\$28.50
CFC-11 Recovery Charge for 1996 and 1997 program years	Per Exhibit B

10. BILLING

10.1 Contractor shall submit a weekly invoice reflecting the per-unit charge for the refrigerators and freezers collected, processed, and recycled, the CFC-11 units processed, and for the purchase and approval of U.S. Savings Bonds and incentives. Contractor shall apply a per-unit charge on units that have been disabled and only for the following transactions:

10.1.1 Collection of an Eligible Refrigerator or Freezer.

10.1.2 Collection contact made for Eligible Refrigerator or Freezer that cannot be removed due to obstruction because of size or structural barrier provided that Contractor obtains written permission from Customer to permanently disable said unit, and Contractor then

permanently disables the unit.

- 10.1.3 Collection of an oversized Eligible Refrigerator or Freezer that requires additional trips, personnel, or equipment to execute removal. Additional services for removal of an oversized Eligible Refrigerator or Freezer shall be charged as a single appointment with no extra charge for said additional services.
- 10.1.4 Collection of an Eligible Refrigerator or Freezer that could not be inspected for eligibility confirmation.
- 10.2 Contractor shall submit a final invoice in hard copy and in electronic format acceptable to Edison, for each Contract Year. The final invoice shall reflect the credit applied to Edison for collection of refrigerators from DWP or any other source, if any.
- 10.3 Contractor shall apply a 25% per unit discount to the Basic Recycling Charge to any additional units when two or more refrigerators or freezers are removed during a single collection appointment from Customer's residence. Said discount shall be clearly documented and identified in Contractor's invoice. This Subsection shall not apply to units collected pursuant to Subsection 7.3.4, above.
- 10.4 Contractor shall submit a weekly invoice for the purchase price of the bonds and for other incentive payments and a monthly invoice for the interest charge identified in paragraph 9.5.
- 10.5 Edison shall make payment (less any unsubstantiated or incorrect charge):
 - 10.5.1 For bond and check incentive services within thirty days of receipt of invoice by Edison's Accounts Payable Department.
 - 10.5.2 Of Basic Recycling Fee and CFC-11 Recovery Fee the first of each month for the prior month's invoiced services.

11. RIGHT TO AUDIT

Edison, or its Authorized Representative, shall have the right and free access, at any reasonable time during normal business hours, to examine, audit, and copy all Contractor's records and books as related to Contractor's obligations under this Agreement, including, but not limited to, verification of costs to Edison, as claimed by Contractor.

12. CHANGES

- 12.1 Changes to this Agreement shall be made by mutual agreement of the Parties through a written amendment to the Agreement, which shall be incorporated into the Purchase Order by Change Order.

13. PERMITS, CODES, AND STATUTES

- 13.1 Contractor shall perform the Work set forth in this Agreement in accordance with all applicable Federal, state, and local laws, rules, and/or ordinances. Prior to performance of any services, Contractor shall, at its own cost, have obtained, and shall have required all Subcontractors to obtain, all licenses and permits required by law, rule, regulation, and ordinance, or any of them, to engage in the activities required in connection with this transaction. Contractor also represents and warrants that, to the best of its knowledge, based upon reasonable and prudent inquiry, any storage site and any disposal facility to which the Hazardous Materials may be moved are in compliance with any and all federal, state and local laws and regulations pertaining thereto and that such storage sites and disposal facilities are suitable and may lawfully receive and/or dispose of the Hazardous Materials.
- 13.2 Contractor shall comply with all applicable local, state, and federal safety and health laws in effect on the date of this Agreement, including, but not limited to, EPA, California EPA, RCRA, the Occupational Safety and Health Act of 1970 (OSHA), and all standards, rules, regulations, and orders issued pursuant to such local, state, and federal safety and health laws. Should any such law, rule, or regulation be enacted or promulgated subsequent to the date of this Agreement, which renders Contractor's performance impractical, Contractor and

Edison shall, in good faith, negotiate an amendment to this Agreement reasonably compensating Contractor for its additional costs; provided, however, that the requirement in Section 19.3 of this Agreement that the TRC and UC ratios each be 1.0 or greater continue to be met.

14. WARRANTY

Contractor warrants to Edison that the Work shall be performed in a competent manner, in accordance with this Agreement, and that the acceptance, handling, storage, recycling, and disposal of the Refrigerators and Freezers and the Hazardous Materials shall be in accordance with (i) the requirements of this Agreement and (ii) the applicable local, state, and federal laws and regulations in effect at the time of the work performed.

15. TITLE

15.1 Title to the Hazardous Materials shall pass to Contractor when Contractor collects refrigerators and freezers from customers.

15.2 Title of collected Refrigerators and Freezers shall pass to Contractor.

16. INSURANCE

16.1 Without limiting Contractor's liability to Edison, including the requirements of Section 18.0 Indemnity, Contractor shall maintain for the Work, and shall require that each Subcontractor of the first tier maintain, at all times during the Work and at its own expense, valid and collectible insurance as described below. This insurance shall not be terminated, expire, not be materially altered, except on thirty days prior written notice to Edison. Contractor shall furnish Edison with certificates of insurance on forms acceptable to Edison and shall require each Subcontractor of the first tier to furnish Contractor with certificates of insurance, as evidence that policies do provide the required coverages and limits of insurance listed below. Such certificates shall be furnished to Edison's Program Manager by Contractor by January 1 of each Contract year upon receipt of the Purchase Order, but in any event prior to start of the Work for each Contract Year, and by Subcontractor for the first tier upon receipt of its subcontract, but in any event prior to start of its portion of the Work. Any other insurance carried by Edison, its officers, agents, and employees, which may be applicable, shall be deemed to be excess insurance, and Contractor's insurance shall be deemed primary for all purposes notwithstanding any conflicting provision in Contractor's policies to the contrary.

(i) Workers' Compensation Insurance with statutory limits, as required by the state in which the Work is performed, and Employer's Liability Insurance with limits of not less than \$5,000,000. Carriers furnishing such insurance shall be required to waive all rights of subrogation against Edison, its officers, agents, employees, and other contractors and subcontractors.

(ii) Comprehensive Bodily Injury and Property Damage Liability Insurance, including owners' and contractors' protective liability, product/completed operations liability, contractual liability, and coverage for liability incurred as a result of sudden and accidental discharge, dispersal, release or escape of polluting materials, (excluding automobile) with a combined single limit of not less than \$3,000,000 for each occurrence. Such insurance shall: (a) acknowledge Edison, its officers, agents, and employees, and additional insureds; (b) be primary for all purposes; and (c) contain standard crossliability provisions.

(iii) Automobile Bodily Injury and Property Damage Liability Insurance with a combined single limit of not less than \$3,000,000 for each occurrence. Such insurance shall cover liability arising out of the use by Contractor and Subcontractors of owned, non owned and hired automobiles in the performance of the Work. As used herein, the term "automobile" means vehicles licensed or required to be licensed under

the Vehicle Code of the state in which the Work is performed. Such insurance shall acknowledge Edison as an additional insured and be primary for all purposes.

(iv) Environmental Impairment Expense Insurance with a combined single limit of not less than \$5,000,000 for each occurrence and overall limits of \$10,000,000. Such insurance shall provide coverage for necessary costs or expense of removing, cleaning-up, transporting, nullifying, and rendering ineffective, or any of them, any substance which has caused environmental impairment and such insurance shall contain no exclusions for non-sudden and/or non-accidental discharge, release or escape of polluting materials. Such insurance shall acknowledge Edison as an additional insured and be primary for all purposes.

Contractor shall report immediately to Edison and confirm in writing any injury, loss, or damage incurred by Contractor or Subcontractors in excess of \$500.00, or its receipt of notice of any claim by a third party in excess of \$500.00, or any occurrence that might give rise to such claim.

If Contractor fails to comply with any of the provisions of this Section 16.0, Contractor shall, at its own cost, defend, indemnify, and hold harmless Edison, its officers, agents, employees, assigns, and successors in interest, from and against any and all liability, damages, losses, claims, demands, actions, causes of action, costs, including attorney's fees and expenses, or any of them, resulting from the death or injury to any person or damage to any property to the extent that Edison would have been protected had Contractor complied with all of the provisions of this Section.

17. ADDITIONAL PARTICIPATION LEVELS

Contractor acknowledges that the Program funding for the First Contract Year and the Program funding for the Second Contract Year contemplated by this Agreement are subject to approval by the California Public Utilities Commission ("CPUC").

Edison shall take all reasonable actions necessary to apply for and obtain funding for the First Contract Year and for the Second Contract Year at 50,000 units for each of said years and to take reasonable actions necessary to obtain Customer participation for such years at such levels provided that the TRC and UC ratios required under Section 19.3 are still met. Edison shall not take any action before the CPUC which could be reasonably calculated to influence the CPUC or any board, division, committee or member thereof to reject Edison's proposed funding of the Program, at the level of 50,000 units per year, for the First Contract Year and 50,000 units for the Second Contract Year. In addition to such other efforts as Edison shall take to encourage Customer participation in the Program, Edison shall spend not less than Five Hundred Thousand Dollars (\$500,000) in both the First Contract Year and not less than an additional Five Hundred Thousand Dollars (\$500,000) in the Second Contract Year for advertising and promotion of the Program. Contractor acknowledges and understands that Edison's annual forecast advice filing for the Second Contract Year (due October 1, 1996 to the CPUC) shall not reflect an amount greater than Edison's Specified Volume for the Second Contract Year.

18. INDEMNITY

18.1 Contractor shall, at its own cost, indemnify, defend, reimburse, and hold harmless Edison, its officers, directors, employees, agents, assigns, and successors in interest, from and against any and all liability, damages, losses, claims, suits, demands, actions, causes of action, costs, expenses, including attorney's fees and expenses, or any of them resulting from the death or injury to any person or damage to or destruction of any property caused by Contractor, Subcontractors, and employees, officers and agents of either Contractor or Subcontractors, or any of them, and arising out of or attributable to the performance or nonperformance of Contractor's obligations under this Agreement and including, without limitation, failure to comply fully with every federal, state, or local law, statute, regulation, rule, ordinance, or government directive which directly or indirectly regulates or affects the handling, storage,

recycling, or disposal of the Hazardous Materials to be managed by Contractor hereunder. In all cases of death or injury to employees, officers or agents of either Contractor or Subcontractors, whether or not caused by Contractor, Edison shall be indemnified by Contractor for any and all liability except to the extent such death or injury results from the negligence of Edison.

- 18.2 Contractor shall, at its own cost, indemnify, defend, reimburse, and hold harmless Edison, its officers, directors, employees, and agents, assigns, and successors in interest, from and against any and all liability imposed upon, or to be imposed upon Edison, under any law imposing liability for the environmental clean-up of the Hazardous Materials at any location (other than Edison's property) where the Hazardous Materials have been placed, stored or disposed of in the performance or nonperformance of Contractor's obligations under this Agreement, or any other site to which the Hazardous Materials have migrated.
- 18.3 The indemnities set forth in this Section 18.0 shall not be limited by the insurance requirements set forth in Section 16.0.

19. TERM AND TERMINATION

- 19.1 This Agreement shall commence on the date hereof and shall continue in effect until December 31, 1997, or until Contractor has picked up all units called in prior to December 31, 1997, whichever is later. This Agreement may be extended as agreed to in writing by the parties.
- 19.2 Either Party may terminate the Agreement for cause by 180 days advance written notice, and failure to cure, to the other Party. If the default has not been cured within said time period, the non-defaulting party may declare this contract terminated, effective the last day of said notice period. Contractor shall be paid for its services rendered to the date of said termination with all required specified volumes prorated to the date of termination.

FOR EXAMPLE:

Notice of Termination March 1. Termination effective September 1. Edison's Specified Volume 30,000. Edison's prorated Specified Volume 22,500. Actual units collected from Edison customers 17,500. Other Specified Volume, prorated to September 1, is 500.

Edison pays for 22,500 units (since greater than actual number collected) less any units invoiced and for which Edison has already paid and less 500 Other Specified Volume Units.

- 19.3 Under Rule No. 6 of the CPUC's Adopted Rules, Terms and Definitions for DSM Programs, as adopted in D.95-06-016, the CPUC requires that the Program's Total Resource Cost ("TRC") ratio and Utility Cost ("UC") ratio each be 1.0 or greater. Edison and Contractor are working together on Program design, and measurement and evaluation, and alternative sources of cost recovery of the per-unit CFC-11 Recover Charge in an effort to ensure that the Program will have TRC and UC ratios, each, of 1.0 or greater for the Second Contract Year. Edison and Contractor agree that all costs associated with the Direct Assistance Refrigerator Replacement Program, including, without limitation, any Edison costs or any Contractor costs, whether direct or indirect, shall not be included for purposes of determining the TRC and UC ratios for the Refrigerator Recycling Program described herein.

