

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

**Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934**

For the fiscal year ended January 3, 2004

or

**Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934**

Commission File No. 0-19621

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of
incorporation or organization)

41-1454591

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

7400 Excelsior Boulevard, Minneapolis, Minnesota
(Address of principal executive offices)

55426-4517
(Zip Code)

Registrant's telephone number, including area code: **952-930-9000**

Securities registered pursuant to Section 12(b) of the Act: **None**
Securities registered pursuant to Section 12(g) of the Act: **Common Stock, without par value**
(Title of class)

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 (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

As of March 5, 2004, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the price at which the common equity was last sold as reported by the OTC Bulletin Board, was \$4,327,750.

As of March 5, 2004, there were outstanding 2,413,777 shares of the registrant's Common Stock, without par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement dated March 19, 2004, are incorporated by reference into Part III hereof.

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PART I

ITEM 1. BUSINESS

General

Appliance Recycling Centers of America, Inc., together with its operating subsidiaries (ARCA or Company), is a leading provider of reverse logistics, energy-efficiency and appliance recycling services for appliance manufacturers and retailers, utility companies, waste management businesses, vending machine companies, property managers, local governments and the general public. The Company generates revenues from the retail sale of appliances through a chain of Company-owned retail stores under the name ApplianceSmart[®], fees charged for the collection and environmentally sound recycling of unwanted appliances, and sales of byproduct materials generated from processed appliances.

The Company was incorporated in Minnesota in 1983, although through its predecessors it commenced the appliance retail and recycling business in 1976. The Company’s principal office is located at 7400 Excelsior Boulevard, Minneapolis, Minnesota 55426-4517. References herein to the Company include its operating subsidiaries. (See Exhibit 21.1.)

Industry Background

There are more than 500 million major household appliances, such as refrigerators, freezers, ranges, dishwashers, microwaves, washers, dryers, room air conditioners, water heaters and dehumidifiers, currently in use in the United States. The Steel Recycling Institute estimates that in 2001, 39 million major household appliances were taken out of use in the United States. The disposal of these appliances is a serious problem as a result of a number of factors including (i) decreasing landfill capacity in many parts of the country; (ii) the inability of incinerators, composting facilities and other landfill alternatives to process appliances; and (iii) the presence in appliances of certain hazardous and other environmentally harmful materials that require special processing.

Legislation affecting appliance disposal has been adopted in more than 30 states. This legislation includes landfill restrictions, disposal bans, advance disposal fees and other types of regulations. As a result, appliances must be dealt with outside the ordinary municipal solid waste system.

Landfill restrictions arise in part because some appliance components contain certain hazardous and other environmentally harmful materials, including polychlorinated biphenyls (PCBs), mercury, refrigerants such as chlorofluorocarbons (CFCs) and sulfur dioxide, and oils. PCBs are suspected as carcinogens, are resistant to degradation when deposited in landfills and can cause groundwater contamination. The production of PCBs was banned by the Environmental Protection Agency (EPA) in 1979, although businesses were allowed to continue using remaining inventories of components that contained PCBs. Mercury is toxic to humans and can enter the body through inhalation, skin absorption or ingestion, and it vaporizes at high temperatures, forming extremely toxic fumes. CFCs are believed to cause long-term damage to the earth’s stratospheric ozone layer and may contribute to global warming when released into the atmosphere. The 1990 Amendments to the Clean Air Act prohibit the venting of CFCs and since July 1, 1992 have required the recovery of CFC refrigerants during the service, repair and disposal of appliances. See “Government Regulation” below.

In addition to these solid waste management and environmental issues, utility companies, motivated by economic and environmental factors to control energy consumption, sponsor various programs to encourage and assist residential consumers to conserve energy, including programs for turning in surplus,

energy-inefficient appliances. Many residential consumers own and operate room air conditioners, freezers or more than one refrigerator, contributing significantly to residential energy use and peak energy demand. In addition, many of the refrigerators manufactured in the 1960s and early 1970s consume up to 1,750 kilowatt-hours of electricity each year. The 1987 National Appliance Energy Conservation Act requires that new refrigerators use less than half of the energy as refrigerators built twelve years ago. As more efficient appliances become available, utility companies have begun to encourage the use of newer models and the disposal of older, less efficient models.

The Federal Energy Policy Act of 1992 gives individual states the option of deregulating their electric utility industry. The potential of deregulation has caused uncertainty about the future and form of energy conservation programs sponsored by electric utilities. The Company believes, however, that energy conservation and efficiency programs will remain a long-term component of the nation’s electric utility industry. See “Government Regulation” below.

Company Background

The Company began business in 1976 as a retailer of reconditioned appliances. Initially, the Company contracted with national and regional retailers of appliances such as Sears, Roebuck & Company, Inc. (Sears) and Montgomery Ward & Co. (Montgomery Ward) to collect major appliances in Minneapolis/Saint Paul and two other metropolitan areas. As part of their new appliance sales efforts, these retailers arranged for the removal of old appliances from consumers’ residences. The Company

collected old appliances on behalf of its customers, reconditioned and sold suitable used appliances through its own retail stores and sold the remaining appliances to scrap metal processors.

In the late 1980s, in response to stricter environmental protection laws, the Company developed and marketed programs to process and dispose of appliances in an environmentally sound manner. These programs were offered to appliance manufacturers and retailers of new appliances, waste management companies, property management companies and the general public. See "Customers and Source of Supply" below.

In 1989, the Company expanded its appliance recycling concept to the electric utility industry when it established an appliance processing center in Milwaukee, Wisconsin, pursuant to a contract with a utility company. From 1989 to 1994, the Company focused its resources on the expansion of its business with electric utility companies. During this time period the Company opened nine centers throughout the U.S. and Canada, primarily serving seventeen electric utility customers. The Company's electric utility business has been negatively impacted by the potential of electric utility industry deregulation. The potential of deregulation has caused electric utilities to decrease their sponsorship of energy conservation programs such as the one the Company offers.

In October 2000, the Company signed a contract with Southern California Edison Company (Edison) to implement a recycling program (Summer Initiative) in the service areas of Pacific Gas & Electric (PG&E), primarily the San Francisco Bay area and San Diego Gas & Electric (SDG&E). This contract was in accordance with a ruling issued by the California Public Utilities Commission (CPUC). Under this contract, the Company recycled approximately 36,000 units. In September of 2000, the Company began providing services for the Summer Initiative, which was completed in the third quarter of 2001. The Company was responsible for advertising the Summer Initiative.

In June 2001, the Company began providing services for the Appliance Early Retirement and Recycling Program serving utility customers in San Diego and surrounding areas; a six-county region in California's Central Valley, including the cities of Fresno and Stockton; and the seven-county Bay Area,

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including San Francisco. The program, which included refrigerators, freezers and room air conditioners, was completed in August 2002. The Company was responsible for advertising the program.

During fiscal year 2003, the Company had one major electric utility customer, Edison, which accounted for approximately 9% or \$3.8 million of the Company's total revenues. In September 2003, the Company signed a contract with Edison to support the 2003 Statewide Residential Appliance Recycling Program in the territories served by Edison and SDG&E. Since January 2003, the Company had handled appliance recycling operations for this energy conservation initiative under an extension of the 2002 program. The 2003 program ran through December 31, 2003. In January 2004, the Company signed a contract with Edison to handle appliance recycling operations in Edison's service territory for the years of 2004 and 2005. In March 2004, the Company signed a contract with SDG&E to handle appliance recycling operations in SDG&E's service territory for 2004.

The Company also is aggressively pursuing new and potentially significant appliance recycling programs in other states, reflecting growing national interest in residential energy conservation programs. Nevertheless, the Company's ability to project recycling revenue for 2004 continues to be limited.

In response to the decrease in demand for services by electric utilities beginning in the mid-1990s, the Company increased its marketing of services to appliance manufacturers and retailers, waste management companies and property management companies. The Company also increased its focus on the sale of used/refurbished appliances. In 1995, under the name Encore Recycled Appliances[®], the Company began operating a chain of Company-owned retail stores. In 1998, the Company began using the name ApplianceSmart[®] for its retail stores. The retail stores now offer special-buy appliances (defined below) to value-conscious individuals and property managers.

A developing market for the Company is in providing fully integrated reverse logistics services—the handling of product that does not fit into a company's normal distribution channels—for appliance manufacturers and retailers. Manufacturers traditionally disposed of these "special-buy" appliances, including manufacturer closeouts, factory overruns, floor samples, returned or exchanged items, and scratch and dent appliances, through their small-dealer network. Large retailers have not wanted to handle these types of appliances because the merchandise is often out of carton, requiring special handling and pricing. In addition, this product often requires some repair or needs to be recycled; functions major retailers are unwilling or unable to perform. As small dealers are struggling to compete with large appliance chains (the top 10 retailers control 80 percent of the appliance sales market), manufacturers are seeing their traditional channel for these distressed appliances shrink. It is anticipated that small appliance retailers will also be negatively affected by manufacturers' direct sale of appliances to consumers via the Internet.

In 1997, the Company entered into pilot program agreements with Whirlpool Corporation (Whirlpool), the nation's largest manufacturer of major household appliances, to develop a program for handling Whirlpool's returned appliances and new appliances that cannot be handled through the manufacturer's normal distribution channels. Through a subsequent 1998 contract with Whirlpool, the Company purchases these appliances from Whirlpool's distribution centers serving the Midwest and certain western states. This merchandise, which includes manufacturer closeouts, factory overruns, floor samples, returned or exchanged items, and scratch and dent appliances, is sold through the Company's network of ApplianceSmart retail stores. With an increased supply of product, the Company began to focus on opening larger factory outlet facilities to offer consumers a wider selection of special-buy appliances and began to close its smaller stores. The Company has also decided not to expand its used/refurbished appliance business.

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In the latter part of 1998, the Company scaled back its agreement with Whirlpool to a level consistent with the Company's financial resources and purchased inventory mainly from Whirlpool's Ohio distribution center. Currently, the Company purchases inventory mainly from Whirlpool's St. Louis, Missouri, distribution center. The Whirlpool agreement for 2004 does not provide for any required or minimum number of units to be offered for sale to the Company. The Whirlpool agreement may be terminated by either party upon thirty (30) days' prior written notice. In addition, the Company has agreed to indemnify Whirlpool for certain claims, allegations or losses with respect to Whirlpool appliances sold by the Company.

In October 2001, the Company entered into an agreement with Maytag Corporation (Maytag) for the acquisition of distressed appliances (Maytag Agreement). Under the Maytag Agreement, there are no minimum purchase requirements. The Maytag Agreement may be terminated by either party upon 60 days' written notice or may be terminated immediately if a default is not cured within ten (10) days after notice of default. In addition, the Company has agreed to indemnify Maytag for all claims, losses, liability and expenses with respect to Maytag appliances sold by the Company.

In December 2001, the Company announced that all retail stores would be carrying a full line of Frigidaire household appliances.

In January 2003, the Company announced that it had entered into a contract with GE Consumer Products (GE) to purchase from GE and sell to consumers special-buy GE appliances.

The Company believes purchases from these four manufacturers will provide an adequate supply of high-quality appliances for its retail outlets. There are no set numbers of units to be sold to the Company by any of the four manufacturers.

In January 2001, the Company opened a 24,000-square-foot store in the Minneapolis/Saint Paul market. The Company opened another 42,000-square-foot store in

the Dayton, Ohio, market in March 2001. In addition, the Company closed a smaller store and opened a 32,000-square-foot store in the Columbus, Ohio, market in May 2001. The Company opened a 49,000-square-foot store in the Minneapolis/Saint Paul market in October 2001. In March 2002, the Company opened another 30,000-square-foot store in Columbus, Ohio. In December 2002, the Company closed an underperforming store in the Dayton, Ohio, market. In February 2003, the Company closed a smaller store and opened a 33,000-square-foot store in the Minneapolis/Saint Paul market. In March 2003, the Company closed an underperforming store in the Dayton, Ohio, market. In December 2003, the Company opened a 30,000-square-foot store in the Atlanta, Georgia, market. The Company currently has three recycling centers, located in Columbus, Ohio; Minneapolis, Minnesota; and Los Angeles, California. Also, the Company currently has nine retail stores: four in Minneapolis/Saint Paul, one in Los Angeles, one in Atlanta and three in Columbus.

During the second quarter of 2003, the Company became a majority (60%) owner in North America Appliance Company LLC (NAACO). NAACO commenced operations in June 2003 as a retailer of special-buy appliances in McAllen, Texas.

Customers and Source of Supply

The Company offers its services to entities that as part of their operations become responsible for disposing of large quantities of new, distressed and unwanted appliances. These entities include appliance manufacturers and retailers of new appliances, waste management businesses, vending machine companies, property management companies and utility companies.

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Appliance Manufacturers and Retailers of New Appliances. The Company began its business by offering appliance recycling programs to Sears, Montgomery Ward and other retailers of new appliances by collecting appliances from either the retailers' facilities or from their customers. Recently the Company has focused its marketing efforts on appliance manufacturers, including Whirlpool, Maytag, Frigidaire and GE, the primary sources of products sold in the Company's stores.

The Company believes its current sources for appliances are adequate to supply its retail stores and allow the Company to grow its retail sales; however, there is a risk that one or more of these sources could be lost.

Waste Management Companies. The Company provides services to waste management companies and the general public for the collection and recycling of appliances for specified fees.

Vending Machine Companies. The Company provides services to vending machine companies for the recycling of vending machines containing refrigerants for specified fees.

Property Management Companies. The Company provides comprehensive appliance exchange and recycling services for property managers of apartment complexes as well as local housing authorities.

Electric Utility Companies. The Company contracts with utility companies to provide comprehensive appliance recycling services tailored to the needs of the particular utility. The contracts historically have had terms of one to four years, with provisions for renewal at the option of the utility company. Under some contracts the utility retains the Company to manage all aspects of its appliance recycling program, while under other contracts the Company provides only specified services. Pricing for the Company's services is on a per-appliance basis and depends upon several factors, including the total number of appliances processed, the length of the contract term and the specific services selected by the utility. Contracts with electric utility customers require that the Company does not recondition for resale appliances received from utility company energy conservation programs. Currently, the Company has a contract with Edison to handle recycling operations in Edison's territory for 2004 and 2005 and a contract with SDG&E to handle recycling operations in SDG&E's territory for 2004.

Company Operations

The Company provides an integrated range of reverse logistics, energy efficiency and appliance recycling services. Appliances are acquired from a wide range of sources, including appliance manufacturers and retailers, utility companies, waste management businesses, vending machine companies, property managers, local governments and the general public.

Appliances acquired from manufacturers that are deemed suitable for sale are repaired, if necessary, before being tested and distributed to the Company's ApplianceSmart retail outlets. Every appliance is under warranty and carries a 100 percent money-back guarantee. The Company also offers consumers extended warranties, delivery, factory-trained technician service and recycling of old appliances.

Appliances acquired from manufacturers that do not meet quality standards for the Company's retail operations and appliances collected through utility customers' energy conservation programs and other sources are processed and recycled in an environmentally sound manner. Appliances are inspected and categorized according to the types of hazardous materials they may contain, and processed according to all applicable federal, state and local regulations by company-trained technicians. When processing at the Company's recycling center is complete and the appliances are free of all environmentally hazardous

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substances, the appliances are delivered to a local metal processing facility for shredding. The shredded materials are then sold to steel mini-mills or other metal recovery facilities for reuse.

Management believes that the uncertainties in the electric utility industry regarding deregulation will persist at least through 2004. The reaction to deregulation among states and utilities has been varied. The Company believes, however, that energy conservation and efficiency programs will remain a long-term component of the nation's electric utility industry.

In 2003, the Company focused on a carefully managed growth plan of opening showroom outlet stores, located in heavily trafficked, conveniently located retail malls, and adding additional sources of supply of product sold in the retail stores. The Company believes that the growth of its retail business in the near future will likely occur primarily through the expansion of revenues from the Company's current and proposed retail stores.

Principal Products and Services

The Company generates revenues from three sources: retailing, recycling and byproduct. The table below reflects the percentage of total revenues from each source. See also "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	2003	2002	2001
Revenues:			
Retail	79.8%	65.4%	50.3%
Recycling	18.4%	32.0%	46.8%
Byproduct	1.8%	2.6%	2.9%

Although the Company has two main sources of revenues, management believes that the Company has only one operating segment. That is, even though certain separate financial information by retail store or retail store and recycling center is available to management, the Company is managed as a single unit. Specifically, the Company does not measure profit or loss or maintain asset information separately for its revenue sources. Recycling and byproduct revenues are the result of both retail revenues and recycling contracts. Retail includes the free removal and recycling of the customer's existing appliance. Recycling includes the recycling of appliances per a contract or agreement.

Sales and Marketing

The Company uses various means to promote awareness of its products and services and believes it is recognized as a leader in the retailing of appliances on a reverse logistics basis and in the recycling industry.

ApplianceSmart's outlet store concept includes establishing large factory showrooms in convenient metropolitan locations to offer consumers a selection of hundreds of appliances. In keeping with ApplianceSmart's branding, both the exterior and interior of ApplianceSmart's stores display Whirlpool, Maytag, Frigidaire and GE signage along with custom-designed ApplianceSmart materials. In every market, the Company actively promotes its stores through various forms of print advertising, including daily classified ads in major newspapers, telephone yellow pages ads and direct mail. In addition, the Company uses radio and television advertisements in some markets, along with other types of promotions. Through the Company's website at www.ApplianceSmart.com, consumers can also access appliance-specific and general Company information.

Seasonality

The Company does not experience seasonal fluctuations in its operating results. However, utility companies that sponsor appliance turn-in programs generally reduce their promotional efforts for such programs during the first and fourth calendar quarters.

Competition

Competition for the Company's retail stores comes from appliance manufacturers and retailers of new appliances and other special-buy retailers. Each retail location will compete not only with local and national chains of new-appliance retailers, many of whom have been in business longer than the Company and may have significantly greater assets than the Company, but will also compete with numerous independently owned retailers of new and special-buy appliances.

Many factors, including existing and proposed governmental regulation, may affect competition in the waste management and environmental services industry. The Company generally competes with two or three other companies which are based in the geographic area to be served under appliance recycling contracts and which generally offer only some of the services provided by the Company.

The Company expects its primary competition for appliance recycling contracts with existing or new customers to come from entrepreneurs entering the appliance recycling business, energy management consultants, current recycling companies, major waste hauling companies and scrap metal processors. In addition, customers such as utility companies and local governments may operate appliance recycling programs internally rather than contracting with the Company or other third parties. There can be no assurance that the Company will be able to compete profitably in any of its chosen markets.

Government Regulation

The business of recycling major appliances is subject to certain governmental laws and regulations. These laws and regulations include landfill disposal restrictions, hazardous waste management requirements and air quality standards, as well as special permit and license conditions for the recycling of appliances. In some instances, there are bonding, insurance and other conditions for bidding on appliance recycling contracts.

The Company's appliance recycling centers are subject to various federal, state and local laws, regulations and licensing requirements relating to the collection, processing and recycling of household appliances. Requirements for registrations, permits and licenses vary among the Company's market areas. The Company's centers are registered with the EPA as hazardous waste generators and are licensed, where required, by appropriate state and local authorities. The Company has agreements with approved and licensed hazardous waste companies for transportation and disposal or recycling of hazardous materials from its centers.

The 1990 Amendments to the Clean Air Act provide for the phaseout of the production of CFCs over a period of years. Effective July 1, 1992, the act prohibited the venting of CFCs in the course of maintaining, servicing, repairing or disposing of an appliance. The act also requires the recovery of CFC refrigerants from appliances prior to their disposal or delivery for recycling. In 1995, the venting of CFC substitute refrigerants was also prohibited.

In 1992, Congress adopted the Energy Policy Act of 1992 to encourage energy efficiency. Requirements under this act establish, among other things, mandatory energy performance standards that

affect the manufacture and sale of major household appliances. Another component of this act allows for deregulation of the nation's energy providers, including the electric utility industry. The ultimate impact of deregulation on the electric utility industry is yet unknown; therefore, there can be no assurance that the Company will be able to continue certain of its current operations in a deregulated environment.

Company management believes that further government regulation of the appliance recycling industry could have a positive effect on the Company's business; however, there can be no assurance what course future regulation may have. Under some circumstances, further regulation could materially increase the costs of the Company's operations and have an adverse effect on the Company's business. In addition, as is the case with all companies handling hazardous materials, under some circumstances the Company may be subject to contingent liabilities.

Employees

At March 1, 2004, the Company had 232 full-time employees, approximately 46% of whom were involved in the collection, transportation and processing of appliances at the Company's centers, approximately 34% of whom were in sales and approximately 20% of whom were in administration and management. The Company has not experienced any work stoppages and believes its employee relations are good.

ITEM 2. PROPERTIES

The Company's executive offices are located in Minneapolis, Minnesota, in a Company-owned facility that includes approximately 11 acres of land. The building

contains approximately 122,000 square feet, including 27,000 square feet of office space, 24,000 square feet of retail space and 71,000 square feet of operations and processing space. The California center building, which also is owned by the Company, is located in Compton, California, and consists of 46,000 square feet: 6,000 square feet of office space and 40,000 square feet of warehouse space. All properties and equipment owned by the Company currently secure outstanding loans of the Company.

The Company generally leases the other facilities it operates. The Company usually attempts to negotiate lease terms for a recycling center that correspond to the term of the principal contract or contracts in connection with which the center is to be operated. The Company's recycling centers typically range in size from 25,000 to 40,000 square feet. The Company usually attempts to negotiate lease terms of two to five years for retail stores with 25,000 to 35,000 square feet. However, the retail stores may be larger depending on favorable demographics, availability and other business factors.

The Company believes that the facilities and equipment at each of its centers are adequate to meet its anticipated needs for the near term and that alternate facilities will readily be available to the Company to meet its future needs.

ITEM 3. LEGAL PROCEEDINGS

The Company and its subsidiaries are involved in various legal proceedings arising in the normal course of business, none of which is expected to result in any material loss to the Company or any of its subsidiaries.

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

The Company did not submit any matters to a vote of security holders during the last quarter of the fiscal year covered by this report.

PART II

ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for Common Stock

The Company's Common Stock, which trades under the symbol "ARCI," began trading on the OTC Bulletin Board on September 8, 1998. Prior to that time, the Common Stock traded as follows: on the Nasdaq SmallCap Market from February 26, 1997 to September 7, 1998; on the Nasdaq National Market from January 8, 1993 to February 25, 1997; on the Nasdaq SmallCap Market from January 7, 1991 to January 7, 1993; and on the local over-the-counter market prior thereto. The following table sets forth, for the periods indicated, the high and low closing bid quotations for the Common Stock, as reported by the OTC Bulletin Board.

	<u>High</u>	<u>Low</u>
2002		
First Quarter	\$ 5.30	\$ 3.70
Second Quarter	4.35	3.60
Third Quarter	3.90	2.30
Fourth Quarter	2.65	1.63
2003		
First Quarter	\$ 2.08	\$ 1.05
Second Quarter	1.80	1.02
Third Quarter	2.10	1.11
Fourth Quarter	2.75	1.50

On March 5, 2004, the last reported sale price of the Common Stock on the OTC Bulletin Board was \$3.15 per share. As of March 5, 2004, there were approximately 862 beneficial holders of the Company's Common Stock.

The Company's line of credit limits the Company's ability to pay dividends.

During 1999, the Company privately placed 1,050,000 unregistered shares and 138,000 warrants to purchase shares. In 2000, the Company registered 1,030,000 of such shares for resale by the holders.

In February 1999, the Company sold in a private placement 1,030,000 shares of Common Stock at a price of \$0.50 per share. The sale represented approximately 45% of the Common Stock outstanding after such sale. The Company paid \$31,500 of the proceeds and issued warrants to purchase 83,000 shares of Common Stock at \$0.50 per share, subject to adjustment, to an investment banker as a placement fee. The

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remaining proceeds were used to repay certain indebtedness, to purchase inventory and for other general corporate purposes.

In March 1999, the Company issued to a board member at that time, as payment for certain consulting services, 5,000 warrants to purchase the Company's Common Stock at \$0.625 per share, the market value of the Company's stock at the date of grant. The warrants are currently exercisable and expire March 1, 2009.

In April 1999, the Company issued to a vendor 50,000 warrants to purchase the Company's Common Stock at \$0.625 per share. The warrants expire March 31, 2004.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial information set forth below should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 8. Financial Statements and Supplementary Data."

Fiscal Years Ended (In thousands, except per-share data)	2003	2002	2001	2000	1999
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Statement of Operations

Total revenues	\$ 43,609	\$ 45,720	\$ 43,810	\$ 21,479	\$ 15,582
Gross profit	\$ 11,879	\$ 15,774	\$ 17,329	\$ 8,921	\$ 6,666
Operating income (loss)	\$ (1,776)	\$ 1,742	\$ 4,749	\$ 1,963	\$ 1,139
Net income (loss)	\$ (1,541)	\$ 332	\$ 2,646	\$ 927	\$ 505
Basic earnings (loss) per common share	\$ (0.66)	\$ 0.14	\$ 1.15	\$ 0.41	\$ 0.24
Diluted earnings (loss) per common share	\$ (0.66)	\$ 0.11	\$ 0.86	\$ 0.32	\$ 0.22
Basic weighted average number of common shares outstanding	2,343	2,320	2,291	2,287	2,142
Diluted weighted average number of common shares outstanding	2,343	3,025	3,068	2,889	2,274

Balance Sheet

Working capital	\$ 3,446	\$ 5,003	\$ 3,188	\$ 1,183	\$ 545
Total assets	\$ 20,833	\$ 20,239	\$ 18,936	\$ 12,651	\$ 9,517
Long-term liabilities	\$ 5,658	\$ 5,797	\$ 4,348	\$ 4,431	\$ 4,831
Shareholders' equity	\$ 4,209	\$ 5,737	\$ 5,397	\$ 2,751	\$ 1,809

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QUARTERLY FINANCIAL DATA

The following table sets forth certain unaudited quarterly financial data for the eight quarters ended January 3, 2004. In the Company's opinion, the unaudited information set forth below has been prepared on the same basis as the audited information and includes all adjustments necessary to present fairly the information set forth herein. The operating results for any quarter are not indicative of results for any future period. All data is in thousands except per-common share data.