At the same time that Edison provides a draft of its annual forecast advice filing (due October 1, 1996 to the CPUC) to Edison's Policy Advisory Group (approximately thirty (30) days prior to October 1, 1996), Edison shall provide Contractor with Edison's preliminary forecast of the TRC ratio and UC ratio for the Program's Second Contract Year, along with assumptions pertinent to said determination. If the TRC and UC ratios are forecasted to be less than 1.0, then Edison shall provide Contractor with all reports, findings, research data, assumptions, summaries and other information or data pertinent to said determination. If the TRC ratio and the UC ratio are each not 1.0 or greater, Edison shall work with Contractor to determine if the TRC and UC ratios for the Second Contract Year are correct. If upon preparation of Edison's annual forecast advice filing (due October 1, 1996 to the CPUC), Edison still reasonably determines that, despite the foregoing

efforts, the Program for the Second Contract Year is forecasted not to achieve a TRC ratio and UC ratio each of at least 1.0 or greater, Edison shall have the right to terminate this Agreement upon 30 days prior written notice to Contractor with respect to the Second Contract Year only. In the event the Agreement is terminated pursuant to this Subsection, then Edison shall be released from any and all of its obligations under this Agreement for the Second Contract Year only, including, but not limited to, payments to Contractor for Edison's Specified Volume for the Second Contract Year.

- 19.4 Edison shall have the right to terminate this Agreement by 30 days advance written notice to Contractor upon CPUC mandate, or upon depletion of the amount of funding authorized by the CPUC for each of the First Contract Year and Second Contract Year. In the event the Agreement is terminated upon CPUC mandate, Edison shall pay Contractor all amounts owed under the Agreement as of 30 days after Edison's written notice to Contractor of the CPUC's mandate (the "Termination Date"). In such event, Edison shall only be obligated to pay Contractor for such Refrigerators and Freezers actually collected by Contractor for recycling as of the Termination Date, and shall not be obligated to pay Contractor for units not collected but which would otherwise be required to be paid for as units comprising Edison's Specified Volume.
- 19.5 In the event of termination pursuant to Section 19, Contractor and Edison shall work cooperatively to facilitate the termination of the Program.
- 19.6 Each Party shall immediately provide at no cost to the other any testimony, or any communications with the CPUC, or any board, division, committee or member thereof, which could reasonably be anticipated to effect the Program or which addresses the Program in any manner.

20. SUBCONTRACTS

- 20.1 Contractor shall contractually require each Subcontractor of the first tier providing service in connection with the Work to be bound by general terms and conditions protecting Edison which are equivalent to the terms and conditions of this Agreement.
- 20.2 Contractor shall, at all times, be responsible for the Work, and acts and omissions, of Subcontractors and persons directly or indirectly employed by them for services in connection with the Work. The Purchase Order and this Agreement shall not constitute a contractual relationship between any Subcontractor and Edison nor any obligation for payment to any Subcontractor.

21. CALIFORNIA PUBLIC UTILITIES COMMISSION

This Agreement and the Purchase Order incorporating this Agreement shall at all times be subject to such changes or modifications by the CPUC as it may from time to time direct in the exercise of its jurisdiction.

22. NON-WAIVER

None of the provisions of the Agreement shall be considered waived by either Party unless such waiver is specifically stated in writing.

23. ASSIGNMENT

Neither party shall delegate or assign the Agreement, or any Purchase Order incorporating this Agreement, or any part or interest thereof, without the prior written consent of the other Party, and any assignment without such consent shall be void and of no effect.

24. FORCE MAJEURE

Failure of Contractor to perform any of the provisions of this Agreement by reason of any of the following shall not constitute an event of default or breach of this Agreement: strikes, picket lines, boycott efforts, earthquakes, fires, floods, war (whether or not declared), revolution, riots, insurrections, acts of God, acts of government (including, without limitation, any agency or department of the United States of America), acts of the public enemy, scarcity or rationing of gasoline or other fuel or vital products, inability to obtain materials or labor, or other causes which are reasonably beyond the control of the Contractor.

25. GOVERNING LAW

The contract shall be interpreted, governed, and construed under the laws of the State of California as if executed and to be performed wholly within the State of California.

26. SECTION HEADINGS

Section headings appearing in this Agreement are for convenience only and shall not be construed as interpretations of text.

27. SURVIVAL

Notwithstanding completion or termination of the Work, of this Agreement, any amendment to the Agreement, or of any Purchase Order or Change Order, the Parties shall continue to be bound by the provisions of this Agreement and any Purchase Order incorporating this Agreement, amendment to this Agreement and Change Orders, which by their nature shall survive such completion or termination. Such provisions shall include, but not be limited to, Contractor's indemnity protecting Edison from any liability for environmental clean up as provided in Section 18 of this Agreement.

28. NONRELIANCE

Neither party has relied upon any representation, warranty, projection, estimate or other communication from the other not specifically so identified in this Agreement.

29 ATTORNEYS' FEES

In the event of any legal action or other proceeding between the parties arising out of this Agreement or the transactions contemplated herein, the prevailing party in such legal action or proceeding shall be entitled to have and recover from the other party all costs and expenses incurred therein, including reasonable attorneys' fees.

30. COOPERATION

Each of the parties agrees to cooperate with the other in whatever manner reasonably required to facilitate such parties' successful completion of the Agreement.

31. ENTIRE AGREEMENT

This Agreement contains the entire agreement and understanding between the Parties and merges and supersedes all prior representations and discussions pertaining to the Agreement, including Contractor's proposal. Any changes, exceptions, or different terms and conditions proposed by Contractor, or contained in Contractor's acknowledgment of the Agreement, or Change Order, are hereby rejected unless expressly stated in the Agreement or incorporated by a Change Order.

CONTRACTOR:

APPLIANCE RECYCLING CENTERS
OF AMERICA, INC.

SOUTHERN CALIFORNIA
EDISON COMPANY

By: _____
Its: _____

By: _____
Its: _____

Dated as of _____

Dated as of _____

GENERAL CREDIT AND SECURITY AGREEMENT

THIS AGREEMENT, dated as of August 30, 1996, between SPECTRUM Commercial Services, Inc., a Minnesota corporation, having its mailing address and principal place of business at 7900 International Drive, Suite 890, Bloomington, Minnesota 55425-1581 (herein called "Lender" or "SCS"), and Appliance Recycling Centers of America, Inc., a Minnesota corporation, having the mailing address and principal place of business at 7400 Excelsior Boulevard, Saint Louis Park, Minnesota 55426 (herein called "Borrower").

AGREEMENT. This Agreement states the terms and conditions under which Borrower may obtain certain loans from Lender.

CERTAIN DEFINITIONS. For purposes of this Agreement, the following terms shall have the following meanings:

"Acceptable Distributions" shall mean, with respect to Borrower, cash distributions made to Borrower's shareholders during any period in which Borrower has made an effective S Corporation election, in an amount equal to the combined federal and state income tax liability of such shareholders arising from their respective allocable share of the earnings and profit of Borrower (with each shareholder's federal and state income tax liability, including any minimum tax liability, to be computed on the basis of the applicable marginal tax rate for individuals under the Code and relevant state law as such applicable marginal tax rates are reduced by deductions for state income taxes with respect to the Code and for federal income taxes with respect to the relevant state law; provided, however, that no such distribution(s) shall be made if and to the extent that, after giving effect thereto, the aggregate amount distributed to all shareholders pursuant to this provision in any given period exceeds an amount equal to the amount of regular state and federal income tax that would be assessed against Borrower for such period if Borrower were subject to the tax provisions applicable to a C Corporation but not including any penalty tax provisions such as provisions for accumulated earnings taxes or personal holding company taxes.

"Advance(s)" shall have the meaning provided in Paragraph 4(a).

"Affiliate" shall include, with respect to any party, any Person which directly or indirectly controls, is controlled by, or is under common control with such party and, in addition, in the case of Borrower, each officer, director or shareholder of Borrower, and each joint venturer and partner of Borrower.

"Borrower" shall have the meaning provided in the preamble hereto.

"Borrowing Base" shall mean the sum of (i) Eighty percent (80%) of the net amount of Eligible Receivables or such greater or lesser percentage as Lender, in its sole discretion, shall deem appropriate, plus (ii) the lesser of (x) Two Hundred Twenty Five Thousand and No/100ths Dollars (\$225,000.00) or (y) Twenty Five percent (25%) of the net amount of Eligible Inventory, or such greater or lesser dollars and/or percentage as Lender, in its sole discretion, shall deem appropriate, plus (iii) One Hundred Sixty Four Thousand and No/100ths Dollars (\$164,000.00) for liquidation value of equipment or such greater or lesser dollars as Lender, in its sole discretion, shall deem appropriate.

"Business Day" shall mean any day on which commercial banks in Minneapolis, Minnesota are open for the transaction of business of the kind contemplated by this Agreement.

"Chattel Paper" shall have the meaning ascribed to such term in Article 9 of the Commercial Code.

"Closing Date" shall mean the day specified by Borrower on which all of the conditions precedent specified in Paragraph 21 shall have been satisfied.

"Code" shall mean the Internal Revenue Code of 1986, as amended from time to time.

"Commercial Code" shall mean the Uniform Commercial Code as enacted in the State of Minnesota, as amended from time to time.

"Consolidated" shall, when used with reference to any financial information pertaining to (or when used as a part of any defined term or statement pertaining to the financial condition of) any Person, mean the accounts of such Person and its subsidiaries, determined on a consolidated basis, all determined as to principles of consolidation and, except as otherwise

specifically required by the definition of such term or by such statement as to such accounts, in accordance with GAAP.

"Contingent Obligations" shall mean, with respect to any Person, all of such Person's liabilities and obligations which are contingent upon and will not mature unless and until the occurrence of some event or circumstance and which are not included within the definition of Liabilities of such Person.

"Current Assets" shall have the meaning given to that term in accordance with GAAP.

"Current Liabilities" shall have the meaning given to that term in accordance with GAAP, except that the outstanding principal amount of the Advance shall, in any event, be excluded.

"Customer(s)" shall have the meaning provided in Paragraph 7(a).

"Default" shall mean any event which, with the giving of notice or passage of time, or both, would constitute an Event of Default.

"Eligible Inventory" shall mean the dollar value of only that Inventory in which only Lender holds a senior security interest and as to which Lender, in its sole discretion, shall elect from time to time to constitute Eligible Inventory. Without limiting the discretion of Lender to consider any Inventory not to be Eligible Inventory, and by way of example of types of Inventory that Lender will consider not to be Eligible Inventory, Lender, notwithstanding any earlier classification of eligibility, may consider any Inventory not to be Eligible Inventory if: (i) such Inventory does not constitute finished goods (eg: "Fixed" or "Scratch & Dent"); (ii) such Inventory does not meet all standards imposed by any governmental agency having regulatory authority over such goods and/or their use, manufacture or sale; (iii) such Inventory has not been physically received in the continental United States by Borrower; (iv) such Inventory is not currently usable or currently salable in the normal course of Borrower's operations; (v) such Inventory is on consignment to or from any other Person or is subject to any bailment; (vi) such Inventory is subject to any lien, security interest or other encumbrance whatsoever, except for the security interest of Lender under this Agreement; (vii) such Inventory has been sold to any other person; or (viii) such Inventory is located in a place other than Borrower's processing centers or stores which are listed on Schedule A. The value of Eligible Inventory shall be the lower of the cost or market value of the Eligible Inventory computed on a first-in, first-out basis in accordance with generally accepted accounting principles on the basis of the most recent inventory certificates delivered to Lender pursuant to Paragraph 17(a)(v).

"Eligible Receivables" shall mean the dollar value of only such Receivables of Borrower arising from the sale of Inventory or the rendition of services in the ordinary course of business which has been fully performed by Borrower and in which only Lender holds a senior security interest and as to which Lender, in its sole discretion, shall from time to time determine to be Eligible Receivables. Without limiting the discretion of Lender to consider any Receivable not to be an Eligible Receivable, and by way of example only of types of Receivables that Lender will consider not to be Eligible Receivables, Lender, notwithstanding any earlier classification of eligibility may consider any Receivable not to be an Eligible Receivable if: (i) any warranty is breached as to the Receivable; (ii) the Receivable is not paid by the account debtor within 90 days from the date of the invoice relating to such Receivable; (iii) the account debtor disputes liability or makes any claim with respect to the Receivable; (iv) a petition in bankruptcy or other application for relief under any insolvency law is filed with respect to the account debtor owing the Receivable; (v) the account debtor on the Receivable makes an assignment for the benefit of creditors, becomes insolvent, fails, suspends, or goes out of business; (vi) the Receivable arises from a sale to an account debtor outside the United States, unless the sale is on terms acceptable to Lender in its sole discretion; (vii) the Receivable is owed by an account debtor who owes Receivables of which more than 10% are more than 90 days past the date of the invoices relating to such Receivables; (viii) the account debtor is an Affiliate or employee of Borrower; (ix) the account debtor is also a supplier or creditor of Borrower; (x) the account debtor is the United States of America, or any department or any agency of any thereof, unless Borrower has complied with the Assignment of Claims Act to Lender's satisfaction; (xi) the Receivable is either a consignment Receivable or a bonded Receivable or a retainage; or (xii) In its reasonable discretion, Lender shall become dissatisfied with the creditworthiness of an account debtor owing a Receivable.

"Equipment" shall have the meaning provided in Paragraph 3(c).

"ERISA" shall mean the Employee Retirement Income Security Act of 1974, as the same may from time to time be amended, and the rules and regulations promulgated thereunder by any governmental agency or authority, as from time to time in effect.

"ERISA Affiliate" shall mean, with respect to any Person, any

trade or business (whether or not incorporated) which is a member of a group of which such Person is a member and which is under common control within the meaning of Section 414 of the Code, as amended from time to time, and the regulations promulgated and rulings issued thereunder.