	Fiscal 2003			
	1 st Quarter	2 nd Quarter	3 rd Quarter	4 th Quarter
Total revenues	\$ 10,026	\$ 10,722	\$ 11,865	\$ 10,996
Net income (loss)	\$ (816)	\$ (475)	\$ 41	\$ (291)
Basic earnings (loss) per common share	\$ (0.35)	\$ (0.20)	\$ 0.02	\$ (0.12)
Diluted earnings (loss) per common share	\$ (0.35)	\$ (0.20)	\$ 0.01	\$ (0.12)
Basic weighted average number of common shares outstanding	2,335	2,344	2,344	2,350
Diluted weighted average number of common shares outstanding	2,335	2,344	2,897	2,350

	Fiscal 2002			
	1 st Quarter	2 nd Quarter	3 rd Quarter	4 th Quarter
Total revenues	\$ 11,699	\$ 11,734	\$ 13,079	\$ 9,208
Net income (loss)	\$ 238	\$ 537	\$ 274	\$ (717)
Basic earnings (loss) per common share	\$ 0.10	\$ 0.23	\$ 0.12	\$ (0.31)
Diluted earnings (loss) per common share	\$ 0.07	\$ 0.16	\$ 0.09	\$ (0.31)
Basic weighted average number of common shares outstanding	2,311	2,320	2,324	2,324
Diluted weighted average number of common shares outstanding	3,310	3,291	3,176	2,324

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE FISCAL YEARS 2003, 2002 AND 2001**OVERVIEW**

The Company's 2003 fiscal year (2003) ended January 3, 2004, its 2002 fiscal year (2002) ended December 28, 2002 and its 2001 fiscal year (2001) ended December 29, 2001.

The Company generates revenues from three sources: retail, recycling and byproduct. Retail revenues are sales of appliances, warranty and service revenue and delivery fees. Recycling revenues are fees charged for the disposal of appliances. Byproduct revenues are sales of scrap metal and reclaimed chlorofluorocarbons (CFCs) generated from processed appliances. The Company is managed as a unit and does not measure profit or loss separately for its three primary revenue sources. Therefore, the Company believes that it has one operating segment.

In 2003, the Company focused on a carefully managed growth plan of opening large showroom outlet stores, located in heavily trafficked, conveniently located retail malls, and adding additional sources of supply of product sold in the retail stores. During 2003, the Company opened one retail store in the Minneapolis/Saint Paul market and one retail store in the Atlanta, Georgia, market. The Company also

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closed a smaller retail store in the Minneapolis/Saint Paul market. Retail revenues accounted for 79.8% of total revenues in 2003.

Critical Accounting Policies and Estimates

The Company's significant accounting policies are summarized in the footnotes to the financial statements. Some of the most critical policies are also discussed below.

Revenue recognition: The Company recognizes revenue from appliance sales in the period the appliances are purchased and paid for by the consumer. Revenue from appliance recycling is recognized when a unit is collected and processed. Byproduct revenue is recognized upon shipment.

The Company defers revenue under certain appliance extended warranty arrangements it services and recognizes the revenue over the related terms of the warranty contracts. On extended warranty arrangements sold by the Company but serviced by others for a fixed portion of the warranty sales price, the Company recognizes revenue for the net amount retained at the time of sale of the extended warranty to the consumer.

Shipping and handling charges to customers are included in the revenues. Shipping and handling costs incurred by the Company are included in cost of revenues.

Product warranty: The Company provides a warranty for the replacement or repair of certain defective units. The Company's standard warranty policy requires the Company to repair or replace certain defective units at no cost to its customers. The Company estimates the costs that may be incurred under its warranty and records a liability reserve in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability reserve for covered units include the number of units sold, historical and anticipated rates of warranty claims on these units, and the cost of these claims. The Company periodically assesses the adequacy of its recorded warranty liability reserve and adjusts the amounts as necessary. The Company believes the warranty liability of \$54,000 is adequate.

Trade receivables: Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. A trade receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 90 days. The current reserve for doubtful accounts of \$117,000 should be adequate for any exposure to loss in the Company's January 3, 2004 accounts receivable.

Inventories: Inventories, consisting principally of appliances, are stated at the lower of cost, first-in, first-out (FIFO), or market. The Company provides estimated reserves for the realizability of its appliance inventories, including adjustments to market, based on various factors including the age of such inventory and management's assessment of the need for such allowances. Management looks at historical inventory agings and margin analysis in determining its reserve estimate. The Company believes the reserve of \$324,000 is adequate. Because of a decrease in volume and a change in business, the Company no longer inventories unrefurbished units.

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Property and equipment: Depreciation is computed using straight-line and accelerated methods over the following estimated useful lives:

	Years
Buildings and improvements	18 - 30
Equipment	3 - 8

The Company did not identify any items that were impaired as of January 3, 2004.

Income taxes: Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Realization of deferred tax assets is dependent upon sufficient future taxable income during the periods when deductible temporary differences and carryforwards are expected to be available to reduce taxable income. The valuation allowance at January 3, 2004 principally relates to net operating loss and tax credit carryforwards whose use is limited under Section 382 of the Internal Revenue Code.

Stock-based compensation: The Company regularly grants options to its employees under various plans as described in Note 8 to the financial statements. As permitted under accounting principles generally accepted in the United States of America, these grants are accounted for following APB Opinion No. 25 and related interpretations. Accordingly, compensation cost would be recognized for those grants where the exercise price is less than the fair market value of the stock on the date of grant. There was no compensation expense recorded for employee grants for the fiscal years 2003, 2002 and 2001.

The Company also grants options and warrants to nonemployees for goods and services and in conjunction with certain agreements. These grants are accounted for under FASB Statement No. 123, *Accounting for Stock-Based Compensation*, based on the grant date fair values.

Recently Issued Accounting Pronouncements

In January 2003, the FASB issued FASB No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*. This statement provided alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, this statement also amended the disclosure requirements of SFAS No. 123 to require more prominent and frequent disclosures in the financial statements about the effects of stock-based compensation. The Company began applying disclosure provisions of this statement in its December 28, 2002 consolidated financial statements. Because the Company continues to account for employee stock-based compensation under APB Opinion No. 25, SFAS No. 148 had no effect on the Company's consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing certain guarantees. It also elaborates on the disclosures in SFAS No. 5, *Accounting for Contingencies*, which are to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued, even when the likelihood of making any payments under the guarantees is remote. The January 3, 2004, consolidated

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financial statements have incorporated the enhanced disclosure requirements of FIN 45, as presented in Note 1 to the financial statements under the caption "Product warranty."

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities* and its amendment (FIN 46R). This interpretation establishes standards for identifying a variable interest entity and for determining under what circumstances a variable interest entity should be consolidated with its primary beneficiary. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. FIN 46 applies to the Company's consolidated financial statements for the year ended January 3, 2004. The adoption of this pronouncement did not have a significant effect on the Company's consolidated financial statements.

The FASB has issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 requires that certain freestanding financial instruments be reported as liabilities in the balance sheet. Depending on the type of financial instrument, it will be accounted for at either fair value or the present value of future cash flows determined at each balance sheet date with the change in that value reported as interest expense in the statement of operations. Prior to the application of SFAS No. 150, either those financial instruments were not required to be recognized, or if recognized, were reported in the balance sheet as equity and changes in the value of those instruments were normally not recognized in net income. The Company adopted SFAS No. 150 for the year ended January 3, 2004 and it had no effect on reported results for that year. The Company does not expect the application of SFAS No. 150 to have a material effect on its future consolidated financial statements.

REVENUES

The Company's total revenues for 2003 were \$43,609,000 compared to \$45,720,000 in 2002.

Retail revenues increased to \$34,805,000 in 2003 from \$29,893,000 in 2002, an increase of 16.4%. Same-store sales for 2003 (a sales comparison of six stores open the full year in both 2003 and 2002) increased 24%. The increase in retail revenues was primarily due to an increase in sales of new in-the-box product of approximately \$5,000,000 due to additional purchases of new product, offset slightly by a decrease in special-buy sales of approximately \$500,000 as a result of opening two stores and closing one small store and one underperforming store during 2003 compared to the same period in the previous year. Special-buy appliances include manufacturer closeouts, factory overruns, floor samples, returned or exchanged items and scratch and dent appliances.

In January 2003, the Company announced that it had entered into a contract with GE Consumer Products (GE) to purchase from GE and sell to consumers special-buy GE appliances. There are no minimum purchase requirements.

The Company continues to purchase appliances from Whirlpool Corporation (Whirlpool), Maytag Corporation (Maytag), GE Corporation (GE) and Frigidaire. There are no minimum purchase requirements with any of these manufacturers. The Company believes purchases from these four manufacturers will provide an adequate supply of high-quality appliances for its retail outlets; however there is a risk that one or more of these sources could be lost. Because of the large available supply of special-buy appliances from these manufacturers and the limited supply of used/refurbished appliances, the Company has decided not to expand its used/refurbished appliance business.

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The Company operated nine retail stores at the end of the current fiscal year and at the end of the previous fiscal year. In March 2002, the Company opened a 30,000-square-foot store in the Columbus, Ohio, market. In December 2002, the Company closed an underperforming store in the Dayton, Ohio, market. In February 2003, the Company closed a smaller store and opened a 33,000-square-foot store in the Minneapolis/Saint Paul market. In March 2003, the Company closed an underperforming store in the Dayton, Ohio, market. In December 2003, the Company opened a 30,000-square-foot store in the Atlanta, Georgia, market.

Recycling revenues decreased to \$8,014,000 in 2003 from \$14,625,000 in 2002. The decrease was primarily due to an overall decrease in total recycling volumes from all the various recycling contracts in California of approximately \$6,500,000. Southern California Edison Company (Edison) accounted for approximately 9% of the Company's total revenues for 2003 and 13% for 2002. The Company recycled appliances during the first eight months of 2003 under an extension of the 2002 Statewide Residential Appliance Recycling Program, which was administered by Edison. Recycling services for this statewide energy-efficiency program included customers of Edison, Pacific Gas & Electric (PG&E) and San Diego Gas & Electric (SDG&E). The Company was responsible for advertising in the PG&E and SDG&E service territories only; Edison was responsible for advertising in the Edison area. During the third quarter of 2003, the Company was awarded a contract by Edison for the 2003 Statewide Residential Appliance Recycling Program in the territories served by Edison and SDG&E. This contract ended December 31, 2003. Under this contract, the Company was responsible for advertising in the SDG&E service territory only; Edison was responsible for advertising in the Edison area. In January 2004, the Company signed a contract with Edison to handle appliance recycling operations in Edison's service territory for the years of 2004 and 2005. In March 2004, the Company signed a contract with SDG&E to handle appliance recycling operations in SDG&E's service territory for 2004. The Company is also aggressively pursuing new appliance recycling programs in other states.

In the first quarter of 2002, the Company recycled appliances for Edison under an extension of Edison's 2001 Residential Appliance Recycling Program. In July 2002, the Company signed a contract in support of California's Statewide Residential Appliance Recycling Program for 2002 to be administered by Edison. This contract was effective April 1, 2002 and ended December 31, 2002. Recycling services for this statewide program included customers of Edison, PG&E and SDG&E. The Company was responsible for advertising in the PG&E and SDG&E service territories only; Edison was responsible for advertising in the Edison area.

During the first eight months of 2002, the Company was handling recycling operations under the Appliance Early Retirement and Recycling Program with the California Public Utilities Commission (CPUC). This refrigerator/freezer/room air conditioner recycling program included San Diego and surrounding areas; a six-county region in California's Central Valley, including the cities of Fresno and Stockton; and the seven-county Bay area, including the city of San Francisco. The CPUC accounted for approximately 12% of the Company's revenues in 2002.

Byproduct revenues decreased to \$790,000 in 2003 from \$1,202,000 in 2002. The decrease was primarily due to a decrease in the volume and price of CFCs of approximately \$360,000 and volume of scrap metal offset slightly by an increase in the price of scrap metal.

The Company's total revenues for 2002 were \$45,720,000 compared to \$43,810,000 in 2001.