"ERISA Event" shall mean: (a) a Reportable Event described in Section 4043 of ERISA and the regulations issued thereunder (other than a Reportable Event not subject to the provision for 30-day notice to the PBGC under such regulations); (b) the withdrawal of Borrower or any ERISA Affiliate from a Plan during a plan year in which it was a "substantial employer" as defined in Section 4001(a)(2) of ERISA; (c) the filing of a notice of intent to terminate a Plan or the treatment of a Plan amendment as a termination under Section 4041 of ERISA; (d) the institution of proceedings to terminate a Plan by the PBGC under Section 4042 of ERISA; or (e) any other event or condition that might reasonably be expected to constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Plan.

"Event of Default" shall have the meaning provided in Paragraph 20.

"GAAP" shall mean generally accepted accounting principles consistently applied and maintained throughout the period indicated and consistent with the audited financial statements delivered to Lender pursuant to Paragraph 16(h). Whenever any accounting term is used herein which is not otherwise defined, it shall be interpreted in accordance with GAAP.

"General Intangibles" shall have the meaning provided in Paragraph 3(d).

"Guarantor" shall mean EDWARD R. CAMERON and any other Person who enters into a Guaranty hereof.

"Guaranty(ies)" shall mean those certain Guaranties dated as of AUGUST 30, 1996, FROM EDWARD R. CAMERON and any other agreement whereby a Person guarantees the payment or performance of any of the Obligations.

"Independent Public Accountants" shall mean MCGLADREY & PULLEN, LLP, or any other firm of independent public accountants which is acceptable to Lender.

"Inventory" shall have the meaning provided in Paragraph 3(b).

"Liabilities" of any Person shall mean those items which, in accordance with GAAP, appear as liabilities on a balance sheet.

"Line Maintenance Fee" shall have the meaning provided in Paragraph 17(j).

"Loan Administration Fee" shall have the meaning provided in Paragraph 17(h).

"Loan Document(s)" shall mean individually or collectively, as the case may be, this Agreement, the Note, the Guaranty[ies], and any and all other documents executed, delivered or referred to herein or therein, as originally executed and as amended, modified or supplemented from time to time.

"Material Adverse Occurrence" shall mean any occurrence of whatsoever nature (including, without limitation, any adverse determination in any litigation, arbitration or governmental investigation or proceeding) which Lender shall determine, in its sole discretion, could materially adversely affect the present or prospective financial condition or operations of Borrower or a Guarantor or impair the ability of Borrower or a Guarantor to perform its obligations under this Agreement or any other Loan Document.

"Maturity Date" shall mean August 30, 1999.

"Maximum Principal Amount" shall mean, at any date, One Million Five Hundred Thousand and No/100ths Dollars (\$1,500,000.00).

"Monthly Payment Date" shall mean the first day of each month.

"Multiemployer Plan" shall mean a "multiemployer plan" as defined in Section 4001(a)(3) of ERISA to which Borrower is making or accruing an obligation to make contributions, or has within any of the preceding three plan years made or accrued an obligation to make contributions.

"Net Income" for any period shall mean net income for such period, determined in accordance with GAAP excluding, however, (i) extraordinary gains, and (ii) gains (whether or not extraordinary) from sales or other dispositions of assets other than the sale of Inventory in the ordinary course of Borrower's business.

"Note" shall mean the promissory note in the form of Exhibit B attached hereto and made a part hereof made by Borrower payable to the order of Lender to evidence the Advances.

"Obligations" shall have the meaning provided in Paragraph 3.

"Origination Fee" shall have the meaning provided in Paragraph 17 (i) .

"Participant" shall mean each Person who purchases a participation interest from Lender in the obligations.

"PBGC" shall mean the Pension Benefit Guaranty Corporation or any successor board, authority, agency, officer or official of the United States administering the principal functions assigned on the date hereof to the Pension Benefit Guaranty Corporation under ERISA.

"Person" shall mean any natural person, corporation, firm, partnership, association, government, governmental agency or any other entity, whether acting in an individual, fiduciary or other capacity.

"Plan" shall mean each employee benefit plan or other class of benefits covered by Title IV of ERISA, in either case whether now in existence or hereafter instituted, of Borrower or any of its Subsidiaries.

"Prime Rate" shall mean the publicly announced base rate (or other publicly announced reference rate) charged by Norwest Bank Minnesota, National Association; Borrower acknowledges that the Prime Rate may not be the lowest rate made available by Lender to its customers and that Lender may lend to its customers at rates that are at, above or below the Prime Rate.

"Receivables" shall have the meaning provided in Paragraph 3(a) .

"Reportable Event" shall have the meaning given to that term in Title IV of ERISA.

"Security Interest" shall mean any lien, pledge, mortgage, encumbrance, charge or security interest of any kind whatsoever (including, without limitation, the lien or retained security title of a conditional vendor) whether arising under a security instrument or as a matter of law, judicial process or otherwise or the agreement by Borrower to grant any lien, security interest or pledge, mortgage or encumber any asset.

"Subordinated Debt" shall mean indebtedness of Borrower for borrowed money which is subordinated to the Obligations on terms satisfactory to Lender in its sole discretion.

"Subsidiary" of any Person shall mean any other corporation of which more than 50% of the outstanding shares of capital stock having ordinary voting power for the election of directors is owned directly or indirectly by such Person, by such Person and one or more Subsidiaries, or by one or more other Subsidiaries.

"Surplus Cash Flow" for any period shall mean Net Income for such period plus depreciation, amortization and other non-cash expenses for such period minus scheduled principal payments of indebtedness for borrowed money payable during such period (excluding principal payments with respect to the Advances, but including any scheduled reductions in the Borrowing Base or the Maximum Principal Amount) minus Acceptable Distributions for such period.

"Termination Date" shall mean the earliest of (i) the Maturity Date or (ii) the date upon which Lender's obligation to make Advances is terminated pursuant to Paragraph 20, or (iii) the date upon which the obligations are declared to be due and payable (or automatically become due and payable) upon the occurrence of an Event of Default as provided in Paragraph 20 or otherwise, or (iv) the date upon which this Agreement terminates as provided in Paragraph 23, or (v) upon demand by Lender in its sole and absolute discretion.

"Withdrawal Liability" shall have the meaning given to that term in Title IV of ERISA.

"Working Capital" at any date shall mean Current Assets at such date minus Current Liabilities at such date.

SECURITY. As security for all present and future sums loaned or advanced by Lender to Borrower and for all other obligations now or hereafter chargeable to Borrower's loan account hereunder, and all other obligations and liabilities of any and every kind of Borrower to Lender, due or to become due, direct or indirect, absolute or contingent, joint or several, howsoever created, arising or evidenced, now existing or hereafter at any time created, arising or incurred (herein called "Obligations"), Borrower hereby grants to Lender a security interest in and to the following property:

All Receivables of Borrower now owned or hereafter acquired or arising, together with all customer lists, original books and records, ledger and account cards, computer tapes, discs, printouts

and records, whether now in existence or hereafter created. "Receivables" means all rights of Borrower to the payment of money, whether or not earned and howsoever evidenced or arising, including (without limitation) all present and future "Accounts", accounts receivable, "Chattel Paper", "Instruments", and rights to payment which are "General Intangibles" (as those terms are used in the Commercial Code), all security therefor and all of Borrower's rights as an unpaid seller of goods (including rescission, replevin, reclamation and stopping in transit) and all of Borrower's rights to any goods represented by any of the foregoing including returned or repossessed goods;

All Inventory of Borrower, whether now owned or hereafter acquired and wherever located. "Inventory" includes all Goods (as defined in Article 9 of the Commercial Code) intended for sale or lease or to be furnished under contracts of service, all raw materials and work in process therefor, all finished goods thereof, all materials and supplies of every nature used or usable or consumed or consumable in connection with the manufacture, packing, shipping, advertising, selling, leasing or furnishing of such Goods, and all accessories thereto and all documents of title therefor evidencing the same;

All Equipment of Borrower, whether now owned or hereafter acquired and wherever located. "Equipment" includes all of Borrower's Goods other than Inventory, all replacements and substitutions therefor and all accessions thereto, and specifically includes, without limitation, all present and future machinery, equipment, vehicles, manufacturing equipment, shop equipment, office and record keeping equipment, furniture, fixtures, parts, tools and all other Goods (except Inventory) used or acquired for use by Borrower for any business or enterprise;

All General Intangibles (as defined in Article 9 of the Commercial Code) of Borrower, whether now owned or hereafter acquired, including (without limitation) all present and future domestic and foreign patents, patent applications, trademarks, trademark applications, copyrights, trade names, trade secrets, patent and trademark licenses (whether Borrower is licensor or licensee), shop drawings, engineering drawings, blueprints, specifications, parts lists, manuals, operating instructions, customer and supplier lists, licenses, permits, franchises, the right to use Borrower's corporate name and the goodwill of Borrower's business; and

All products and proceeds of any and all of the foregoing and all products and proceeds of any other Collateral (as hereinafter defined) including the proceeds of any insurance covering any of the Collateral.

All such Receivables, Inventory, Equipment, General Intangibles, products and proceeds, together with all other assets and properties of Borrower in or on which Lender is now or hereafter granted a security interest, mortgage, lien or encumbrance pursuant to this Agreement or otherwise, are hereinafter sometimes referred to as "Collateral".

ADVANCES.

At the request of Borrower, Lender agrees, subject to the terms and conditions hereinafter set forth, to make loans (each such loan being herein sometimes called individually an "Advance" and collectively the "Advances") to Borrower from time to time on any Business Day during the period from the date hereof and ending on the Termination Date; provided, however, that Lender shall not be required to make any Advance if, after giving effect to such Advance, the aggregate unpaid principal amount of Advances outstanding would exceed the lesser of the Borrowing Base or the Maximum Principal Amount. The amount of each such Advance shall be charged to Borrower's loan account. Borrower acknowledges that Lender may, but shall not be obligated to, make an Advance at any time in an amount equal to any overdraft in any account of Borrower maintained with Lender or any Participant even if the aggregate unpaid principal amount of Advances exceeds or would exceed the Borrowing Base or the Maximum Principal Amount.

In order to obtain an Advance, Borrower shall give written or telephonic notice to Lender, by not later than 11:00 a.m. (Minneapolis time) on the date the requested Advance is to be made. Lender, shall make such Advance by transferring the amount thereof in immediately available funds for credit to an account (other than a payroll account) of Borrower at Lender, as specified in such notice. At the request of Lender, Borrower shall confirm in writing any telephonic notice.

The obligation of Lender to make Advances shall terminate on the Termination Date.

If at any time the sum of the aggregate outstanding principal balance of the Advances exceeds the lesser of (i) the Maximum Principal Amount or (ii) the Borrowing Base, then Borrower agrees to make, on demand, a principal repayment on the Advances in an amount equal to such excess together with accrued interest on the amount repaid to the date of repayment. Borrower agrees that, on the Termination Date, it will repay the entire outstanding principal balance of the Advances together with accrued interest thereon and all accrued fees without presentment or demand for payment, notice of dishonor, protest or notice of protest, all of which are hereby waived.

The Advances shall be evidenced by the Note made by Borrower payable to the order of Lender in a principal amount equal to the Maximum Principal Amount; subject, however, to the provisions of the Note to the effect that the principal amount payable thereunder at any time shall not exceed the then unpaid principal amount of all Advances made by Lender. Borrower hereby irrevocably authorizes Lender to make or cause to be made, at or about the time of each Advance made by Lender, an appropriate notation on the records of Lender, reflecting the principal amount of such Advance, and Lender shall make or cause to be made, on or about the time of receipt of payment of any principal of the Note, an appropriate notation on its records reflecting such payment. The aggregate amount of all Advances set forth on the records of Lender shall be rebuttable presumptive evidence of the principal amount owing and unpaid on the Note.

4A. DEMAND FACILITY. All interest, principal, Advances, and any other amounts owing hereunder are due ON DEMAND and Lender specifically reserves the absolute right to demand payment of all such amounts at any time, with or without advance notice, for any reason or no reason whatsoever. Lender's right to make such demand is not exclusive and Lender may coincidentally or separately from such demand make further demand for payment pursuant to Paragraph 20 or otherwise hereunder and, further, amounts may become due hereunder (pursuant to Paragraph 20 or otherwise) without a demand by Lender, as provided in this agreement.

INTEREST. Borrower agrees to pay interest on the outstanding principal amount of the Note, at the close of each day at a fluctuating rate per annum (computed on the basis of actual number of days elapsed and a year of 360 days) which is at all times equal to Four Percent (4%) in excess of the Prime Rate; each change in such fluctuating rate caused by a change in the Prime Rate to occur simultaneously with the change in the Prime Rate; provided, however, that (i) in no event shall the interest rate in effect hereunder at any time be less than 10% per annum; and (ii) interest payable hereunder with respect to each calendar month shall not be less than \$7,500.00 regardless of the amount of loans, Advances or other credit extensions that actually may have been outstanding during the month. Interest accrued through the last day of each month will be due and payable to Lender on the next Monthly Payment Date, commencing October 1, 1996. Interest shall also be payable on the Maturity Date or on any earlier Termination Date. Interest accrued after the Maturity Date or earlier Termination Date shall be payable on Demand. Interest may be charged to Borrower's loan account as an Advance at Lender's option, whether or not Borrower then has the right to obtain an Advance pursuant to the terms of this Agreement. Notwithstanding the foregoing, after an Event of Default, this Note shall bear interest until paid at 5% per annum in excess of the rate otherwise then in effect, which rate shall continue to vary based on further changes in the Prime Rate; provided, however, that after an Event of Default, (i) in no event shall the interest rate in effect hereunder at any time be less than 15% per annum; and (ii) interest payable hereunder with respect to each calendar month shall not be less than \$7,500.00 regardless of the amount of loans, Advances or other credit extensions that actually may have been outstanding during the month. The undersigned also shall pay the holder of this Note a late fee equal to 10% of any payment under this Note that is more than 10 days past due.