Retail revenues increased to \$29,893,000 in 2002 from \$22,037,000 in 2001, an increase of 35.6%. Same-store sales for 2002 (a sales comparison of five stores open the full year in both 2002 and 2001) increased 12%. The increase in retail revenues was primarily due to an increase in sales of new in-the-box

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product of approximately \$5,500,000 due to additional purchases of new product and an increase in special-buy sales of approximately \$2,300,000 as a result of operating three additional stores during 2002 compared to the same period in the previous year. The Company purchased appliances from Whirlpool, Maytag and Frigidaire.

In October 2001, the Company entered into an agreement with Maytag Corporation for the acquisition of distressed appliances (Maytag Agreement). Under the Maytag Agreement, there are no minimum purchase requirements. The Maytag Agreement may be terminated by either party upon 60 days' written notice or may be terminated immediately if a default is not cured within ten (10) days after notice of default. In addition, the Company has agreed to indemnify Maytag for all claims, losses, product liability and expenses with respect to Maytag appliances sold by the Company.

In December 2001, the Company announced that it will be purchasing appliances from Frigidaire. There are no minimum purchase requirements.

The Company operated nine retail stores at both the end of 2002 and 2001. During the first quarter of 2001, the Company opened a 24,000-square-foot store in the Minneapolis/Saint Paul market and a 42,000-square-foot store in the Dayton, Ohio, market. In the second quarter of 2001, the Company closed a smaller store and opened a 32,000-square-foot store in the Columbus, Ohio, market. In the fourth quarter of 2001, the Company opened a 49,000-square-foot store in the Minneapolis/Saint Paul market. In March 2002, the Company opened a 30,000-square-foot store in the Columbus, Ohio, market. In December 2002, the Company closed an underperforming store in the Dayton, Ohio, market.

Recycling revenues decreased to \$14,625,000 in 2002 from \$20,506,000 in 2001. The decrease was primarily due to an overall decrease in total recycling volumes from all the various recycling contracts in California of approximately \$6,000,000. Edison accounted for approximately 13% of the Company's total revenues for 2002 and 29% for 2001. In the first quarter of 2002, the Company recycled appliances for Edison under an extension of Edison's 2001 Residential Appliance Recycling Program. In July 2002, the Company signed a contract in support of California's Statewide Residential Appliance Recycling Program for 2002 to be administered by Edison. This contract was effective April 1, 2002 and ended December 31, 2002. Recycling services for this statewide program included customers of Edison, PG&E and SDG&E. The Company was responsible for advertising in the PG&E and SDG&E service territories only; Edison was responsible for advertising in the Edison area.

In June 2001, the Company signed a contract (the Appliance Early Retirement and Recycling Program) with the CPUC to operate a refrigerator/freezer/room air conditioner recycling program in San Diego and surrounding areas; a six-county region in California's Central Valley, including the cities of Fresno and Stockton; and the

seven-county Bay Area, including the city of San Francisco. The Company started taking customer orders for the Appliance Early Retirement and Recycling Program in San Diego in June 2001. The CPUC budgeted \$14 million to fund the recycling program. The budget allocation included \$50 incentive payments to participants for refrigerators and freezers and \$25 incentive payments for room air conditioners. The program was completed August 31, 2002. The CPUC accounted for approximately 12% of the Company's total revenues in 2002 and 9% in 2001.

Byproduct revenues decreased to \$1,202,000 in 2002 from \$1,267,000 in 2001. The decrease was primarily due to a decrease in the volume and price of CFCs of approximately \$200,000 offset by an increase in scrap metal revenues of approximately \$140,000.

GROSS PROFIT

The Company's overall gross profit decreased to 27.2% in 2003 from 34.5% in 2002. The decrease was primarily due to lower recycling revenues and volumes related to the recycling programs and a decrease in gross margin in sales of special-buy appliances. Gross profit as a percentage of total revenues for future periods can be affected favorably or unfavorably by numerous factors, including the mix of retail products sold, the prices at which product is purchased from the four manufacturers, the volume of appliances recycled from the 2004-2005 Edison contract and 2004 SDG&E contract and the price and volume of byproduct revenues. The Company expects gross profit percentages to remain about the same for future periods.

The Company's overall gross profit decreased to 34.5% in 2002 from 39.6% in 2001. The decrease was primarily due to lower recycling revenues and volumes related to the recycling programs, offset by slightly improved gross margins in sales of special-buy appliances.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses were 31.3% of total revenues in 2003 compared to 30.7% in 2002. Selling, general and administrative expenses decreased to \$13,655,000 in 2003 from \$14,032,000 in 2002, a 2.7% decrease. Selling expenses increased to \$8,210,000 in 2003 from \$8,007,000 in 2002, a 2.5% increase. The increase in selling expenses was primarily due to the expense of opening and operating two new stores during 2003, offset by closing one smaller store and one underperforming store in 2003 compared to 2002. General and administrative expenses decreased to \$5,445,000 in 2003 from \$6,025,000 in 2002, a 9.6% decrease. The decrease was primarily due to a decrease in administration costs as a result of an overall decrease in recycling volumes.

Selling, general and administrative expenses were 30.7% of total revenues in 2002 compared to 28.7% in 2001. Selling, general and administrative expenses increased to \$14,032,000 in 2002 from \$12,580,000 in 2001, an 11.5% increase. Selling expenses increased to \$8,007,000 in 2002 from \$5,959,000 in 2001. The increase was primarily due to the expenses of opening an additional retail store during 2002 and operating three additional stores in 2002 compared to the previous year, which also increased advertising by \$273,000 and commissions by \$201,000. General and administrative expenses decreased to \$6,025,000 in 2002 from \$6,621,000 in 2001. The decrease was primarily due to a decrease in administrative costs as a result of an overall decrease in recycling volumes and a decrease in bad debt expense.

INTEREST EXPENSE

Interest expense decreased to \$748,000 in 2003 from \$1,236,000 in 2002. The decrease was due to a lower effective rate on outstanding debt in 2003 as compared to 2002 as a result of refinancing the debt in 2002 on the two company-owned buildings, offset by a minimum interest amount on the line of credit.

Interest expense increased to \$1,236,000 in 2002 from \$1,074,000 in 2001. The increase was primarily due to a one-time write-off of deferred financing fees and debt discount related to a pay down of long-term debt and a higher effective interest rate as a result of a higher minimum interest amount on the line of credit, offset by a lower average borrowed amount.

INCOME TAXES AND NET OPERATING LOSSES

The Company recorded a benefit for income taxes of \$976,000 for 2003 compared to a provision for income taxes of \$221,000 in 2002. The change was due to both a pretax loss versus pretax income and a slightly lower effective tax rate resulting from no benefit being attributable to 2003 state tax losses.

The Company had net operating loss carryovers and credit carryforwards of approximately \$7 million at January 3, 2004, which may be available to reduce taxable income and therefore income taxes payable in future years. However, future utilization of these loss and credit carryforwards is subject to certain significant limitations under provisions of the Internal Revenue Code including limitations subject to Section 382, which relate to a 50 percent change in control over a three-year period, and are further dependent upon the Company maintaining profitable operations. The Company believes that the issuance of Common Stock during 1999 resulted in an "ownership change" under Section 382. Accordingly, the Company's ability to use net operating loss carryforwards generated prior to February 1999 may be limited to approximately \$56,000 per year, or less than \$1 million through 2018.

As of its 2003 and 2002 year-ends, the Company had recorded cumulative valuation allowances of \$3,072,000 and \$2,998,000 against its net deferred tax assets due to the uncertainty of their realization. The realization of deferred tax assets is dependent upon sufficient future taxable income during the periods when deductible temporary differences and carryforwards are expected to be available to reduce taxable income. At January 3, 2004, the remaining valuation allowance is principally due to the Section 382 limitation of its net operating losses (NOLs) and tax credits.

LIQUIDITY AND CAPITAL RESOURCES

At January 3, 2004, the Company had working capital of \$3,446,000 compared to \$5,003,000 at December 28, 2002. Cash and cash equivalents decreased to \$1,196,000 at January 3, 2004 from \$2,802,000 at December 28, 2002. Net cash used in operating activities was \$2,391,000 in 2003 compared to net cash provided by operating activities of \$3,307,000 in 2002. The cash used in operating activities was primarily due to the net loss plus an increase in receivables and inventories, offset by an increase in accounts payable. During 2003, inventories increased by \$1,022,000 principally due to more and larger stores and increased retail sales and receivables increased \$758,000 principally due to the timing of receivables related to recycling contracts.

Net cash used in investing activities was \$558,000 in 2003 compared to \$498,000 in 2002. The 2003 capital expenditures were primarily related to continued software development and building improvements. The cash used in investing activities in 2002 was primarily related to leasehold improvements for new stores, offset by the proceeds of disposal of certain equipment. The Company did not have any material purchase commitments for assets as of January 3, 2004.

Net cash provided by financing activities was \$1,343,000 in 2003 compared to net cash used in financing activities of \$513,000 in 2002. The cash provided by financing activities was primarily due to increased borrowings under the line of credit in 2003.

As of January 3, 2004, the Company had a \$10,000,000 line of credit with a lender. The interest rate as of January 3, 2004 was 5.50%. The amount of borrowings available under the line of credit is based on a formula using receivables and inventories. The line of credit has a stated maturity date of August 30, 2004, if not renewed, and provides that the lender may demand payment in full of the entire outstanding balance of the loan at any time. The line of credit is secured by substantially all the Company's

assets and requires minimum monthly interest payments of \$37,500, regardless of the outstanding principal balance.

The lender is also secured by an inventory repurchase agreement with Whirlpool Corporation for purchases from Whirlpool only. The line requires that the Company meet certain financial covenants, provides payment penalties for noncompliance and prepayment, limits the amount of other debt the Company can incur, limits the amount of spending on fixed assets, and limits payments of dividends. The Company's unused borrowing capacity was \$355,000 at January 3, 2004.

A summary of the Company's contractual cash obligations at January 3, 2004 is as follows:

Contractual Cash Obligations	Cash payments due by period						
	Total	2004	2005	2006	2007	2008	2009 and Thereafter
Long-term debt, including interest	\$ 7,640,000	\$ 506,000	\$ 546,000	\$ 454,000	\$ 448,000	\$ 448,000	\$ 5,238,000
Operating leases	\$ 6,086,000	\$ 1,959,000	\$ 1,812,000	\$ 1,131,000	\$ 742,000	\$ 416,000	\$ 26,000
Total contractual cash obligations	\$ 13,726,000	\$ 2,465,000	\$ 2,358,000	\$ 1,585,000	\$ 1,190,000	\$ 864,000	\$ 5,264,000

The Company also has a commercial commitment as described below:

Other Commercial Commitment	Total Amount Committed	Outstanding at 01/03/04	Date of Expiration
Line of credit	\$ 10,000,000	\$ 5,089,000	August 30, 2004

The Company believes that its cash balance, availability under the Company's line of credit, if needed, and anticipated cash flows from operations will be adequate to fund cash requirements for fiscal 2004.

In June 2001, the Company signed a contract (the Appliance Early Retirement and Recycling Program) with the CPUC to operate a refrigerator/freezer/room air conditioner recycling program in San Diego and surrounding areas; a six-county region in California's Central Valley, including the cities of Fresno and Stockton; and the seven-county Bay Area, including the city of San Francisco. The Company started taking customer orders for the Appliance Early Retirement and Recycling Program in San Diego in June. The CPUC budgeted \$14 million to fund the recycling program. The budget allocation included \$50 incentive payments to participants for refrigerators and freezers and \$25 incentive payments for room air conditioners. The program was completed August 31, 2002.

In July 2002, the Company signed a contract in support of California's Statewide Residential Appliance Recycling Program to be administered by Edison. This contract was effective April 1, 2002 and continued until December 31, 2002. Recycling services for this statewide program included customers of Edison, PG&E and SDG&E. The Company was responsible for advertising in the PG&E and SDG&E service territories only; Edison was responsible for advertising in the Edison area.

In September 2002, the Company refinanced its building in St. Louis Park, Minnesota, and used the proceeds to pay down long-term debt. The new long-term debt was for \$3,470,000. The terms include a

20-year amortization, a 10-year balloon and a variable interest rate based on the 30-day LIBOR rate. The interest rate as of January 3, 2004 was 3.8214% and as of December 28, 2002 was 4.5191%.

In December 2002, the Company refinanced its building in Compton, California. The proceeds were included in cash. The new long-term debt was for \$2,000,000. The terms include a 20-year amortization, a 10-year balloon and an interest rate of 6.85%.

In September 2003, the Company signed a contract with Edison to support the 2003 Statewide Residential Appliance Recycling Program in the territories served by Edison and SDG&E. Since January 2003, the Company had handled appliance recycling operations for this energy conservation initiative under an extension of the 2002 program. The 2003 program ran through December 31, 2003.

In January 2004, the Company signed a contract with Edison to handle appliance recycling operations in Edison's service territory for 2004 and 2005.