SET-OFF; ETC. Upon the occurrence of a Default or an Event of Default, Lender is hereby authorized at any time and from time to time, without notice to Borrower (any such notice being expressly waived by Borrower), to set off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held and other indebtedness at any time owing by Lender or any Participant to or for the credit or the account of Borrower, including specifically any amounts held in any account maintained at Lender or any Participant, against any and all amounts which may be owed to Lender or any Participant by Borrower whether in connection with this Agreement or otherwise and irrespective of whether Borrower shall have made any requests under this Agreement.

REPORTS AND COLLECTION.

Borrower agrees to furnish to Lender, at least weekly, schedules describing Receivables created or acquired by Borrower (including confirmatory written assignments thereof), and, if requested by Lender, copies of all invoices to account debtors and other obligors (all herein referred to as "Customers") and original shipping or delivery receipts for all goods sold, but if Borrower fails

to do so the rights of Lender as a secured party will not be impaired. At any time after the occurrence of an Event of Default, Lender may notify Customers at any time that Receivables have been assigned to Lender and collect them directly in Lender's own name but unless and until Lender does so or gives Borrower other instructions, Borrower shall make collection for Lender at Borrower's sole cost and expense. Borrower shall advise Lender promptly of any goods which are returned by Customers or otherwise recovered involving an amount in excess of \$5,000.00 and, unless instructed to deliver such goods to Lender, Borrower shall resell them for Lender and assign or deliver to Lender the resulting Receivables or other proceeds. Borrower shall also advise Lender promptly of all disputes and claims by Customers involving an amount in excess of \$5,000.00 and settle or adjust them at no expense to Lender. At any time after the occurrence and during the continuance of an Event of Default, Lender may at all times settle or adjust such disputes and claims directly with the Customers for amounts and upon terms which Lender considers advisable. If Lender so directs at any time after an Event of Default, no discount, credit or allowance shall be granted by Borrower to any Customer and no return of goods shall be accepted by Borrower without Lender's written consent.

Borrower agrees to furnish to Lender Inventory certifications in accordance with Paragraph 17(a) (v) and a physical listing of all Inventory, wherever located, at least once every twelve months or, in either case, as more frequently requested by Lender.

All full and partial payments arising from the sale or other disposition of Collateral shall immediately be delivered by Borrower to Lender in their original form, except for endorsement where necessary. Until such payments are so delivered to Lender, such payments shall be held in trust by Borrower for and as Lender's property and shall not be commingled with any funds of Borrower. The net amount received by Lender as proceeds arising from the sale or other disposition of Collateral will be credited by Lender to Borrower's loan account (subject to final collection thereof) after allowing the number of days required by the applicable bank for collection of checks and other instruments.

WARRANTY AS TO COLLATERAL. Borrower warrants that:

all Receivables listed in or reported on Borrower's schedules will, when Borrower delivers the schedules to Lender, be bona fide existing obligations created by the sale and actual delivery of goods or the rendition of services to Customers in the ordinary course of business, which Borrower then owns free of any Security Interest except for the Security Interest in favor of Lender created by this Agreement or Security Interests permitted under Paragraph 18(d), and which are then unconditionally owing to Borrower without defense, offset or counterclaim; and that all shipping or delivery receipts, invoice copies and other documents furnished to Lender in connection therewith will be genuine; and

all Inventory and Equipment is and shall be owned by Borrower, free of any Security Interest except for the Security Interest of Lender created by this Agreement or Security Interests permitted by Paragraph 18(d).

Lender's rights to and security interest in the Collateral will not be impaired by the ineligibility of any such Collateral for Advances and will continue to be effective until all obligations chargeable to Borrower's loan account have been fully satisfied.

POWER OF ATTORNEY. Borrower appoints Lender, or any of Lender's officers, employees or agents whom Lender may from time to time designate, as Borrower's attorney with power to: (a) to endorse Borrower's name on any checks, notes, acceptances, drafts or other forms of payment or security that may come into Lender's possession; (b) to sign Borrower's name on any invoice or bill of lading relating to any Receivables, on drafts against Customers, on schedules and confirmatory assignments of Receivables, on notices of assignment, financing statements and amendments under the Commercial Code and other public records, on verifications of accounts and on notices to Customers; (c) to notify the post office authorities to change the address for delivery of Borrower's mail to an address designated by Lender; (d) to receive, open and dispose of all mail addressed to Borrower; (e) to send requests for verification of accounts to Customers; and (f) to do all things necessary to carry out this Agreement; provided however, that the powers specified in clauses (c) and (d) above may be exercised only after the occurrence of an Event of Default. Borrower ratifies and approves all acts of the attorney. Neither Lender nor the attorney will be liable for any acts of commission or omission nor for any error in judgment or mistake of fact or law. This power, being coupled with an interest, is irrevocable so long as any Receivable in which Lender has a security interest or any obligation remains unpaid. Borrower waives presentment and protest of all instruments and notice thereof, notice of default and dishonor and all other notices to which Borrower may otherwise be entitled.

LOCATION OF COLLATERAL. Borrower warrants that its chief executive office is at the address stated in the opening paragraph of this Agreement and that its books and records concerning Receivables are located there. Borrower's Inventory, Equipment and other goods are at the location or locations as designated on Schedule A annexed hereto. Borrower shall immediately notify Lender if any additional locations for Collateral are subsequently established. Borrower shall not change the location of its chief executive office, the place where it keeps its books and records, or the location of any Collateral (except for sales of Inventory in the ordinary course of business) until Borrower has obtained the written consent of Lender and all necessary filings have been made and other actions taken to continue the perfection of Lender's Security Interest in such new location. Lender's Security Interest attaches to all the Collateral wherever located, and the failure of Borrower to inform Lender of the location of any item or items of Collateral shall not impair Lender's Security Interest therein.

OWNERSHIP AND PROTECTION OF COLLATERAL. Borrower warrants, represents and covenants to Lender that the Collateral is now and, so long as Borrower is obligated to Lender, will be owned by Borrower free and clear of all Security Interests except for the Security Interest in favor of Lender created by this Agreement and except for the Security Interests, if any, permitted by Paragraph 18(d), and that said Collateral, including the Receivables and proceeds resulting from the collection, sale or other disposition thereof, will remain free and clear of any and all Security Interests except for the Security Interest in favor of Lender created by this Agreement and except for the Security Interests, if any, permitted under Paragraph 18(d). Borrower will not sell, lease or otherwise dispose of the Collateral, or attempt so to do (except for sales of Inventory in the ordinary course of business and sales of obsolete and worn equipment not in excess of \$25,000.00 in the aggregate in any calendar year) without the prior written consent of Lender and unless the proceeds of any such sale are paid to Lender for application on Borrower's Obligations. After the occurrence of a Default or an Event of Default, Lender will at all times have the right to take physical possession of any Inventory and Equipment constituting Collateral and to maintain such possession on Borrower's premises or to remove the same or any part thereof to such other places as Lender may wish. If Lender exercises Lender's right to take possession of such Collateral, Borrower shall on Lender's demand, assemble the same and make it available to Lender at a place reasonably convenient to Lender. Borrower shall at all times keep the Equipment constituting Collateral in good condition and repair. All expenses of protecting, storing, warehousing, insuring, handling and shipping of the Collateral, all costs of keeping the Collateral free of any Security Interests prohibited by this Agreement and of removing the same if they should arise, and any and all excise, property, sales and use taxes imposed by any state, federal or local authority on any of the Collateral or in respect of the sale thereof, shall be borne and paid by Borrower and if Borrower fails to promptly pay any thereof when due, Lender may, at its option, but shall not be required to, pay the same and charge Borrower's loan account therefor. Borrower agrees to renew all insurance required by this Paragraph 11 or Paragraph 13 at least 30 days prior to its expiration. Borrower agrees that, with respect to any Inventory maintained in a public warehouse, (i) Borrower will ensure that any warehouse receipts issued are not in a negotiable form, (ii) Borrower will, upon request from Lender, deliver all warehouse receipts to Lender, and (iii) Borrower will cause the public warehouseman to execute an agreement similar to those delivered pursuant to Paragraph 21(m) and in form and substance satisfactory to Lender.

PERFECTION OF SECURITY INTEREST. Borrower agrees to execute such financing statements together with any and all other instruments or documents and take such other action, including delivery, as may be required to create, evidence, perfect and maintain Lender's Security Interest in the Collateral and Borrower shall not in any manner do any act or omit to do any act which would in any manner impair or invalidate Lender's Security Interest in the Collateral or the perfection thereof.

INSURANCE. Borrower shall maintain insurance coverage on any Collateral other than Receivables with such companies, against such hazards, and in such amounts as may from time to time be acceptable to Lender and shall deliver such policies or copies thereof to Lender with satisfactory lender's loss payable endorsements naming Lender. Each policy of insurance shall contain a clause requiring the insurer to give not less than 30 days prior written notice to Lender in the event of any anticipated cancellation of the policy for any reason and a clause that the interest of Lender shall not be impaired or invalidated by any act or neglect of Borrower nor by the occupation of the premises wherein such Collateral is located for purposes more hazardous than are permitted by said policy. Borrower will maintain, with financially sound and reputable insurers, insurance with respect to its properties and business against such casualties and contingencies of such types (which may include, without limitation, public and product liability, larceny, embezzlement, or other criminal misappropriation insurance) and in such amounts as may from time to time be required by Lender.

BORROWER'S ACCOUNT. Lender may charge to Borrower's loan account at any time the amounts of all Obligations (and interest, if any, thereon) owing by Borrower to Lender, including (without limitation) loans, Advances, debts, liabilities, obligations acquired by purchase, assignment or

participation and all other obligations, whenever arising, whether absolute or contingent and whether due or to become due; also the amount of all costs and expenses and all attorneys' fees and legal expenses incurred in connection with efforts made to enforce payment of such obligations, or to obtain payment of any Receivables, or the foreclosure of any Collateral or in the prosecution or defense of any actions or proceedings relating in any way to this Agreement whether or not suit is commenced, including reasonable attorneys' fees and legal expenses incurred in connection with any appeal of a lower court's order or judgment; and also the amounts of all unpaid taxes and the like, owing by Borrower to any governmental authority or required to be deposited by Borrower, which Lender pays or deposits for Borrower's account. All of Borrower's borrowings hereunder and (unless otherwise specified) all other obligations which are chargeable to Borrower's loan account shall be payable ON DEMAND; recourse to security will not be required at any time. All sums at any time standing to Borrower's credit on Lender's books and all of Borrower's property at any time in Lender's possession or upon or in which Lender has a Security Interest, may be held by Lender as security for all obligations which are chargeable to Borrower's loan account. Subject to the foregoing, Lender, at Borrower's request, will remit to Borrower any net balance standing to Borrower's credit on Lender's books. Lender will account to Borrower monthly and each monthly accounting will be fully binding on Borrower, unless, within thirty days thereafter, Borrower gives Lender specific written notice of exceptions. All debit balances in Borrower's loan account will bear interest as provided in Paragraph 5 of this Agreement. If Lender so requests at any time, Borrower will immediately execute and deliver to Lender a promissory note in negotiable form payable on demand to Lender's order in a principal amount equal to the amount of the debit balance in Borrower's loan account, with interest as provided in Paragraph 5 of this Agreement. In any event, Borrower covenants to pay all Advances, debts, accounts and interest when due.

PARTICIPATIONS. If any Person shall acquire a participation in Advances made to Borrower hereunder, Borrower hereby grants to any such Person holding a participation, and such Person shall have and is hereby given a continuing Security Interest in any money, securities and other property of Borrower in the custody or possession of such Participant, including the right of set-off as fully as if such Participant had lent directly to Borrower the amount of such participation.

GENERAL REPRESENTATIONS AND WARRANTIES. To induce Lender to make Advances hereunder, Borrower makes the following representations and warranties, all of which shall survive the initial Advance:

Borrower is a corporation duly organized, existing, and in good standing under the laws of the state of Minnesota has corporate power to own its property and to carry on its business as now conducted, and is duly qualified to do business in all states in which the nature of its business requires such qualification. During the past five years, Borrower has done business solely under the names listed on Schedule B attached hereto. Borrower does not own any capital stock of any corporation, except as set forth on Schedule C attached hereto.

The execution and delivery of this Agreement and the other Loan Documents and the performance by Borrower of its obligations hereunder and thereunder do not and will not conflict with any provision of law, or of the charter or bylaws of Borrower, or of any agreement binding upon Borrower.

The execution and delivery of this Agreement and the other Loan Documents have been duly authorized by all necessary corporate action by directors and shareholders of Borrower; and this Agreement and the other Loan Documents have in fact been duly executed and delivered by Borrower and constitute its lawful and binding obligations, legally enforceable against it in accordance with their respective terms.

Except as disclosed to Lender on Schedule D attached hereto, there is no action, suit or proceeding at law or equity, or before or by any federal, state, local or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, pending or, to the knowledge of Borrower, threatened against Borrower or any Guarantor or the property of Borrower or any Guarantor which, if determined adversely, would be a Material Adverse Occurrence or would affect the ability of Borrower or any Guarantor to perform its obligations under the Loan Documents; and neither Borrower nor any Guarantor is in default with respect to any final judgment, writ, injunction, decree, rule or regulation of any court or federal, state, local or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, where the effect of such default would be a Material Adverse Occurrence.