In March 2004, the Company signed a contract with SDG&E to handle appliance recycling operations in SDG&E's service territory for 2004.

The Company believes, based on the anticipated revenues from the 2004-2005 Statewide Residential Appliance Recycling Program contract with Edison, the 2004 Statewide Appliance Recycling Program with SDG&E, the anticipated sales per retail store and its anticipated gross profit, that its cash balance, anticipated funds generated from operations and its current line of credit, if renewed, will be sufficient to finance its operations and capital expenditures through December 2004. The Company's total capital requirements for 2004 will depend upon, among other things as discussed below, the recycling volumes generated from the Statewide Residential Appliance Recycling Programs in 2004 and the number and size of retail stores operating during the fiscal year. Currently, the Company has three centers and nine stores in operation. If revenues are lower than anticipated or expenses are higher than anticipated, the Company may require additional capital to finance operations. Sources of additional financing, if needed in the future, may include further debt financing or the sale of equity (common or preferred stock) or other securities. There can be no assurance that such additional sources of financing will be available on terms satisfactory to the Company or permitted by the Company's current lender.

FORWARD-LOOKING STATEMENTS

Statements contained in this annual report regarding the Company's future operations, performance and results, and anticipated liquidity discussed herein are forward-looking and therefore are subject to certain risks and uncertainties, including, but not limited to, those discussed herein. Any forward-looking information regarding the operations of the Company will be affected primarily by the Company's continued ability to purchase product from Whirlpool, Maytag, Frigidaire and GE at acceptable prices, the ability and timing of Edison to deliver units under its 2004-2005 Statewide Residential Appliance Recycling Program contract, and the ability and timing of SDG&E to deliver units under its 2004 Statewide Appliance Recycling Program contract, with the Company. In addition, any forward-looking information will also be affected by the ability of individual retail stores to meet planned revenue levels, the rate of sustainable growth in the number of retail stores, the speed at which individual retail stores reach profitability, costs and expenses being realized at higher than expected levels, the Company's ability to secure an adequate supply of special-buy appliances for resale, and the continued availability of the Company's current line of credit.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

MARKET RISK AND IMPACT OF INFLATION

The Company does not believe there is any significant risk related to interest rate fluctuations on the long-term fixed rate debt. However, there are interest rate risks

on the line of credit, since its interest rate floats with prime, and on approximately \$3,300,000 in long-term debt entered into in September 2002, since its interest rate is based on the 30-day LIBOR rate. Also, the Company believes that inflation has not had a material impact on the results of operations for each of the fiscal years in the three-year period ended January 3, 2004. However, there can be no assurance that future inflation will not have an adverse impact on the Company's operating results and financial conditions.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Description

[Independent Auditor's Report](#)
[Consolidated Balance Sheet as of January 3, 2004 and December 28, 2002](#)
[Consolidated Statement of Operations for the three years ended January 3, 2004](#)
[Consolidated Statement of Shareholders' Equity for the three years ended January 3, 2004](#)
[Consolidated Statement of Cash Flows for the three years ended January 3, 2004](#)
[Notes to Consolidated Financial Statements](#)

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders
Appliance Recycling Centers of America, Inc.
Minneapolis, Minnesota

We have audited the accompanying consolidated balance sheet of Appliance Recycling Centers of America, Inc. and Subsidiaries as of January 3, 2004 and December 28, 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three year period ended January 3, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Appliance Recycling Centers of America, Inc. and Subsidiaries as of January 3, 2004 and December 28, 2002, and the results of their operations and their cash flows for each of the years in the three year period ended January 3, 2004, in conformity with accounting principles generally accepted in the United States of America.

McGLADREY & PULLEN, LLP

Minneapolis, Minnesota
February 17, 2004

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**APPLIANCE RECYCLING CENTERS OF AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET**

	January 3, 2004	December 28, 2002
ASSETS (Note 3)		
Current Assets		
Cash	\$ 1,196,000	\$ 2,802,000
Accounts receivable, net of allowance of \$117,000 and \$26,000, respectively (Note 9)	1,887,000	1,129,000
Inventories, net of reserves of \$324,000 and \$548,000, respectively	9,338,000	8,316,000
Refundable income taxes	904,000	523,000
Deferred income taxes (Note 7)	566,000	490,000
Other current assets	521,000	448,000
Total current assets	<u>14,412,000</u>	<u>13,708,000</u>
Property and Equipment, at cost (Notes 2 and 4)		
Land	2,050,000	2,050,000
Buildings and improvements	4,090,000	3,945,000
Equipment	5,359,000	4,979,000
	<u>11,499,000</u>	<u>10,974,000</u>
Less accumulated depreciation	5,321,000	4,763,000
Net property and equipment	<u>6,178,000</u>	<u>6,211,000</u>
Other Assets		
	243,000	320,000
Total assets	<u>\$ 20,833,000</u>	<u>\$ 20,239,000</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities		
Line of credit (Note 3)	\$ 5,089,000	\$ 3,515,000
Current maturities of long-term obligations	240,000	259,000
Accounts payable	2,958,000	2,929,000
Accrued expenses (Note 5)	2,019,000	1,273,000
Income taxes payable	660,000	729,000
Total current liabilities	<u>10,966,000</u>	<u>8,705,000</u>

Long-Term Obligations , less current maturities (Note 4)	5,209,000	5,424,000
Deferred Income Tax Liabilities (Note 7)	449,000	373,000
Total liabilities	<u>16,624,000</u>	<u>14,502,000</u>
Commitments (Note 6)		
Shareholders' Equity (Note 8)		
Common Stock, no par value; authorized 10,000,000 shares; issued and outstanding 2,364,000 and 2,324,000 shares, respectively	11,381,000	11,368,000
Accumulated deficit	(7,172,000)	(5,631,000)
Total shareholders' equity	<u>4,209,000</u>	<u>5,737,000</u>
Total liabilities and shareholders' equity	<u>\$ 20,833,000</u>	<u>\$ 20,239,000</u>

See Notes to Consolidated Financial Statements.

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**APPLIANCE RECYCLING CENTERS OF AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS**

	For the fiscal year ended		
	January 3, 2004	December 28, 2002	December 29, 2001
Revenues (Note 9)			
Retail	\$ 34,805,000	\$ 29,893,000	\$ 22,037,000
Recycling	8,014,000	14,625,000	20,506,000
Byproduct	790,000	1,202,000	1,267,000
Total revenues	<u>43,609,000</u>	<u>45,720,000</u>	<u>43,810,000</u>
Cost of Revenues (Note 9)	<u>31,730,000</u>	<u>29,946,000</u>	<u>26,481,000</u>
Gross profit	11,879,000	15,774,000	17,329,000
Selling, General and Administrative Expenses (Note 2)	<u>13,655,000</u>	<u>14,032,000</u>	<u>12,580,000</u>
Operating income (loss)	(1,776,000)	1,742,000	4,749,000
Other Income (Expense)			
Other income (expense)	(5,000)	47,000	88,000
Interest income	12,000	—	—
Interest expense	(748,000)	(1,236,000)	(1,074,000)
Income (loss) before provision (benefit) for income taxes	(2,517,000)	553,000	3,763,000
Provision (Benefit) for Income Taxes (Note 7)	<u>(976,000)</u>	<u>221,000</u>	<u>1,117,000</u>
Net income (loss)	<u>\$ (1,541,000)</u>	<u>\$ 332,000</u>	<u>\$ 2,646,000</u>
Basic Earnings (Loss) per Common Share	<u>\$ (0.66)</u>	<u>\$ 0.14</u>	<u>\$ 1.15</u>
Diluted Earnings (Loss) per Common Share	<u>\$ (0.66)</u>	<u>\$ 0.11</u>	<u>\$ 0.86</u>
Weighted Average Number of Common Shares Outstanding:			
Basic	<u>2,343,000</u>	<u>2,320,000</u>	<u>2,291,000</u>
Diluted	<u>2,343,000</u>	<u>3,025,000</u>	<u>3,068,000</u>

See Notes to Consolidated Financial Statements.

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**APPLIANCE RECYCLING CENTERS OF AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**

	Common Stock	Accumulated Deficit	Total
Balance, December 30, 2000	\$ 11,360,000	\$ (8,609,000)	\$ 2,751,000
Net income	—	2,646,000	2,646,000
Balance, December 29, 2001	11,360,000	(5,963,000)	5,397,000
Exercise of stock options (Note 8)	8,000	—	8,000
Net income	—	332,000	332,000
Balance, December 28, 2002	11,368,000	(5,631,000)	5,737,000
Exercise of warrants (Note 8)	13,000	—	13,000
Net loss	—	(1,541,000)	(1,541,000)
Balance, January 3, 2004	<u>\$ 11,381,000</u>	<u>\$ (7,172,000)</u>	<u>\$ 4,209,000</u>

See Notes to Consolidated Financial Statements.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

	For the fiscal year ended		
	January 3, 2004	December 28, 2002	December 29, 2001
Cash Flows from Operating Activities			
Net income (loss)	\$ (1,541,000)	\$ 332,000	\$ 2,646,000
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	611,000	507,000	483,000
Write-off of deferred financing fees and debt discount	—	258,000	—
(Gain) loss on sale of property and equipment	5,000	7,000	(60,000)
Accretion of long-term debt discount	—	46,000	43,000
Deferred income taxes	—	391,000	(400,000)
Change in assets and liabilities:			
Receivables	(758,000)	3,246,000	(2,644,000)
Inventories	(1,022,000)	(1,568,000)	(2,515,000)
Other assets	(11,000)	(238,000)	(27,000)
Accounts payable and accrued expenses	775,000	877,000	1,110,000
Income taxes refundable or payable	(450,000)	(551,000)	240,000
Net cash provided by (used in) operating activities	(2,391,000)	3,307,000	(1,124,000)
Cash Flows from Investing Activities			
Purchases of property and equipment	(558,000)	(598,000)	(910,000)
Proceeds from disposals of property and equipment	—	100,000	—
Net cash used in investing activities	(558,000)	(498,000)	(910,000)
Cash Flows from Financing Activities			
Net borrowings (payments) under line of credit	1,574,000	(1,193,000)	2,306,000
Payments on long-term obligations	(244,000)	(4,648,000)	(350,000)
Proceeds from long-term obligations	—	5,470,000	282,000
Payments of deferred financing fees	—	(150,000)	—
Proceeds from issuance of Common Stock	13,000	8,000	—
Net cash provided by (used in) financing activities	1,343,000	(513,000)	2,238,000
Increase (decrease) in cash and cash equivalents	(1,606,000)	2,296,000	204,000
Cash and Cash Equivalents			
Beginning	2,802,000	506,000	302,000
Ending	\$ 1,196,000	\$ 2,802,000	\$ 506,000
Supplemental Disclosures of Cash Flow Information			
Cash payments (receipts) relative to:			
Interest	\$ 748,000	\$ 1,056,000	\$ 1,031,000
Income taxes, net	(527,000)	439,000	279,000
Equipment acquired under capital lease	\$ 10,000	\$ —	\$ —

See Notes to Consolidated Financial Statements.

APPLIANCE RECYCLING CENTERS OF AMERICA, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Nature of Business and Significant Accounting Policies

Nature of business: Appliance Recycling Centers of America, Inc. and Subsidiaries (Company) are in the business of providing reverse logistics, energy conservation and recycling services for major household appliances. The Company sells appliances through a chain of Company-owned factory outlet stores under the name ApplianceSmart®. The Company also provides recycling services on a credit basis to appliance retailers, electric utilities, waste management companies and local governments.

A summary of the Company's significant accounting policies is as follows:

Principles of consolidation: The consolidated financial statements include the accounts of Appliance Recycling Centers of America, Inc. and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

During the second quarter of 2003, the Company became a majority (60%) owner in North America Appliance Company, LLC (NAACO). NAACO was formed and commenced operations in June 2003 and is a retailer of special-buy appliances in Texas. Because NAACO has a net shareholder's deficit, no minority interest has been recognized on the Company's consolidated balance sheet and 100% of NAACO's operations are included in the Company's consolidated financial statements as of January 3, 2004.

Fair value of financial instruments: The following methods and assumptions are used to estimate the fair value of each class of financial instrument:

Cash equivalents, accounts receivable and accounts payable: Due to their nature and short-term maturities, the carrying amounts approximate fair value.

Short- and long-term debt: The fair value of short- and long-term debt has been estimated based on discounted cash flows using interest rates being offered for similar debt having the same or similar remaining maturities and collateral requirements.

No separate comparison of fair values versus carrying values is presented for the aforementioned financial instruments since their fair values are not significantly different than their balance sheet carrying amounts. In addition, the aggregate fair values of the financial instruments would not represent the underlying value of the Company.

Fiscal year: The Company uses a 52-53 week fiscal year. The Company's 2003 fiscal year (2003) ended January 3, 2004, its 2002 fiscal year (2002) ended December 28, 2002 and its 2001 fiscal year (2001) ended December 29, 2001. The 2003 fiscal year contains 53 weeks. The 2002 and 2001 fiscal years contain 52 weeks.