The authorization, execution and delivery of this Agreement, and the payment of the loans and interest hereon, is not, and will not be, subject to the jurisdiction, approval or consent of any federal, state or local regulatory body or administrative agency.

All of the assets of Borrower are free and clear of Security Interests except those listed on Schedule E attached hereto.

Borrower has filed all federal, state and local tax returns which, to the knowledge of Borrower, are required to be filed, and Borrower has paid all taxes shown on such returns and all assessments which are due. Borrower has made all required withholding deposits. Federal income tax returns of Borrower have been examined and approved or adjusted by the applicable taxing authorities or closed by applicable statutes for all fiscal years prior to and including the fiscal year ended on . Borrower does not have knowledge of any objections to or claims for additional taxes by federal, state or local taxing authorities for subsequent years which would be a Material Adverse Occurrence.

Borrower has furnished to Lender the financial statements listed on Schedule G attached hereto. These statements were prepared in accordance with GAAP and present fairly the financial condition of Borrower and its Consolidated Subsidiaries. There has been no material adverse change in the condition of Borrower and its Consolidated Subsidiaries, financial or otherwise, since the date of the most recent of such financial statements.

The value of the assets and properties of Borrower at a fair valuation and at their then present fair salable value is and, after giving effect to any pending Advance and the application of the amount advanced, will be materially greater than its total liabilities, including Contingent Obligations, and Borrower has (and has no reason to believe that it will not have) capital sufficient to pay its liabilities, including Contingent Obligations, as they become due.

Borrower is in compliance with all requirements of law relating to pollution control and environmental regulations in the respective jurisdictions where Borrower is presently doing business or conducting operations.

All amounts obtained pursuant to Advances will be used for Borrower's working capital purposes.

Except for the trademarks, patents, copyrights and franchise rights listed on Schedule F attached hereto, Borrower is not the owner of any patent, trademark, copyright or franchise rights.

(i) Each Plan is in compliance in all material respects with all applicable provisions of ERISA and the Code; (ii) the aggregate present value of all accrued vested benefits under all Plans (calculated on the basis of the actuarial assumptions specified in the most recent actuarial valuation for such Plans) did not exceed as of the date of the most recent actuarial valuation for such Plans the fair market value of the assets of such Plans allocable to such benefits; (iii) Borrower is not aware of any information since the date of such valuations which would materially affect the information contained therein; (iv) no Plan which is subject to Part 3 of Subtitle B of Title I of ERISA or Section 412 of the Code has incurred an accumulated funding deficiency, as that term is defined in Section 302 of ERISA or Section 412 of the Code (whether or not waived); (v) no liability to the PBGC (other than required premiums which have become due and payable, all of which have been paid) has been incurred with respect to any Plan, and there has not been any Reportable Event which presents a material risk of termination of any Plan by the PBGC; and (vi) Borrower has not engaged in a transaction which would subject it to tax, penalty or liability for prohibited transactions imposed by ERISA or the Code. Borrower does not contribute to any Multiemployer Plan.

No part of any Advance shall be used at any time by Borrower to purchase or carry margin stock (within the meaning of Regulation U promulgated by the Board of Governors of the Federal Reserve System) or to extend credit to others for the purpose of purchasing or carrying any margin stock. Borrower is not engaged principally, or as one of its important activities, in the business of extending credit for the purposes of purchasing or carrying any such margin stock. No part of the proceeds of any Advance will be used by Borrower for any purpose which violates, or which is inconsistent with, any regulations promulgated by the Board of Governors of the Federal Reserve System.

Borrower is not an "investment company", or an "affiliated person" of, or a "promoter" or "principal underwriter" for, an "investment company", as such terms are defined in the Investment Company Act of 1940, as amended. The making of the Advances, the application of the proceeds and repayment thereof by Borrower and the performance of the transactions contemplated by this Agreement will not violate any provision of said Act, or any rule, regulation or order issued by the Securities and Exchange Commission thereunder.

The number of shares and classes of the capital stock of Borrower and the ownership thereof are accurately set forth on Schedule H attached hereto. Borrower has not: (i) issued any unregistered securities in violation of the registration requirements of Section 5 of the Securities Act of 1933, as amended, or any other law; or (ii) violated any rule, regulation or requirement under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, in either case where the effect of such violation would be a Material Adverse Occurrence. No proceeds of the Advances will be used to acquire any security in any transaction which is subject to Section 13(d) or 14(d) of the Securities Exchange Act of 1934, as amended.

Except for Contingent Obligations shown on Schedule I attached hereto, Borrower does not have any Contingent obligations.

All factual information heretofore or herewith furnished by or on behalf of Borrower to Lender for purposes of or in connection with this Agreement or any transaction contemplated hereby is, and all other such factual information hereafter furnished by or on behalf of Borrower to Lender will be, true and accurate in every material respect on the date as of which such information is dated or certified and no such information contains any material misstatement of fact or omits to state a material fact or any fact necessary to make the statements contained therein not misleading.

Each representation and warranty shall be deemed to be restated and reaffirmed to Lender on and as of the date of each Advance under this Agreement except that any reference to the financial statements referred to in Paragraph 16(h) shall be deemed to refer to the financial statements then most recently delivered to Lender pursuant to Paragraphs 17(a) (i) and (ii).

AFFIRMATIVE COVENANTS. Borrower agrees that it will:

Furnish to Lender in form satisfactory to Lender:

Within 90 days after the end of each fiscal year of Borrower, a complete audited financial report prepared and certified without qualification or explanatory language by Independent Public Accountants on a Consolidated and consolidating basis for Borrower and any Consolidated Subsidiaries of Borrower; together with a copy of the management letter or memorandum, if any, delivered by such independent certified public accountant to Borrower and Borrower's response thereto. If Borrower shall fail to supply the report within such time limit, Lender shall have the right (but not the duty) to employ certified public accountants acceptable to Lender to prepare such report at Borrower's expense;

Within 30 days after the end of each month, a balance sheet with operating figures as to that month, certified as correct by the chief financial officer or treasurer of Borrower but subject to adjustments as to inventories or other items to which an officer of Borrower directs attention in writing, together with a reconciliation of any variances between the information provided on such balance sheet and the information for that day previously delivered to Lender pursuant to Paragraph 17(a) (v);

With the financial statements described in Paragraph 17(a) (i) and (ii), a compliance certificate in the form attached as Exhibit A certified as true and accurate by the chief financial officer or treasurer of Borrower;

Within 10 days after the end of each month, an aging of accounts receivable together with a reconciliation in a form satisfactory to Lender and an aging of accounts payable in form acceptable to Lender and certified as true and accurate by an officer of Borrower;

Within 10 days after the end of each month, an inventory certification report for all Inventory locations in form acceptable to Lender and certified as true and accurate by an officer of Borrower; and

From time to time, at Lender's request, any and all other material, reports, information, or figures reasonably required by Lender.

Permit Lender and its representatives access to, and the right to make copies of, the books, records, and properties of Borrower at all reasonable times; and permit Lender and its

representatives to discuss Borrower's financial matters with officers of Borrower and with its Independent Public Accountant (and, by this provision, Borrower authorizes its Independent Public Accountant to participate in such discussions).

Pay when due all taxes, assessments, and other liabilities against it or its properties except those which are being contested in good faith and for which an adequate reserve has been established; Borrower shall make all withholding payments when due; during any period for which Borrower has made an effective S Corporation election, Borrower shall promptly provide Lender with evidence of payment by Borrower's shareholders of estimated income taxes.

Promptly notify Lender in writing of any substantial change in present management of Borrower.

Pay when due all amounts necessary to fund in accordance with its terms any Plan.

Comply in all material respects with all laws, acts, rules, regulations and orders of any legislative, administrative or judicial body or official applicable to Borrower's business operation or Collateral or any part thereof; provided, however, that Borrower may contest any such law, act, rule, regulation or order in good faith by appropriate proceedings so long as (i) Borrower first notifies Lender of such contest, and (ii) such contest does not, in Lender's sole discretion, adversely affect Lender's right or priority in the Collateral or impair Borrower's ability to pay the Obligations when due.

Pay Lender for the period commencing on the date of this Agreement and continuing through the date of payment of all Obligations after the Termination Date, a reasonable administration fee (herein called the "Loan Administration Fee"), which so long as no Default or Event of Default exists under this Agreement, shall be equal to the sum of \$1,000.00 per quarter (commencing with the quarter beginning October 1, 1996) plus all out-of-pocket expenses incurred by Lender in conducting examinations. The Loan Administration Fee shall be non-refundable, shall be deemed earned when paid and shall be payable to Lender in advance on October 1, 1996 and on the first day of each subsequent 3 month period/quarter. Borrower hereby consents to such examinations by Lender.

Pay to Lender an origination fee (the "Origination Fee") in the amount of Five Thousand and No/100ths Dollars (\$5,000.00). Pay to Lender a survey fee (the "Survey Fee") in the amount of Three Thousand Five Hundred and No/100ths Dollars (\$3,500.00), receipt of which is hereby acknowledged. The entire amount of the Origination Fee and Survey Fee shall be nonrefundable and shall be deemed to have been earned upon execution of this Agreement.

Pay Lender, for the period commencing on the date of this Agreement and continuing through the Termination Date, a non-refundable line maintenance fee (the "Line Maintenance Fee") at the rate of 1.0% per annum of the Maximum Principal Amount. Such Line Maintenance Fee shall be payable to Lender in advance on the Closing Date and on each subsequent anniversary date of this Agreement until all amounts owing hereunder are repaid in full. The Line Maintenance Fee shall be non-refundable and shall be deemed earned when paid.

Notwithstanding the above subparagraph, should Borrower's 1996 Net Income (before provision for income taxes) or gross profit fail to meet or exceed a figure which is 90% of the projected Net Income for 1996 (as it appears on Borrower's projected income statement attached as Exhibit C), then the Line Maintenance Fee for the first calendar quarter of 1997 shall be increased from 1.0% per annum to 1.5% per annum, and Borrower shall immediately pay to Lender, on demand, the amount of any deficiency in the Line Maintenance Fee previously paid with respect to such quarter.

Notwithstanding the above subparagraph, during 1997, should Borrower's Net Income (before provision for income taxes) or gross profit in any calendar quarter fail to meet or exceed a figure which is 85% of the projected Net Income for that quarter (as it appears on Borrower's projected income statement attached as Exhibit C), then the Line Maintenance Fee for the next calendar quarter shall be increased from 1.0% per annum to 1.5% per annum, and Borrower shall immediately pay to Lender, on demand, the amount of any deficiency in the Line Maintenance Fee previously paid with respect to such quarter.

Promptly notify Lender in writing of (x) any litigation which (i) involves an amount in dispute in excess of \$10,000.00 (ii) relates to the matters which are the subject of this Agreement, or (iii) if determined adversely to Borrower would be a

Material Adverse Occurrence; and (y) any adverse development in any litigation described in clause (x).

Promptly notify Lender of any Default or Event of Default.

At the end of each quarter of the Borrower's fiscal year, Borrower must achieve Seventy-Five percent (75%) of their projected Net Income (before provision for income taxes) and gross profit both for that calendar quarter and for the fiscal year to date through the end of that quarter, as reflected in the projections which are attached hereto as Exhibit A.

NEGATIVE COVENANTS. Borrower agrees that it will not:

Without Lender's consent, expend or contract to expend an aggregate in excess of \$400,000.00 for fixed assets in any fiscal year, whether by way of purchase, lease or otherwise, and whether payable currently or in the future.

Purchase or redeem any shares of Borrower's capital stock; or declare or pay any dividends (other than dividends payable in capital stock); or make any distribution to stockholders of any assets of Borrower; (provided, however, that so long as no Default or Event of Default exists or would result from such distributions, Borrower may make Acceptable Distributions to be used by Borrower's shareholders solely to make required income tax payments.

Without Lender's consent, incur or permit to exist any indebtedness, secured or unsecured, for money borrowed, except: (i) borrowings under this Agreement; (ii) borrowings, if any, which are existing on the date of this Agreement and which are disclosed on Schedule J attached hereto; or (iii) indebtedness, not exceeding \$50,000.00 at any one time in the aggregate outstanding incurred to acquire fixed assets but only to the extent that such fixed asset acquisition is permitted by Paragraph 18(a).

Create or permit to exist any Security Interest on any assets now owned or hereafter acquired except: (i) those created in Lender's favor and held by Lender; (ii) liens of current taxes not delinquent or taxes which are being contested in good faith for which an adequate reserve has been established; (iii) purchase money security interests securing indebtedness permitted by Paragraph 18(c)(iii); provided, however, that such Security Interest extends only to the fixed assets acquired with the proceeds of such indebtedness; and (iv) Security Interests disclosed on Schedule E attached hereto, securing only debt outstanding on the date of this Agreement and disclosed on Schedule J.

Effect any recapitalization; or be a party to any merger or consolidation; or, except in the normal course of business, sell, transfer, convey or lease all or any substantial part of its property; or sell or assign (except to Lender), with or without recourse, any Receivables or General Intangibles.

Enter into a new business or purchase or otherwise acquire any business enterprise or any substantial assets of any person or entity; or make any loans to any person or entity; or purchase any shares of stock of, or similar interest in, or make any capital contribution to or investment in, any entity.