Revenue recognition: The Company recognizes revenue from appliance sales in the period the appliances are purchased and paid for by the consumer. Revenue from appliance recycling is recognized when a unit is collected and processed. Byproduct revenue is recognized upon shipment.

The Company defers revenue under certain appliance extended warranty arrangements it services and recognizes the revenue over the related terms of the warranty contracts. On extended warranty arrangements sold by the Company but serviced by others for a fixed portion of the warranty sales price, the Company recognizes revenue for the net amount retained at the time of sale of the extended warranty to the consumer.

Shipping and handling charges to customers are included in revenues. Shipping and handling costs incurred by the Company are included in cost of revenues.

Product warranty: The Company provides a warranty for the replacement or repair of certain defective units. The Company's standard warranty policy requires the Company to repair or replace certain defective units at no cost to its customers. The Company estimates the costs that may be incurred under its warranty and records a liability reserve in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability reserve for covered units include the number of units sold, historical and anticipated rates of warranty claims on these units, and the cost of such claims. The Company periodically assesses the adequacy of its recorded warranty liability reserve and adjusts the amounts as necessary.

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Changes in the Company's warranty liability reserve are as follows:

	2003	2002	2001
Balance, beginning	\$ 82,000	\$ 187,000	\$ 106,000
Standard accrual based on units sold	164,000	203,000	301,000
Actual costs incurred	(133,000)	(134,000)	(253,000)
Periodic accrual adjustments	(59,000)	(174,000)	33,000
Balance, ending	<u>\$ 54,000</u>	<u>\$ 82,000</u>	<u>\$ 187,000</u>

Trade receivables: Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. A trade receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 90 days. The reserve for doubtful accounts of \$117,000 is considered by management to be adequate to cover any exposure to loss in the Company's January 3, 2004 accounts receivable.

Cash: The Company maintains its cash in bank deposit and money-market accounts which, at times, exceed federally insured limits. The Company has not experienced any losses in such accounts.

Inventories: Inventories, consisting principally of appliances, are stated at the lower of cost, first-in, first-out (FIFO), or market and consist of:

	2003	2002
Finished goods	\$ 9,662,000	\$ 8,596,000
Work-in-process- unrefurbished units	—	268,000
Less reserves	(324,000)	(548,000)
	<u>\$ 9,338,000</u>	<u>\$ 8,316,000</u>

The Company provides estimated reserves for the realizability of its appliance inventories, including adjustments to market, based on various factors including the age of such inventory and management's assessment of the need for such allowances. Management looks at historical inventory agings and margin analysis in determining its reserve estimate. The Company believes the reserve of \$324,000 as of January 3, 2004 is adequate. Because of a decrease in volume and a change in business, unrefurbished units are no longer valued in inventory.

Property and equipment: Depreciation is computed using straight-line and accelerated methods over the following estimated useful lives:

	Years
Buildings and improvements	18 - 30
Equipment	3 - 8

Software development costs: The Company capitalizes software developed for internal use in accordance with Statement of Position 98-1 and is amortizing such costs over their estimated useful life of five years. Costs capitalized were \$255,000, \$221,000, and \$225,000 for the fiscal years of 2003, 2002 and 2001, respectively. Amortization expense on software development costs was \$164,000, \$119,000 and \$78,000 for the fiscal years of 2003, 2002 and 2001, respectively. Estimated amortization expenses are \$216,000, \$240,000, \$207,000, \$159,000 and \$113,000 for the fiscal years 2004, 2005, 2006, 2007 and 2008, respectively.

Accounting for long-lived assets: Long-lived assets such as property and equipment are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The Company assesses the fair value of the assets based on the estimated future net undiscounted cash flows expected to result from the use of the assets, including cash flows from disposition. Should the sum of the expected future net cash flows be less than the carrying value, the Company recognizes an impairment loss at that time. An impairment loss is measured by comparing the amount by which the carrying value exceeds the fair value (estimated discounted future cash flows or appraisal of assets) of the long-lived assets. The Company wrote off approximately \$26,000 of leasehold improvements due to the closing of a retail store in the fiscal year ending January 3, 2004. Also see Note 2.

Deferred financing fees: Deferred financing fees are presented in the consolidated balance sheet as a component of other assets and are reported net of accumulated amortization. Amortization expense is determined on a straight-line basis over the term of the underlying debt.

Advertising expense: Advertising is expensed as incurred, and was \$1,545,000, \$1,823,000 and \$1,487,000 for the 2003, 2002 and 2001 fiscal years, respectively.

Income taxes: Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating

loss and tax credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax

assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Realization of deferred tax assets is dependent upon sufficient future taxable income during the periods when deductible temporary differences and carryforwards are expected to be available to reduce taxable income. At January 3, 2004 a valuation allowance of \$3,072,000 has been recorded against deferred tax assets principally relating to net operating loss and tax credit carryforwards, the use of which is limited under Section 382 of the Internal Revenue Code.

Basic and diluted net earnings per share: Basic per-share amounts are computed, generally, by dividing net income or loss by the weighted-average number of common shares outstanding. Diluted per-share amounts assume the conversion, exercise or issuance of all potential common stock instruments unless their effect is antidilutive, thereby reducing the loss or increasing the income per common share.

In arriving at diluted weighted-average shares and per-share amounts, options and warrants (see Note 8) with exercise prices below average market prices, for the respective fiscal quarters in which they were dilutive, were included using the treasury stock method. The number of additional shares was calculated by assuming the outstanding stock options and warrants were exercised and that the proceeds from such exercises were used to acquire Common Stock at the average market price during the year. The dilutive effect of these additional shares for the fiscal years of 2002 and 2001 was to increase the weighted average shares outstanding by 705,000 and 777,000, respectively. Because the effect of options and warrants on 2003 is antidilutive, they were not included in the computation of per-share amounts.

Stock-based compensation: The Company regularly grants options to its employees under various plans as described in Note 8. As permitted under accounting principles generally accepted in the United States of America, these grants are accounted for following APB Opinion No. 25 and related interpretations. Accordingly, compensation cost would be recognized for those grants where the exercise price is less than the fair market value of the stock on the date of grant. There was no compensation expense recorded for employee grants for fiscal years 2003, 2002 and 2001.

The Company also grants options and warrants to nonemployees for goods and services and in conjunction with certain agreements. These grants are accounted for under SFAS No. 123, *Accounting for Stock-Based Compensation*, based on the grant date fair values.

Had compensation cost for all of the employee stock-based compensation grants and warrants issued been determined based on the fair values at the grant date consistent with the provisions of SFAS No. 123, the Company's net income (loss) and net income (loss) per basic and diluted common share would have been as indicated below.

	2003	2002	2001
Net income (loss):			
As reported	\$ (1,541,000)	\$ 332,000	\$ 2,646,000
Deduct pro forma stock-based compensation	(52,000)	(80,000)	(58,000)
Pro forma	<u>\$ (1,593,000)</u>	<u>\$ 252,000</u>	<u>\$ 2,588,000</u>
Basic earnings (loss) per share:			
As reported	\$ (0.66)	\$ 0.14	\$ 1.15
Pro forma	<u>\$ (0.68)</u>	<u>\$ 0.11</u>	<u>\$ 1.13</u>
Diluted earnings (loss) per share:			
As reported	\$ (0.66)	\$ 0.11	\$ 0.86
Pro forma	<u>\$ (0.68)</u>	<u>\$ 0.08</u>	<u>\$ 0.84</u>

The above pro forma effects on net income (loss) and net income (loss) per basic and diluted common share are not likely to be representative of the effects on reported net income (loss) or net income (loss) per common share for future years because options vest over several years and additional awards generally are made each year.

Comprehensive income: Comprehensive income is equivalent to net income in the statement of operations.

Segment information: The Company has one operating segment. Although certain separate financial information by retail store, or retail store and recycling center, is available to management, the Company is managed as a unit. Specifically, the Company does not measure profit or loss or maintain assets separately for its products or revenue sources (retail appliance sales, appliance recycling including recycling services for utilities, and byproduct sales).

Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently issued accounting pronouncements: The following items represent accounting standards that have been recently issued.

In January 2003, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*. This statement provided alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, this statement also amended the disclosure requirements of SFAS No. 123 to require more prominent and frequent disclosures in the financial statements about the effects of stock-based compensation. The Company began applying disclosure provisions of this statement in its December 28, 2002 consolidated financial statements. Because the Company continues to account for employee stock-based compensation under APB Opinion No. 25, SFAS No. 148 had no effect on the Company's consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing certain guarantees. It also elaborates on the disclosures in SFAS No. 5, *Accounting for Contingencies*, which are to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued, even when the likelihood of making any payments under the guarantees is remote. The January 3, 2004 consolidated financial statements have incorporated the enhanced disclosure requirements of FIN 45, as presented in Note 1 to the financial statements under the caption "Product warranty."

In 2003, the FASB issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities* and its amendment (FIN 46R). This interpretation establishes standards for identifying a variable interest entity and for determining under what circumstances a variable interest entity should be consolidated with its primary beneficiary. Until now, a company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. FIN 46 applies to the Company's consolidated financial statements for the year ended January 3, 2004. The adoption of this pronouncement did not have a significant effect on the Company's consolidated financial statements.

The FASB has issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 requires that certain freestanding financial instruments be reported as liabilities in the balance sheet. Depending on the type of financial instrument, it will be accounted for at either fair value or the present value of future cash flows determined at each balance sheet date with the change in that value reported as interest expense in the statement of operations. Prior to the application of SFAS No. 150, either those financial instruments were not required to be recognized, or if recognized were reported in the balance sheet as equity and changes in the value of those instruments were normally not recognized in net income. The Company adopted SFAS No. 150 for the year ended January 3, 2004 and it had no effect on reported results for that year. The Company does not expect the application of SFAS No. 150 to have a material effect on its future consolidated financial statements.

Note 2. Market Closings and Loss on Impaired Assets

In December 2002, the Company closed a retail store in the Dayton, Ohio, market and incurred expenses of \$108,000 for the remaining lease payments and write-off of leasehold improvements.

In February 2003, the Company closed a retail store in the Minneapolis market that resulted in no closing costs.

In March 2003, the Company closed a retail store in the Dayton, Ohio, market and wrote off leasehold improvements of approximately \$26,000.

Note 3. Line of Credit

At January 3, 2004, the Company had a \$10 million line of credit with a lender. The interest rate as of January 3, 2004 was 5.50%. The amount of borrowings available under the line of credit is based on a formula using receivables and inventories. The line of credit has a stated maturity date of August 30, 2004, if not renewed, and provides that the lender may demand payment in full of the entire outstanding balance of the loan at any time. The line of credit is secured by substantially all the Company's assets and requires minimum monthly interest payments of \$37,500, regardless of the outstanding principal balance. The lender is also secured by an inventory repurchase agreement with Whirlpool Corporation for purchases from Whirlpool only. The loan requires that the Company meet certain financial covenants, provides payment penalties for noncompliance and prepayment, limits the amount of other debt the Company can incur, limits the amount of spending on fixed assets, and limits payments of dividends. At January 3, 2004 the Company's unused borrowing capacity under this line was \$355,000.

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Note 4. Long-Term Obligations

Long-term obligations consisted of the following:

	2003	2002
13.00% note payable, due in monthly interest payments of \$541 with balance due September 2005, secured by equipment	\$ 50,000	\$ 50,000
Adjustable rate mortgage based on the 30-day LIBOR rate (1.12% as of January 3, 2004) plus 2.7%, adjusted yearly, monthly payments include interest and principal, and are based on a 20-year amortization, due October 2012, secured by land and building	3,340,000	3,452,000
6.85% mortgage, due in monthly installments of \$15,326, including interest, due January 2013, secured by land and building	1,956,000	2,000,000
Other	103,000	181,000
	5,449,000	5,683,000
Less current maturities	240,000	259,000
	<u>\$ 5,209,000</u>	<u>\$ 5,424,000</u>

The future annual maturities of long-term obligations are as follows:

Fiscal year	
2004	\$ 240,000
2005	206,000
2006	238,000
2007	196,000
2008	183,000
2009 and thereafter	4,386,000
	<u>\$ 5,449,000</u>

Note 5. Accrued Expenses

Accrued expenses were as follows:

	2003	2002
Compensation and benefits	\$ 930,000	\$ 813,000
Warranty expense	54,000	82,000
Accrued incentives	686,000	—
Other	349,000	378,000
	<u>\$ 2,019,000</u>	<u>\$ 1,273,000</u>

Note 6. Commitments

Operating leases: The Company leases certain of its retail stores and recycling center facilities and equipment under noncancelable operating leases. The leases require the payment of taxes, maintenance, utilities and insurance.

Minimum future rental commitments under noncancelable operating leases as of January 3, 2004 are as follows:

Fiscal Year	
2004	\$ 1,959,000
2005	1,812,000
2006	1,131,000
2007	742,000
2008	416,000
2009 and thereafter	26,000
	<u>\$ 6,086,000</u>

Rent expense for fiscal years 2003, 2002 and 2001 was \$1,686,000, \$1,973,000 and \$1,519,000, respectively.

Contracts: The Company has entered into contracts with four of its appliance vendors. Under the agreements there are no minimum purchase commitments; however, the Company has agreed to indemnify the vendors for certain claims, allegations or losses with respect to appliances sold by the Company. Also see Note 9.

Note 7. Income Taxes

The provision (benefit) for income taxes consisted of the following:

	2003	2002	2001
Current:			
Federal	\$ (976,000)	\$ (170,000)	\$ 1,289,000
State	—	—	228,000
Deferred	—	391,000	(400,000)
	<u>\$ (976,000)</u>	<u>\$ 221,000</u>	<u>\$ 1,117,000</u>

A reconciliation of the Company's income tax expense with the federal statutory tax rate is shown below:

	2003	2002	2001
Income tax expense (benefit) at statutory rate	\$ (856,000)	\$ 188,000	\$ 1,278,000
State taxes net of federal tax effect	(152,000)	25,000	189,000
Permanent differences and other	(42,000)	8,000	20,000
Change in valuation allowance (net of effect of NOL attribute reduction in 2001)	74,000	—	(370,000)
	<u>\$ (976,000)</u>	<u>\$ 221,000</u>	<u>\$ 1,117,000</u>

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The components of net deferred tax assets are as follows:

	2003	2002
Deferred tax assets:		
Net operating loss carryforwards	\$ 3,002,000	\$ 2,834,000
Federal and state tax credits	269,000	199,000
Reserves	322,000	362,000
Accrued expenses	134,000	93,000
Prepaid expenses	(106,000)	—
Other	17,000	—
Net deferred tax assets	\$ 3,638,000	\$ 3,488,000
Valuation allowance	(3,072,000)	(2,998,000)
	<u>\$ 566,000</u>	<u>\$ 490,000</u>
Deferred tax liabilities:		
Property and equipment	\$ 449,000	\$ 373,000

At January 3, 2004, the Company had a valuation allowance against deferred tax assets to reduce the total to an amount management believes is appropriate. Realization of deferred tax assets is dependent upon sufficient future taxable income during the periods when deductible temporary differences and carryforwards are expected to be available to reduce taxable income. The reduction in the valuation allowance during 2001 was due to the determination that certain deferred tax assets are more likely than not to be realized and to the effect of an NOL attribute reduction.

At January 3, 2004, the Company had NOL carryforwards expiring as follows:

Expiration	Amount
2011	\$ 3,185,000
2012	\$ 1,144,000
2018	\$ 2,645,000

Future utilization of NOL and tax credit carryforwards is subject to certain limitations under provisions of Section 382 of the Internal Revenue Code. This section relates to a 50 percent change in control over a three-year period. The Company believes that the issuance of Common Stock during 1999 resulted in an "ownership change" under Section 382. Accordingly, the Company's ability to use NOL and tax credit carryforwards generated prior to February 1999 may be limited to approximately \$56,000 per year.

Note 8. Shareholders' Equity

Stock options: The Company has two stock option plans (Plans) that permit the granting of "incentive stock options" meeting the requirements of Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified options that do not meet the requirements of Section 422. The Plans have 150,000 and 600,000 shares, respectively, available for grant. The options that have been granted under the Plans are exercisable for a period of five to ten years from the date of grant and vest over a period of six months to five years from the date of grant.

The pro forma fair value of each option grant as presented in Note 1 to the financial statements is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2003	2002	2001
Expected dividend yield	—	—	—
Expected stock price volatility	79.5 %	79.7 %	82.3 %
Risk-free interest rate	0.9 %	1.4 %	6.2 %
Expected life of options (years)	2	2	2

Additional information relating to all outstanding options is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at December 30, 2000		
Granted	373,000	\$ 2.59
Cancelled	(21,000)	\$ 1.82
Outstanding at December 29, 2001	408,000	\$ 1.98
Granted	57,000	\$ 3.77
Exercised	(8,000)	\$ 0.96

Cancelled	(20,000)	\$	3.60
Outstanding at December 28, 2002	437,000	\$	2.16
Granted	15,000	\$	1.60
Cancelled	(44,000)	\$	3.06
Outstanding at January 3, 2004	408,000	\$	2.04

The weighted average fair value per option of options granted during fiscal years 2003, 2002 and 2001 was \$0.69, \$1.65 and \$0.86, respectively.

The following tables summarize information about stock options outstanding as of January 3, 2004:

OPTIONS OUTSTANDING

Range of Exercise Prices	Number of Options Outstanding	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price
\$4.05 to \$4.30	38,000	7.0	\$ 4.15
\$2.38 to \$3.50	46,000	3.3	\$ 2.55
\$0.75 to \$2.20	249,000	3.1	\$ 1.95
\$0.59 to \$0.65	75,000	3.2	\$ 0.63
	<u>408,000</u>		<u>\$ 2.04</u>

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OPTIONS EXERCISABLE

Range of Exercise Prices	Number of Options Exercisable	Weighted Average Exercise Price
\$4.05 to \$4.30	30,000	\$ 4.11
\$2.38 to \$3.50	46,000	\$ 2.55
\$0.75 to \$2.20	185,000	\$ 1.86
\$0.59 to \$0.65	75,000	\$ 0.63
	<u>336,000</u>	<u>\$ 1.88</u>

The following table summarizes options exercisable for stock options outstanding as of December 28, 2002 and December 29, 2001:

	December 28, 2002	December 29, 2001
Number of options exercisable	325,000	275,000
Weighted average exercise price	\$ 2.01	\$ 1.77

Warrants: The Company has adopted the provisions of SFAS No. 123 in accounting for its warrants issued for financing or services. Accordingly, the expense, if any, applicable to the value of such warrants is recognized as of the date of grant. Such warrants are generally issued to non-employees.

In September 1998, the Company entered into a loan agreement with a lender resulting in gross proceeds to the Company of \$3.5 million. In connection with this loan, the Company issued the lender a warrant to purchase 700,000 shares of Common Stock at an adjustable exercise price, which is currently \$0.60 per share. The Company also issued to an investment banker associated with this transaction a warrant to purchase 125,000 shares of Common Stock at \$2.50 per share. The portion of the gross loan proceeds ascribed to the aforementioned warrants issued in conjunction with this debt financing was \$307,000 as determined using the Black-Scholes method. During 2002, 32,136 warrants were exercised resulting in the issuance of 14,872 shares of Common Stock.

During 2001, 53,750 warrants related to a 1998 financing transaction were exercised resulting in the issuance of 9,768 shares of Common Stock and 15,000 of warrants from the same financing transaction expired.

In February 1999, in connection with a private placement, the Company issued warrants to purchase 83,000 shares of Common Stock at \$0.50 per share, subject to adjustment. During 2002, 4,000 warrants were exercised resulting in the issuance of 3,506 shares of Common Stock. During 2003, 26,000 warrants were exercised resulting in the issuance of 20,326 shares of Common Stock. In the first quarter of 2004, the remaining 53,000 warrants were exercised resulting in the issuance of 44,061 shares of Common Stock.

In March 1999, the Company issued to a board member at that time 5,000 warrants to purchase the Company's Common Stock at \$0.625 per share, the market value of the Company's stock at the date of grant.

In April 1999, the Company issued to a vendor 50,000 warrants to purchase Common Stock at \$0.625 per share. In February 2003, 20,000 warrants were exercised resulting in the issuance of 20,000 shares of Common Stock.

All issued warrants are exercisable and expire as follows: 83,000 in 2004; 700,000 in 2007 and 5,000 in 2009.

Preferred Stock: The Company's amended Articles of Incorporation authorize two million shares of Preferred Stock of the Company (Preferred Stock) which may be issued from time to time in one or more series having such rights, powers, preferences and designations as the Board of Directors may determine. To date no such preferred shares have been issued.

Note 9. Major Customer and Suppliers

Revenues from the Company's major recycling customers as a percentage of total revenues are as follows:

	2003	2002	2001
Revenue percentage:			
Customer A	9 %	13 %	29 %
Customer B	—	12 %	9 %

As of January 3, 2004, the Company had a receivable from Customer A of \$717,000.

During the three-year period ended January 3, 2004, the Company purchased a vast majority of appliances for resale from four suppliers. The Company has and is continuing

to secure other vendors from which to purchase appliances. However, the loss of one of these suppliers or any appliance supplier could adversely affect Company's operations.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

No changes in or disagreements with accountants have occurred within the two-year period ended January 3, 2004 that required reporting on Form 8-K.

ITEM 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including its principal executive officer and principal financial officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of the filing date of this annual report, and, based on the evaluation, its principal executive officer and principal financial officer have concluded that these controls and procedures are effective. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Disclosure controls and procedures are the Company's controls and other procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files under the Exchange Act is accumulated and communicated to its management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding directors and executive officers of the Company is set forth under the headings "Nominees and Information Concerning Officers Who Are Not Directors" and "Section 16 (a) Beneficial Ownership Reporting Compliance" in the Company's Proxy Statement for its 2004 Annual Meeting of Shareholders to be held April 29, 2004, and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information regarding executive compensation is set forth under the heading "Executive Compensation and Stock Options Granted and Exercised in Last Fiscal Year" in the Company's Proxy Statement for its 2004 Annual Meeting of Shareholders to be held April 29, 2004, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information regarding security ownership of certain beneficial owners and management is set forth under the heading "Common Stock Ownership" in the Company's Proxy Statement for its 2004 Annual Meeting of Shareholders to be held April 29, 2004, and is incorporated herein by reference.

The following table gives aggregate information under our equity compensation plans as of January 3, 2004:

	(a)	(b)	(c)
	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column(a))
Equity compensation plans approved by stockholders	408,000	\$ 1.98	181,750
Equity compensation plans not approved by stockholders (1)	788,000	\$ 0.59	N/A
Total	1,196,000	\$ 1.07	181,750

(1) See Note 8 regarding warrants issued for financing or services.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information regarding certain relationships and related transactions is set forth under the heading "Nominees and Information Concerning Officers and Key Employees Who Are Not Directors" in the Company's Proxy Statement for its 2004 Annual Meeting of Shareholders to be held April 29, 2004, and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information regarding principal accountant fees and services is set forth under the heading "Fees Paid to Auditors by the Company During the Last Fiscal Year" in the Company's Proxy Statement for its 2004 Annual Meeting of Shareholders to be held April 29, 2004, and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Financial Statements, Financial Statement Schedules and Exhibits

1. Financial Statements

See Index to Financial Statements under Item 8 of this report.

2. Financial Statement Schedule

To the Board of Directors
Appliance Recycling Centers of America, Inc.
Minneapolis, Minnesota

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements of Appliance Recycling Centers of America, Inc. and Subsidiaries taken as a whole. The supplemental Schedule II is presented for purposes of complying with the Securities and Exchange Commission's rules and is not a part of the basic consolidated financial statements. This schedule has been subjected to the auditing procedures applied in our audits of the basic consolidated financial statements and in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

McGLADREY & PULLEN, LLP

Minneapolis, Minnesota
February 17, 2004

Schedule II - Valuation and Qualifying Accounts

	Accounts Receivable Allowance		Inventory Allowance	
Balance, December 30, 2000	\$	20,000	\$	375,000
Additional allowance/adjustments		578,000		359,000
Write-offs		(498,000)		(270,000)
Balance, December 29, 2001	\$	100,000	\$	464,000
Additional allowance/adjustments		(35,000)		265,000
Write-offs		(39,000)		(181,000)
Balance, December 28, 2002	\$	26,000	\$	548,000
Additional allowance/adjustments		100,000		148,000
Write-offs		(9,000)		(372,000)
Balance, January 3, 2004	\$	117,000	\$	324,000

3. Exhibits

See Index to Exhibits on page 40 of this report.

(b) Reports on Form 8-K

The Company filed Form 8-K on October 29, 2003 announcing its third quarter 2003 results.

SIGNATURES

Pursuant to the requirements of Section 13 or Section 15(d) 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.