Permit more than \$150,000.00 to be owing at any one time to Borrower by all of Borrower's employees, officers, directors, or shareholders, or members of their families, as a result of any borrowings, purchases, travel advances or other transactions or events;

Become a guarantor or surety or pledge its credit or its assets on any undertaking of another, except for the Contingent Obligations shown on Schedule I attached hereto;

In any fiscal year pay excessive or unreasonable salaries, bonuses, fees, commissions, fringe benefits or other forms of compensation (such salaries, bonuses, fees, commissions, fringe benefits or other forms of compensation being "Compensation") to any of its officers or directors; or increase the Compensation of any officers by more than percent (10%) or pay any such increases in Compensation of officers other than from profits earned in the year of such payment;

Permit any default to occur under the terms of any note, loan agreement, lease, mortgage, contract for deed, security agreement, or other contractual obligation binding upon Borrower;

Make any substantial change in present management or policy or in its present business or enter into a new business;

Enter into any agreement providing for the leasing by Borrower of property which has been or is to be sold or transferred by Borrower to the lessor thereof, or which is substantially similar in purpose to the property so sold or transferred;

Change its terms of trade with respect to the due date of any Receivable;

Change its fiscal year;

(i) Permit or suffer any Plan maintained for employees of Borrower or any commonly controlled entity to engage in any transaction which results in a liability of Borrower under Section 409 or 502(i) of ERISA or Section 4975 of the Code; (ii) permit or suffer any such Plan to incur any "accumulated funding deficiency" (within the meaning of Section 302 of ERISA and Section 412 of the Code), whether or not waived; (iii) terminate, or suffer to be terminated, any Plan covered by Title IV of ERISA maintained by Borrower or any commonly controlled entity or permit or suffer to exist a condition under which PBGC may terminate any such Plan; or (iv) permit to exist the occurrence of any Reportable Event (as defined in Title IV of ERISA) which represents termination by the PBGC of any Plan;

Enter into any transaction with any Affiliate of Borrower upon terms and conditions less favorable to Borrower than the terms and conditions which would apply in a similar transaction with an unrelated third party;

Enter into any agreement containing any provision which would be violated or breached by Borrower under any Loan Document or by the performance by Borrower of its obligations under any Loan Document;

Amend or modify the provisions of any Subordinated Debt; or

Maintain any Inventory at a warehouse which issues negotiable warehouse receipts with respect to such inventory.

AVAILABILITY OF COLLATERAL. Lender may from time to time, for its convenience, segregate or apportion the Collateral for purposes of determining the amounts and maximum amounts of Advances which may be made hereunder. Nevertheless, Lender's security interest in all such Collateral, and any other collateral rights, interests and properties which may now or hereafter be available to Lender, shall secure and may be applied to the payment of any and all loans, Advances and other Obligations secured by Lender's security interest, in any order or manner of application and without regard to the method by which Lender determines to make Advances hereunder.

DEFAULT AND REMEDIES. It shall be an Event of Default under this Agreement if:

Borrower fails to make any payment when due or required under this Agreement, or any present or future supplements hereto, or any note issued by Borrower in favor of Lender, or any other agreement between Borrower and Lender (including payments due upon demand should demand be made); or

Borrower fails to perform or observe any covenant, condition or agreement contained in this Agreement or in any other Loan Document; or

Any warranty, representation or statement made or furnished to Lender by or on behalf of Borrower or any Guarantor proves to have been false, incorrect or misleading in a material respect when made; or

A proceeding seeking an order for relief under the Bankruptcy Code is commenced by or against Borrower or any Guarantor, provided however, that if such a proceeding is commenced against Borrower or any Guarantor on an involuntary basis, then only if such action is not dismissed within 60 days of first being filed; or

Borrower or any Guarantor becomes insolvent or generally fails to pay, or admit in writing its or his inability to pay, its or his debts as they become due; or

Borrower or any Guarantor applies for, consents to, or acquiesces in, the appointment of a trustee, receiver or other custodian for it or him or for any of its or his property, or makes a general assignment for the benefit of creditors; or, in the absence of such application, consent or acquiescence, a trustee, receiver or other custodian is appointed for Borrower or for Guarantor or for a substantial part of Borrower's or any Guarantor's property; or

Any other reorganization, debt arrangement, or other case or proceeding under any bankruptcy or insolvency law, or any dissolution or liquidation proceeding is commenced in respect of Borrower or any Guarantor, provided however, that if such a proceeding is commenced against any Guarantor on an involuntary basis, then only if such action is not dismissed within 60 days of first being filed; or

Borrower or any Guarantor takes any action to authorize, or in furtherance of, any of the events described in the foregoing clauses (d) through (g); or

Any judgments, writs, warrants of attachment, executions or similar process (not covered by insurance) in the aggregate amount that exceeds \$10,000.00 is issued or levied against Borrower, any Guarantor or any of its or his assets and is not released, vacated or fully bonded prior to any sale and in any event within five days after its issue or levy; or

(k) the attachment of any tax lien to any property of Borrower or any Guarantor which is other than for taxes or assessments not yet due and payable; or

there is a material adverse change in the condition (financial or otherwise), business or property of Borrower or any Guarantor; or

Any Guarantor dies or attempts to revoke his or its guaranty.

Upon the occurrence of any Event of Default described in Paragraphs 20(d), (e), (f), (g) or (h), all Obligations shall be and become immediately due and payable without any declaration, notice, presentment, protest, demand or dishonor of any kind (all of which are hereby waived by Borrower) and Borrower's ability to obtain any additional Advances under this Agreement shall be immediately and automatically terminated. Upon the occurrence of any other Event of Default, Lender, without notice to Borrower, may terminate Borrower's ability to obtain any additional Advances under this Agreement and may declare all or any portion of the Obligations to be due and payable, without notice, presentment, protest or demand or dishonor of any kind (all of which are hereby waived), whereupon the full unpaid amount of the obligations which shall be so declared due and payable shall be and become immediately due and payable. Upon the occurrence of an Event of Default, Lender shall have all the rights and remedies of a secured party under the commercial Code and may require Borrower to assemble the Collateral and make it available to Lender at a place designated by Lender, and Lender shall have the right to take immediate possession of the Collateral and may enter any of the premises of Borrower or wherever the Collateral is located with or without process of law and to keep and store the same on said premises until sold (and if said premises be the property of Borrower, Borrower agrees not to charge Lender or a purchaser from Lender for storage thereof for a period of at least 90 days). upon the occurrence of an Event of Default, Lender, without further demand, at any time or times, may sell and deliver any or all of the Collateral at public or private sale, for cash, upon credit or otherwise, at such prices and upon such terms as Lender deems advisable, at its sole discretion. Any requirement under the Commercial Code or other applicable law of reasonable notice will be met if such notice is mailed to Borrower at its address set forth in the opening paragraph of this Agreement at least ten days before the date of sale. Lender may be the purchaser at any such sale, if it is public. The proceeds of sale will be applied first to all expenses of retaking, holding, preparing for sale, selling and the like, including attorneys' fees and legal expenses (whether or not suit is commenced) including, without limitation, reasonable attorneys' fees and legal expenses incurred in connection with any appeal of a lower court's order or judgment, and second to the payment (in whatever order Lender elects) of all other obligations chargeable to Borrower's loan account hereunder. Subject to the provisions of the Commercial Code, Lender will return any excess to Borrower and Borrower shall remain liable to Lender for any deficiency. Borrower agrees to give Lender immediate notice of the existence of any Default or Event of Default.

CONDITIONS PRECEDENT TO INITIAL ADVANCE. The obligation of Lender to make the initial Advance is subject to the condition precedent that Lender shall have received on or before the date of the initial Advance copies of all of the following, unless waived by Lender:

A favorable opinion of counsel to Borrower and the Guarantors in form and substance satisfactory to Lender;

UCC-1 Financing Statements in a form acceptable to Lender appropriately completed and duly executed by Borrower;

Acceptable recent UCC, tax lien, judgment, and bankruptcy searches from the filing offices in all states required by Lender;

The Guaranties, in form attached hereto as Exhibit D, appropriately completed and duly executed by each Guarantor;

Subordination Agreements relating to all notes payable under which Borrower is obligated;

A certified copy of all documents evidencing any necessary consent or governmental approvals (if any) with respect to the Loan Documents or any other documents provided for in this Agreement;

A certificate by the Secretary or any Assistant Secretary of Borrower certifying as to: (i) attached resolutions of Borrower's Board of Directors authorizing or ratifying the execution, delivery and performance of the Loan Documents to which Borrower is a party and any other documents provided for by this Agreement, (ii) the names of the officers of Borrower authorized to sign the Loan Documents together with a sample of the true signature of such officers, and (iii) attached bylaws of Borrower;

Certificates of Good Standing for Borrower issued by its state of incorporation and by those states requested by Lender;

A copy of the articles of incorporation of each Guarantor that is a corporation certified by the Secretary of State;

Evidence of insurance for all insurance required by the Loan Documents;

An officer certificate, in form and substance satisfactory to Lender, executed by the President of Borrower;

The Note, in form and substance satisfactory to Lender, appropriately completed and duly executed by the Borrower;

Appropriate collateral account agreements executed by Borrower and the other parties thereto;

A collateral assignment of life insurance in the amount of Five Hundred Thousand and No/100ths Dollars (\$500,000.00) on the life of Eward R. Cameron in form and substance satisfactory to Lender; and

Such landlord lien waivers and mortgagee consents as Lender, in its sole discretion, may require, in form and substance satisfactory to Lender in its sole discretion, appropriately completed and duly executed;

Such other approvals, opinions or documents as Lender may require.

CONDITIONS PRECEDENT TO ALL ADVANCES. The obligation of Lender to make any Advance (including the initial Advance) shall be subject to the satisfaction of each of the following conditions, unless waived in writing by Lender:

The representations and warranties of Borrower set forth in this Agreement are true and correct on the date of the Advance (and after giving effect to the Advance then being made);

No Default, no Event of Default and no Material Adverse Occurrence shall then have occurred and be continuing on the date of the Advance or result from the making of the Advance; and

No litigation, arbitration or governmental investigation or proceeding shall be pending or, to the knowledge of Borrower or any Guarantor, threatened against Borrower or any Guarantor or affecting its business or operations or its ability to perform its obligations hereunder which, if adversely determined to Borrower or any Guarantor, would constitute a Material Advance Occurrence.

TERMINATION. Subject to automatic termination of Borrower's ability to obtain additional Advances under this Agreement upon the occurrence of any Event of Default specified in Paragraphs 20(d), (e), (f) or (g) and to Lender's right to terminate Borrower's ability to obtain additional Advances under this Agreement upon the occurrence of any other Event of Default or upon demand, this Agreement shall have a term ending on the Termination Date provided, however, that Borrower may terminate this Agreement at any earlier time upon sixty days prior written notice; provided further, however, that if Borrower terminates this Agreement at any time on or prior to August 30, 1997, then Borrower shall pay to Lender a prepayment charge equal to the product arrived at by multiplying \$7,500.00 times the number of calendar months (whole and fractional) from the Termination Date to and including August 30, 1999; provided further, however, that if Borrower terminates this Agreement at any time after August 30, 1997 and on or before August 30, 1999, then Borrower shall pay to Lender a prepayment charge equal to \$20,000.00; provided further, however, that if Borrower terminates this Agreement on or prior to August 30,

1999 and repays all amounts owing to Lender hereunder completely from funds borrowed from Western State Bank (and not from any other source of funds), then no prepayment charge shall be due. On the Termination Date, all obligations arising under this Agreement shall become immediately due and payable without further notice or demand. Lender's rights with respect to outstanding Obligations owing on or prior to the Termination Date will not be affected by termination and all of said rights including (without limitation) Lender's Security Interest in the Collateral existing on such Termination Date or acquired by Borrower thereafter, and the requirements of this Agreement that Borrower furnish schedules and confirmatory assignments of Receivables and Inventory and turn over to Lender all full and partial payments thereof shall continue to be operative until all such Obligations have been duly satisfied.

GRANT OF LICENSE TO USE PATENTS AND TRADEMARKS COLLATERAL. For the purpose of enabling Lender to exercise rights and remedies under this Agreement, Borrower hereby grants to Lender an irrevocable, non-exclusive license (exercisable without payment of royalty or other compensation to Borrower) to use, license or sublicense any patent or trademark now owned or hereafter acquired by Borrower and wherever the same may be located, and including in such license reasonable access to all media in which any of the licensed items may be recorded or stored and to all computer and automatic machinery software and programs used for the compilation or printout thereof.

MISCELLANEOUS.

The performance or observance of any affirmative or negative covenant or other provision of this Agreement and any supplement hereto may be waived by Lender in a writing signed by Lender but not otherwise. No delay on the part of Lender in the exercise of any remedy, power or right shall operate as a waiver thereof, nor shall any single or partial exercise of any remedy, power or right preclude other or further exercise thereof or the exercise of any other remedy, power or right. Each of the rights and remedies of Lender under this Agreement will be cumulative and not exclusive of any other right or remedy which Lender may have hereunder or as allowed by law.

Any notice, demand or consent authorized by this Agreement to be given to Borrower shall be deemed to be given when transmitted by telex or telecopier (provided a confirmation copy thereof is sent by First Class U.S. mail within 24 hours of transmission) or personally delivered, or three days after being deposited in the U.S. mail, postage prepaid, or one day after delivery to Federal Express or other overnight courier service, in each case addressed to Borrower at its address shown in the opening paragraph of this Agreement, or at such other address as Borrower may, by written notice received by Lender, designate as Borrower's address for purposes of notice hereunder. Any notice or request authorized by this Agreement to be given to Lender shall be deemed to be given when personally delivered, or three days after being deposited in the U.S. mail, certified, return receipt requested, postage prepaid, or one day after delivery to Federal Express or other overnight courier, in each case addressed to Lender at its address shown in the opening paragraph of this Agreement, or at such other address as Lender may, by written notice received by Borrower, designate as Lender's address for purposes of notice hereunder; provided, however, that any notice to Lender given pursuant to Paragraph 4(b) shall not be deemed given until received.

This Agreement, including exhibits and schedules and other agreements referred to herein, is the entire agreement between the parties supersedes and rescinds all prior agreements relating to the subject matter herein, cannot be changed, terminated or amended orally, and shall be deemed effective as of the date it is accepted by Lender.

Borrower agrees to pay and will reimburse Lender on demand for all out-of-pocket expenses incurred by Lender arising out of this transaction including without limitation filing and recording fees and attorneys' fees and legal expenses, including costs of in-house counsel (whether or not suit is commenced), whether incurred in the negotiation and preparation of this Agreement, in the protection and perfection of Lender's security interest in the Collateral, in the enforcement of any of the provisions of this Agreement or of Lender's rights and remedies hereunder and against the Collateral, in the defense of any claim or claims made or threatened against Lender arising out of this transaction, or otherwise including, without limitation, in each instance, all reasonable attorneys' fees and legal expenses incurred in connection with any appeal of a lower court's order or judgment. Lender is authorized to deduct any such expenses from any amount due Borrower and/or to add such expenses to Borrower's loan account hereunder.

Borrower acknowledges that Lender has certain responsibilities in connection with the taking of Advances and the administration of this Agreement.

Borrower hereby agrees to indemnify, exonerate and hold Lender, and its officers, directors, employees and agents (the "Indemnified Parties") free and harmless from and against any and all actions, causes of action, suits, losses, liabilities and damages, and expenses in connection therewith including, without limitation, reasonable attorneys' fees and disbursements (the "Indemnified Liabilities"), incurred by the Indemnified Parties or any of them as a result of, or arising out of, or relating to:

any transaction financed or to be financed in whole or in part directly or indirectly with proceeds of any Advance, or

the execution, delivery, performance or enforcement of this Agreement or any document executed pursuant hereto by any of the Indemnified Parties, except for any such Indemnified Liabilities arising on account of any Indemnified Party's gross negligence or willful misconduct.

If and to the extent that the foregoing undertaking may be unenforceable for any reason, Borrower hereby agrees to make the maximum contribution to the payment and satisfaction of each of the Indemnified Liabilities which is permissible under applicable law. The provisions of this Paragraph shall survive termination of this Agreement.

This Agreement is made under and shall be governed by and interpreted in accordance with the internal laws of the state of Minnesota, except to the extent that the perfection of the Security Interest hereunder, or the enforcement of any remedies hereunder with respect to any particular Collateral, shall be governed by the laws of a jurisdiction other than the State of Minnesota. Captions herein are for convenience only and shall not be deemed part of this Agreement.

This Agreement shall be binding upon Borrower and Lender and their respective successors, assigns, heirs, and personal representatives and shall inure to the benefit of Borrower, Lender and the successors and assigns of Lender, except that Borrower may not assign or transfer its rights hereunder without the prior written consent of Lender, and any assignment or transfer in violation of this provision shall be null and void. In connection with the actual or prospective sale by Lender of any interest or participation in the obligations, Borrower authorizes Lender to furnish any information in its possession, however acquired, concerning Borrower or any of its Affiliates to any person or entity.

Borrower hereby irrevocably consents and submits to the personal jurisdiction of any Minnesota state court or federal court over any action or proceeding arising out of or relating to the Agreement, and Borrower hereby irrevocably agrees that all claims in respect of such action or proceeding may be shall be venued (at the sole option of Lender) in either the District Court of Dakota or Hennepin County, Minnesota, or the United States District Court, District of Minnesota. Borrower hereby irrevocably waives, to the fullest extent it may effectively do so, the defense of an inconvenient forum to the maintenance of such action or proceeding. Borrower irrevocably consents to the service of copies of the summons and complaint and any other process which may be served in any such action or proceeding by the mailing by United States certified mail, return receipt requested, of copies of such process to Borrower's address stated in the preamble hereto. Borrower agrees that judgment final by appeal, or expiration of time to appeal without an appeal being taken, in any such action or proceeding shall be conclusive and may be enforced in any other jurisdictions by suit on the judgment or in any other manner provided by law. Nothing in this Paragraph shall affect the right of Lender to serve legal process in any other manner permitted by law or affect the right of Lender to bring any action or proceeding against Borrower or its property in the courts of any other jurisdiction. Borrower agrees that, if it brings any action or proceeding arising out of or relating to this Agreement, it shall bring such action or proceeding in the District Court of Hennepin County, Minnesota.

(continued)

(i) A photocopy or other reproduction hereof may be filed as a financing statement.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

LENDER: SPECTRUM COMMERCIAL SERVICES, INC.

By

Its

BORROWER: APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

By

Its

Fed. Tax ID #: 41-1454591

List of Exhibits

Exhibit A	Compliance Certificate
Exhibit B	Form of Note
Exhibit C	Borrower's Financial Projections
Exhibit D	Form of Guaranties

List of Schedules

Schedule A	Locations of Inventory and Equipment (Paragraph 10)
Schedule B	Names Under Which Borrower Has Done Business (Paragraph 16(a))
Schedule C	Capital Stock of Corporations Owned by Borrower (Paragraph 16(a))
Schedule D	Litigation (Paragraph 16(d))
Schedule E	Security Interests (Paragraphs 16(f) and 18(d))
Schedule F	Patents, Trademarks, Copyrights and Franchise Rights (Paragraph 16(l))
Schedule G	Financial Statements (Paragraph 16(h))
Schedule H	Stock and Stock Ownership of Borrower (Paragraph 16(p))
Schedule I	Contingent Obligations (Paragraph 16(q))
Schedule J	Permitted Existing Indebtedness (Paragraphs 18(c) and (d))

FIRST AMENDMENT
TO
GENERAL CREDIT AND SECURITY AGREEMENT AND WAIVER

THIS FIRST AMENDMENT TO GENERAL CREDIT AND SECURITY AGREEMENT AND WAIVER, dated as of November 8, 1996 (the "Amendment"), between APPLIANCE RECYCLING CENTERS OF AMERICA, INC., a Minnesota corporation (the "Borrower") and SPECTRUM COMMERCIAL SERVICES, A DIVISION OF LYON FINANCIAL SERVICES, INC., the successor to Spectrum Commercial Services, Inc. ("Spectrum, Inc.") with Lyon Financial Services, Inc. (the "Lender").

RECITALS:

A. The Borrower and the Lender, as the successor to Spectrum, Inc., are parties to that certain General Credit and Security Agreement, dated as of August 30, 1996 (the "Original Agreement").

B. The Borrower has requested the Lender to amend certain provisions of the Original Agreement.

C. Subject to the terms and conditions of this Amendment, the Lender will agree to the Borrower's foregoing requests.

NOW, THEREFORE, the parties agree as follows:

1. DEFINED TERMS. All capitalized terms used in this Amendment shall, except where the context otherwise requires, have the meanings set forth in the Original Agreement as amended hereby.

2. AMENDMENT. The Original Agreement is hereby amended as follows:

(a) The definitions of "Borrowing Base," "Guarantor," "Guaranties," "Loan Documents," and "Net Income" appearing in Paragraph 2 are respectively amended in their entirety to read as follows:

'Borrowing Base' shall mean the sum of (i) Eighty percent (80%) of the net amount of Eligible Receivables or such greater or lesser percentage as Lender, in its sole discretion, shall deem appropriate, plus (ii) the lesser of (x) One Hundred Fifty Thousand and No/100ths Dollars (\$150,000) or (y) Twenty Five percent (25%) of the net amount of Eligible Inventory, or such greater or lesser dollars and/or percentage as Lender, in its sole discretion, shall deem appropriate, plus (iii) One Hundred Sixty Four Thousand and No/100ths (\$164,000.00) for liquidation value of equipment or such greater or lesser dollars as Lender, in its sole discretion shall deem appropriate, plus (iv) Six Hundred Fifty Thousand and No/100ths (\$650,000.00) for the value of the Mortgaged Premises or such greater or lesser dollars as Lender, in its sole discretion, shall deem appropriate.

'Guarantor' shall mean EDWARD R. CAMERON, APPLIANCE RECYCLING CENTERS OF AMERICA, CALIFORNIA, INC., ARCA OF ST. LOUIS, INC., and ARCA-MARYLAND, INC. and any other Person who enters into a Guaranty hereof.

'Guaranty(ies)' shall mean individually or collectively, as the case may be, the separate Guaranties dated as of August 30, 1996 separately made by each of the Guarantors in favor of Lender and any other agreement whereby a Person guarantees the payment or performance of any of the Obligations.

'Loan Document(s)' shall mean individually or collectively, as the case may be, this Agreement, the Note, the Guaranties, the Subsidiary Security Agreements, the Mortgage, the Assignment of Leases and Rents, the Indemnity Agreement and any and all other documents executed, delivered or referred to herein or therein, as originally executed and as amended, modified or supplemented from time to time.

'Net Income' or 'Net Loss' for any period shall mean net income or loss for such period, determined in accordance with GAAP excluding, however, (i) extraordinary gains, and (ii) gains (whether or not extraordinary) from sales or other dispositions of assets other than the sale of Inventory in the ordinary course of Borrower's business; and (iii) provisions for income taxes."

(b) The definition of "Maximum Principal Amount" appearing in Paragraph 2 is amended by changing the amount "One Million Five Hundred

Thousand and No/100ths Dollars (\$1,500,000.00)" to the amount "Two Million and No/100ths Dollars (\$2,000,000.00)".

(c) Paragraph 2 is further amended by adding the following definitions of "Assignment of Leases and Rents," "Indemnity Agreement," "Mortgage" and "Subsidiary Security Agreement(s)" in proper alphabetical order:

"Assignment of Leases and Rents' shall mean that certain Assignment of Leases and Rents dated as of November 8, 1996 made by the Borrower in favor of Lender relating to the Mortgaged Premises.

'Indemnity Agreement' shall mean that certain Environmental and ADA Indemnification Agreement dated as of November 8, 1996 made by the Borrower and the Guarantors in favor of Lender relating to the Mortgaged Premises.

'Mortgage' shall mean that certain Combination Mortgage, Security Agreement, Assignment of Leases and Rents, and Fixture Financing Statement dated as of November 8, 1996 made by the Borrower in favor of Lender subjecting the property described therein as the 'Mortgaged Premises' (the 'Mortgaged Premises') to a Security Interest in favor of Lender.

'Subsidiary Security Agreement(s)' shall mean individually or collectively, as the case may be, the separate Security Agreements dated as of August 30, 1996 separately made by each of the Borrower's Subsidiaries in favor of Lender."

(d) Paragraph 5 is amended by changing: (i) the percentage over the Prime Rate applicable when no Event of Default has occurred from "Four Percent (4%)" to the percentage "Five Percent (5%); and (ii) the amount of minimum interest from "\$7,500.00" to "10,000.00".

(e) Paragraph 17(i) is amended in its entirety to read as follows:

"(i) Pay Lender, for the period commencing on the date of this Agreement and continuing through the Termination Date, a non-refundable line maintenance fee (the "Line Maintenance Fee") at the rate of 1.0% per annum of the Maximum Principal Amount. Such Line Maintenance Fee shall be payable to Lender in advance on the Closing Date and on each subsequent anniversary date of this Agreement until all amounts owing hereunder are repaid in full. The Line Maintenance Fee shall be non-refundable and shall be deemed earned when paid.

Notwithstanding the above subparagraph, the Line Maintenance Fee for the first fiscal quarter of 1997 shall be increased from 1.0% per annum to 2.0% per annum as follows: (x) if Net Income is projected for fiscal year 1996 on Borrower's projected income statement (the "Projected Income Statement") attached as Exhibit C (Amended 11/96) to that certain First Amendment to General Credit and Security Agreement and Waiver dated as of November 8, 1996 (the 'First Amendment') between Borrower and Lender and Borrower's 1996 Net Income shall fail to meet or exceed a figure which is 90% of the projected Net Income for 1996; or (y) if Net Loss is projected for fiscal year 1996 on Borrower's Projected Income Statement and Borrower's 1996 Net Loss is greater than (ie. a greater negative number than) One Hundred Ten Percent (110%) of its projected Net Loss for 1996. Borrower shall immediately pay to Lender, on demand, the amount of any deficiency in the Line Maintenance Fee previously paid with respect to such quarter.

Notwithstanding the above, the Line Maintenance Fee for any subsequent fiscal quarter of 1997 or thereafter shall be increased from 1.0% per annum to 2.0% per annum as follows: (x) if Net Income is projected for that fiscal quarter on the Projected Income Statement and Borrower's Net Income for that quarter shall fail to meet or exceed a figure which is 85% of the projected Net Income for that quarter; or (y) if Net Loss is projected for that fiscal quarter on Borrower's Projected Income Statement and Borrower's Net Loss for that quarter is greater than (ie. a greater negative number than) One Hundred Fifteen Percent (115%) of its projected Net Loss for that quarter. Borrower shall immediately pay to Lender, on demand, the amount of any deficiency in the Line Maintenance Fee previously paid with respect to such quarter.

(f) Paragraph 17(1) is amended in its entirety to read as follows:

"(l) At the end of each quarter of Borrower's fiscal year: (w) if Net Income is projected for such quarter on Borrower's Projected Income Statement, then Borrower must achieve Seventy-Five Percent (75%) of its projected Net Income and gross profit for that fiscal quarter; (x) if Net Loss is projected for such quarter on Borrower's Projected Income Statement, then Borrower must achieve either Net Income or a Net Loss which is no greater than (ie. a greater negative number than) One Hundred Twenty-Five Percent (125%) of its projected Net Loss for that fiscal quarter; (y) if Net Income is projected for the fiscal year to date through the end of that quarter on Borrower's Projected Income Statement, then Borrower must achieve Seventy-Five Percent (75%) of its projected Net Income and gross profit for that fiscal year to date through the end of that fiscal quarter; or (z) if Net Loss is projected for the fiscal year to date through the end of that quarter on Borrower's Projected Income Statement, then Borrower must achieve either Net Income or a Net Loss which is no greater than (ie. a greater negative number than) One Hundred Twenty-Five Percent (125%) of its projected Net Loss for that fiscal year to date through the end of that fiscal quarter."

(g) Paragraph 18 is amended by removing the word "or" following subparagraph "(r)", changing the period at the end of subparagraph "(s)" to a semi-colon followed by the word "or", and by adding the following new subparagraph (t):

"(t) Open any more processing or servicing centers or retail stores in any geographic area where Borrower or its Subsidiaries do not presently have such centers or stores as determined by the Standard Metropolitan Statistical Area for Borrower's and its Subsidiaries' respective existing centers or stores."

(h) The "provided further" clause of Paragraph 23 beginning on the fifth line of page 24 of the Original Agreement is amended its entirety to read as follows:

"provided further, however, that if Borrower terminates this Agreement at any time after August 30, 1997 and on or before August 30, 1998, then Borrower shall pay to Lender a prepayment charge equal to \$40,000.00; provided further, however, that if Borrower terminates this Agreement at any time after August 30, 1998 and on or before August 30, 1999, then Borrower shall pay to Lender a prepayment charge equal to \$35,000.00;"

3. CONDITIONS TO EFFECTIVENESS. This Amendment shall become effective on the date (the "Effective Date") when, and only when, the Lender shall have received counterparts of this Amendment executed by the Borrower, and the Lender shall have received all of the following, unless waived in writing by the Lender:

(a) a replacement note (the "Replacement Note") in a form provided by Lender appropriately completed and duly executed by Borrower;

(b) an Acknowledgement and Amendment in a form provided by Lender appropriately completed and duly executed by the Guarantors;

(c) the Mortgage, Assignment of Leases and Rents and Indemnity Agreement in forms provided by Lender appropriately completed and duly executed by Borrower and each Guarantor which is a party thereto together with such surveys, title insurance policies, appraisals and environmental audits as Lender may require;

(d) a copy of the Borrower's and each corporate Guarantor's corporate resolutions authorizing the execution, delivery and performance of this Amendment and the other documents required to be executed and/or delivered by the terms hereof, certified by the Secretary or an Assistant Secretary of the Borrower or the relevant corporate Guarantor, as the case may be;

(e) an incumbency certificate showing the names and titles, and bearing the signatures of, the officers of the Borrower and each corporate Guarantors authorized to execute this Amendment and the other documents required to be executed and/or delivered by the terms hereof, certified by the Secretary or an Assistant Secretary of the Borrower or the relevant corporate Guarantor, as the case may be;

(f) a certificate stating to the effect that there has been no further change in the Borrower's or any corporate Guarantor's articles or certificate of incorporation or bylaws previously delivered to the

Lender, certified by the Secretary or an Assistant Secretary of the Borrower or the relevant corporate Guarantor, as the case may be;

(g) payment in immediately available funds of a closing fee of \$20,000.00; and

(h) such other documents or items as the Lender may reasonably request.

4. REPRESENTATIONS AND WARRANTIES. To induce Lender to enter into this Amendment, the Borrower represents and warrants to Lender as follows:

(a) The execution, delivery and performance by the Borrower of this Amendment, the Replacement Note and any other documents required to be executed and/or delivered by the Borrower by the terms of this Amendment have been duly authorized by all necessary corporate action, do not require any approval or consent of, or any registration, qualification or filing with, any government agency or authority or any approval or consent of any other person (including, without limitation, any stockholder or partner), do not and will not conflict with, result in any violation of or constitute any default under, any provision of the Borrower's articles of incorporation or bylaws, any agreement binding on or applicable to the Borrower or any of its property, or any law or governmental regulation or court decree or order, binding upon or applicable to the Borrower or of any of its property and will not result in the creation or imposition of any security interest or other lien or encumbrance in or on any of its property pursuant to the provisions of any agreement applicable to the Borrower or any of its property;

(b) The representations and warranties contained in the Original Agreement are true and correct as of the date hereof as though made on that date except to the extent that such representations and warranties relate solely to an earlier date;

(c) (i) No events have taken place and no circumstances exist at the date hereof which would give the Borrower the right to assert a defense, offset or counterclaim to any claim by Lender for payment of the obligations now or hereafter arising under the Original Agreement as amended by this Amendment or any other Loan Document; and (ii) the Borrower hereby releases and forever discharges Lender and its successors, assigns, directors, officers, agents, employees and participants from any and all actions, causes of action, suits, proceedings, debts, sums of money, covenants, contracts, controversies, claims and demands, at law or in equity, which the Borrower ever had or now has against Lender or its successors, assigns, directors, officers, agents, employees or participants by virtue of their relationship to the Borrower in connection with the Loan Documents and the transactions related thereto;

(d) The Original Agreement as amended by this Amendment, the Replacement Note and the other Loan Documents to which the Borrower is a party are the legal, valid and binding obligations of the Borrower and are enforceable in accordance with their respective terms, subject only to bankruptcy, insolvency, reorganization, moratorium or similar laws, rulings or decisions at the time in effect affecting the enforceability of rights of creditors generally and to general equitable principles which may limit the right to obtain equitable remedies; and

(e) After giving effect to this Amendment, there does not exist any Default or Event of Default.

5. REFERENCE TO AND EFFECT ON THE LOAN DOCUMENTS.

(a) From and after the date of this Amendment, each reference in: (i) the Original Agreement to "this Agreement", "hereunder", "hereof", "herein" or words of like import referring to the Original Agreement, and each reference to the "Loan Agreement", "thereunder", "thereof", "therein" or words of like import referring to the Original Agreement or any other Loan Document shall mean and be a reference to the Original Agreement as amended hereby; and (ii) any Loan Document to the "Note", "thereunder", "thereof", "therein" or words of like import referring to the Note shall mean and be a reference to the Replacement Note.

(b) Except as specifically set forth above, the Original Agreement remains in full force and effect.

(c) The execution, delivery and effectiveness of this Amendment shall not, except as expressly provided herein, operate as a waiver of any right, power or remedy of the Lender under the Original Agreement or any other Loan Document, nor constitute a waiver of any provision of the Original Agreement or any such other Loan Document.

6. COSTS, EXPENSES AND TAXES. The Borrower agrees to pay on demand all costs and expenses of Lender in connection with the preparation, reproduction, execution and delivery of this Amendment and the other documents to be delivered hereunder or thereunder, including Lender's reasonable attorneys' fees and legal expenses. In addition, the Borrower shall pay any and all stamp and other taxes and fees payable or determined to be payable in connection with the execution and delivery, filing or recording of this Amendment and the other instruments and documents to be delivered hereunder, and the Borrower agrees to hold Lender harmless from and against any and all liabilities with respect to, or resulting from, any delay in the Borrower's paying or omission to pay, such taxes or fees.

7. GOVERNING LAW. This Amendment shall be governed by and construed in accordance with the laws of the State of Minnesota.

8. HEADINGS. Paragraph headings in this Amendment are included herein for convenience of reference only and shall not constitute a part of this Amendment for any other purpose.

9. COUNTERPARTS. This Amendment may be executed in one or more counterparts, each of which shall be deemed to be an original.

10. WAIVERS. On the Effective Date, Lender waives the Borrower's compliance with Paragraph 17(1) through November 8, 1996. Lender's waiver is limited to the specific Defaults or Events of Default described above and is not intended, and shall not be construed, to be a general waiver of any term or provision of the Original Agreement or a waiver of any other existing or future Default or Event of Default.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed by their respective officers thereunto duly authorized as of the date first written above.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

By
Its

SPECTRUM COMMERCIAL SERVICES, A DIVISION OF LYON
FINANCIAL SERVICES, INC.

By
Its

GUARANTOR ACKNOWLEDGMENT AND AMENDMENT

Each of the undersigned (individually a "Guarantor" and collectively the "Guarantors") has entered into a certain Guaranty, dated as of August 30, 1996 (such Guarantor's "Guaranty") pursuant to which such Guarantor has guaranteed the payment and performance of certain "Indebtedness" of Appliance Recycling Centers of America, Inc., a Minnesota corporation ("Borrower") to Spectrum Commercial Services, Inc. ("Spectrum, Inc."), which Indebtedness includes, without limitation, all obligations of Borrower under that certain General Credit and Security Agreement dated as of August 30, 1996 between the Borrower and Spectrum, Inc. (the "Original Agreement;" capitalized terms not otherwise defined herein being used herein as therein defined).

Each of the Guarantors hereby acknowledges that: (a) subsequent to the date of the Original Agreement, Spectrum, Inc.'s rights under the Original Agreement and the other Loan Documents were assigned (the "Assignment") to Lyon Financial Services, Inc. ("Lyon") and that, as a result of the Assignment, Lyon is the "Lender" under the Original Agreement and has succeeded to Spectrum, Inc.'s rights under the other Loan Documents so that each reference to the "Lender", "SPECTRUM", "Secured Party" or other reference to Spectrum, Inc. in the Original Agreement or any other Loan Document shall mean and be a reference to Lyon acting in the described capacity; and (b) such Guarantor has received a copy of the proposed First Amendment to General Credit and Security Agreement and Waiver, to be dated as of November 8, 1996 (the "Amendment").

Each of the Guarantors hereby agrees and acknowledges that neither the Merger nor the Amendment shall in any way impair or limit the right of the Lender under such Guarantor's Guaranty or any other Loan Document to which such Guarantor is a party and confirms that: (a) by such Guarantor's Guaranty, such Guarantor continues to guaranty payment and performance of the "Indebtedness" of the Borrower to Lender described in such Guarantor's Guaranty, including, without limitation, Borrower's obligations to Lender under the Original Agreement as amended by the Amendment; and (b) with respect to each corporate Guarantor, by such Guarantor's Subsidiary Security Agreement, such Guarantor continues to grant a security interest in the "Collateral" described in such

Guarantor's Subsidiary Security Agreement to secure the payment and performance of the "Obligations" described therein.

Each of the corporate Guarantors hereby agrees that:

(a) its Guaranty is amended by adding the following new Section 16:

"16. The provisions of this guaranty are severable, and in any action or proceeding involving any State corporate law, or any State or Federal bankruptcy, insolvency, reorganization or other law affecting the rights of creditors generally, if the obligations of the undersigned hereunder would otherwise be held or determined to be void, invalid or unenforceable on account of the amount of the undersigned's liability under this guaranty, then, notwithstanding any other provision of this guaranty to the contrary, the amount of such liability shall, without any further action by the undersigned, SPECTRUM or any other person, be automatically limited and reduced to the highest amount which is valid and enforceable as determined in such action or proceeding." and

(b) its Subsidiary Security Agreement is amended by adding the following new Section 8:

"8. The provisions of this Agreement are severable, and in any action or proceeding involving any State corporate law, or any State or Federal bankruptcy, insolvency, reorganization or other law affecting the rights of creditors generally, if the obligations of Debtor hereunder would otherwise be held or determined to be void, invalid or unenforceable on account of the amount of Debtor's liability under this Agreement, then, notwithstanding any other provision of this Agreement to the contrary, the amount of such liability shall, without any further action by Debtor, the Secured Party or any other person, be automatically limited and reduced to the highest amount which is valid and enforceable as determined in such action or proceeding."

Each of the Guarantors: (a) represents and warrants to Lender that no events have taken place and no circumstances exist at the date hereof which would give such Guarantor the right to assert a defense, offset or counterclaim to any claim by Lender for payment of the obligations now or hereafter arising under the Guaranty or any other Loan Document to which such Guarantor is a party; and (ii) hereby releases and forever discharges Lender and its successors, assigns, directors, officers, agents, employees and participants from any and all actions, causes of action, suits, proceedings, debts, sums of money, covenants, contracts, controversies, claims and demands, at law or in equity, which such Guarantor ever had or now has against Lender or its successors, assigns, directors, officers, agents, employees or participants by virtue of their relationship to Borrower or the Guarantors in connection with the Loan Documents and the transactions related thereto.

Edward R. Cameron

Appliance Recycling Centers of America,
California, Inc.

By:
Its:

ARCA of St. Louis, Inc.

By:
Its:

ARCA-Maryland, Inc.

By;
Its:

Accepted and Agreed to this 8th day of November, 1996

Spectrum Commercial Services, a division of Lyon
Financial Services, Inc.

By:
Its:

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