Dated: March 16, 2004

APPLIANCE RECYCLING CENTERS OF
AMERICA, INC.
(Registrant)

By /s/ Edward R. Cameron
Edward R. Cameron
President and Chief Executive Officer

By /s/ Linda A. Koenig
Linda A. Koenig
Vice President of Finance

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
<u>/s/ Edward R. Cameron</u> Edward R. Cameron	Chairman of the Board, President and Chief Executive Officer	March 16, 2004
<u>/s/ Linda A. Koenig</u> Linda A. Koenig	Vice President of Finance	March 16, 2004
<u>/s/ Duane S. Carlson</u> Duane S. Carlson	Director	March 16, 2004
<u>/s/ Harry W. Spell</u> Harry W. Spell	Director	March 16, 2004

INDEX TO EXHIBITS

Exhibit No.	Description
3.1	Restated Articles of Incorporation of Appliance Recycling Centers of America, Inc. [filed as Exhibit 3.1 to the Company's Form 10-K for the year ended January 2, 1999 (File No. 0-19621) and incorporated herein by reference].
3.2	Amended and Restated Bylaws of Appliance Recycling Centers of America, Inc. [filed as Exhibit 3.2 to the Company's Form 10-K for the year ended January 2, 1999 (File No. 0-19621) and incorporated herein by reference].
*10.1	Amended Appliance Recycling Centers of America, Inc. Restated 1989 Stock Option Plan [filed as Exhibit 19.3 to the Company's Form 10-Q for the quarter ended June 30, 1993 (File No. 0-19621) and incorporated herein by reference].
10.2	Line of credit dated August 30, 1996, between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, a division of Lyons Financial Services, Inc. [filed as exhibit 10.15 to the Company's Form 10-Q for the quarter ended September 28, 1996 (File No. 0-19621) and incorporated herein by reference].
10.3	Amended line of credit dated November 8, 1996, between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, a division of Lyons Financial Services, Inc. [filed as exhibit 10.16 to the Company's Form 10-Q for the quarter ended September 28, 1996 (File No. 0-19621) and incorporated herein by reference].
*10.4	1997 Stock Option Plan and Amendment [filed as Exhibits 28.1 and 28.2 to the Company's Registration Statement on Form S-8 (Registration No. 333-28571) and incorporated herein by reference].
10.5	Amended line of credit dated February 12, 1998 between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, a division of Lyons Financial Services, Inc., Amended Revolving Note and Amended Guarantor Acknowledgments [filed as Exhibit 10.10 to the Company's Form 10-K for year ended January 3, 1998 (File No. 0-19621) and incorporated herein by reference].
*10.6	Amendment, effective April 24, 1997, to 1989 Stock Option Plan [filed as Exhibit 28.2 to the Company's Post-Effective Amendment No. 1 (June 5, 1997) to Registration Statement on Form S-8 (Registration No. 33-68890) and incorporated herein by reference].
10.7	Reverse Logistics Master Service Agreement between Whirlpool Corporation and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10 to the Company's Form 10-Q for the quarter ended July 4, 1998 (File No. 0-19621) and incorporated herein by reference].
10.8	Loan Agreement between Medallion Capital, Inc. and Appliance Recycling Centers of America, Inc. dated September 10, 1998 [filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended October 3, 1998 (File No. 0-19621) and incorporated herein by reference].
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10.9	Promissory note of the Company to Medallion Capital, Inc. in the principal amount of \$3,500,000 due September 30, 2005 [filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended October 3, 1998 (File No. 0-19621) and incorporated herein by reference].
10.10	Security Agreement of the Company [filed as Exhibit 10.3 to the Company's Form 10-Q for the quarter ended October 3, 1998 (File No. 0-19621) and incorporated herein by reference].
10.11	Warrant of the Company in favor of Medallion Capital, Inc. for 700,000 shares of the Company's stock [corrected copy] [filed as Exhibit 10.14 to the Company's Form 10-K for the year ended January 2, 1999 (File No. 0-19621) and incorporated herein by reference].
10.12	Amendment to the line of credit dated September 10, 1998 between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, a division of Lyons Financial Services, Inc., Amendment to General Credit and Security Agreement and Amended Guarantor Acknowledgement [filed as Exhibit 10.15 to the Company's Form 10-K for the year ended January 2, 1999 (File No. 0-19621) and incorporated herein by reference].
10.13	Amendment to the line of credit dated September 17, 1998 between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, a division of Lyons Financial Services, Inc., Amendment to General Credit and Security Agreement, Amended Guarantor Acknowledgement and Amended and Restated Revolving Note [filed as Exhibit 10.16 to the Company's Form 10-K for the year ended January 2, 1999 (File No. 0-19621) and incorporated herein by reference].
*10.14	Amendment effective April 29, 1999 to 1997 Stock Option Plan [filed as Exhibit 10 to the Company's Form 10-Q for the quarter ended July 3, 1999 (File No. 0-19621) and incorporated herein by reference].
10.15	Agreement dated June 12, 2000 between Southern California Edison Company and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10 to the Company's Form 10-Q for the quarter ended July 1, 2000 (File No. 0-19621) and incorporated herein by reference].
10.16	Agreement dated August 21, 2000 between Southern California Edison Company and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended September 30, 2000 (File No. 0-19621) and incorporated herein by reference].
10.17	Amendment to the line of credit dated August 30, 2000 between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, a division of Lyons Financial Services, Inc., Amendment to General Credit and Security Agreement and Amended and Restated Revolving Note [filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended September 30, 2000 (File No. 0-19621) and incorporated herein by reference].
10.18	Updated contract dated January 1, 2001 between Southern California Edison Company and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended March 31, 2001 (File No. 0-19621) and incorporated herein by reference].
*10.19	Amendment effective April 26, 2001 to 1997 Stock Option Plan [filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended March 31, 2001 (File No. 0-19621) and incorporated herein by reference].

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- 10.20 Agreement dated June 12, 2001 between the California Public Utilities Commission and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10.1 to the Company Form 10-Q for the quarter ended June 30, 2001 (File No. 0-19621) and incorporated herein by reference].
 - 10.21 Agreement dated June 18, 2001 between Spectrum Commercial Services Company and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended June 30, 2001 (File No. 0-19621) and incorporated herein by reference].
 - 10.22 Agreement dated July 26, 2001 between Spectrum Commercial Services Company and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10.3 to the Company's Form 10-Q for the quarter ended June 30, 2001 (File No. 0-19621) and incorporated herein by reference].
 - 10.23 Amendment to the line of credit dated August 24, 2001 between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, Amendment to General Credit and Security Agreement and Amended and Restated Revolving Note [files as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended September 29, 2001 (File No. 0-19621) and incorporated herein by reference].
 - 10.24 Retail Dealer Sales Agreement dated October 12, 2001 between Appliance Recycling Centers of America, Inc. and Maytag Corporation [filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended September 29, 2001 (File No. 0-19621) and incorporated herein by reference].
 - 10.25 Amendment dated March 7, 2002 to the agreement between the California Public Utilities Commission and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10.29 to the Company's Form 10-K for the year ended December 20, 2001 (File No. 0-19621) and incorporated herein by reference].
 - 10.26 Amendment to the line of credit dated April 11, 2002 between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, Amendment to General Credit and Security Agreement and Amended Guarantor Acknowledgement [filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended March 30, 2002 (File No. 0-19621) and incorporated herein by reference].
 - *10.27 Amendment effective April 25, 2002 to 1997 Stock Option Plan [filed as Exhibit 10.2 to the Company's Form 10-Q for the quarter ended March 30, 2002 (File No. 0-19621) and incorporated herein by reference].
 - 10.28 Agreement dated June 18, 2002 between Southern California Edison Company and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended June 29, 2002 (File No. 0-19621) and incorporated herein by reference].
 - 10.29 Loan agreement dated September 19, 2002 between Appliance Recycling Centers of America, Inc. and General Electric Capital Business Asset Funding Corp. [filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended September 28, 2002 (File No. 0-19621) and incorporated herein by reference].
 - 10.30 Agreements dated September 24, 2002 between Appliance Recycling Centers of America, Inc. and the Department of Water and Power of the City of Los Angeles [filed as Exhibit 10.32 to the Company's Form 10-K for the year ended December 28, 2002 (File No. 0-19621) and incorporated herein by reference].

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- 10.31 Loan agreement dated December 28, 2002 between Appliance Recycling Centers of America, Inc. and General Electric Capital Business Asset Funding Corp. [filed as Exhibit 10.33 to the Company's Form 10-K for the year ended December 28, 2002 (File No. 0-19621) and incorporated herein by reference].
 - 10.32 Amendment to the line of credit dated January 23, 2003 between Appliance Recycling Centers of America, Inc. and Spectrum Commercial Services, Amendment to General Credit and Security Agreements [filed as Exhibit 10.34 to the Company's Form 10-K for the year ended December 28, 2002 (File No. 0-19621) and incorporated herein by reference].
 - 10.33 Agreement dated September 2, 2003 between Southern California Edison Company and Appliance Recycling Centers of America, Inc. [filed as Exhibit 10.1 to the Company's Form 10-Q for the quarter ended September 27, 2003 (File No. 0-19621) and incorporated herein by reference].
 - +10.34 Agreement dated January 1, 2004 between Southern California Edison Company and Appliance Recycling Centers of America, Inc.
 - +10.35 Agreement dated March 1, 2004 between San Diego Gas & Electric and Appliance Recycling Centers of America, Inc.
 - +21.1 Subsidiaries of Appliance Recycling Centers of America, Inc.
 - +23.1 Consent of McGladrey & Pullen, LLP, Independent Public Accountants.
 - +31.1 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
 - +31.2 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
 - +32 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Items that are management contracts or compensatory plans or arrangements required to be filed as an exhibit pursuant to Item 14(a)3 of this Form 10-K.
 + Filed herewith.

2004-05 STATEWIDE RESIDENTIAL APPLIANCE RECYCLING PROGRAM AGREEMENT

BETWEEN

ARCA CALIFORNIA, INC.

AND

SOUTHERN CALIFORNIA EDISON COMPANY

This program is funded by California utility customers and administered by Southern California Edison Company under the auspices of the California Public Utilities Commission.

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THIS AGREEMENT ("Agreement") is effective as of the 1st day of January, 2004 ("Effective Date") by and between **SOUTHERN CALIFORNIA EDISON COMPANY**, a California corporation ("SCE") and **ARCA CALIFORNIA, INC.**, a California corporation and wholly owned subsidiary of Appliance Recycling Centers of America, Inc. ("Contractor"). SCE and Contractor are also each individually referred to herein as "Party" and collectively as "Parties."

RECITALS

WHEREAS the Parties desire to implement an appliance recycling program during Program Years 2004 and 2005 under the terms and conditions required by the California Public Utilities Commission and as set forth herein, for the removal of older, working inefficient refrigerators and freezers ("Eligible Refrigerators and Freezers") ("the 2004-05 Statewide Residential Appliance Recycling Program" or "Program") from customer residences in the service territory of SCE.

WHEREAS, SCE desires to ensure the safe, lawful recovery and recycling or lawful disposal, as necessary, of CFCs, HCFCs, HFCs, PCBs, mercury, and used oil and Hazardous Materials.

WHEREAS, SCE desires to contract with Contractor for the comprehensive management of the 2004-05 Statewide Residential Appliance Recycling Program in the SCE Territory.

WHEREAS, Contractor desires to contract with SCE for the comprehensive implementation of recycling services of the 2004-05 Statewide Residential Appliance Recycling Program in the SCE Territory, said management to include, without limitation, the collection, disabling and proper disposal of primary and secondary working Eligible Refrigerators and Freezers; removal of CFCs, HCFCs, HFCs, PCBs, mercury and other Hazardous Materials from collected Eligible Refrigerators and Freezers; handling storage and legal disposal of compressor oil, PCBs and other Hazardous Materials; recycling of metal, sulfur dioxide, CFCs, HCFCs, HFCs and oil; providing incentives to participating customers of SCE and SDG&E who relinquish Eligible Refrigerators and Freezers, performance of a Program Participant survey, and providing reports and data to assist SCE in tracking program goals and expenditures and evaluating the program.

WHEREAS, Contractor represents (i) that it has knowledge of the federal Clean Air Act, the Resource Conservation and Recovery Act, and Toxic Substances Control Act as well as the California Health and Safety Act (Article 10.1, commencing with Section 25211 of Chapter 6.5 of Division 20), the California Public Resources Code (Chapter 3.5, commencing with Section 42160 of Part 3 of Division 30), and all other applicable federal, state, and local regulations regarding the proper processing and recycling of refrigerators and freezers and hazardous materials contained within the 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 established and will continue to operate and maintain its recycling center in the City of Compton or other areas acceptable to Contractor and SCE.

WHEREAS, 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.

NOW THEREFORE, for valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Parties agree as follows:

1. DEFINITIONS

- 1.1 Agreement: This document, the terms and conditions contained in this Agreement as amended from time to time.
- 1.2 Amendment: Future document signed by the authorized representatives of both Parties which changes or modifies the terms of this Agreement.
- 1.3 Business Day: The period from one midnight to the following midnight, excluding Saturdays, Sundays, and holidays.
- 1.4 Calendar Day: The period from one midnight to the following midnight, including Saturdays, Sundays, and holidays.
- 1.5 CFCs: Chlorofluorocarbons. (See also HCFCs and HFCs.)

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- 1.6 CFC-11: Chlorofluorocarbons used as the blowing agent in the refrigerator and freezer polyurethane foam insulation.

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- 1.7 Change Order: Document issued by SCE to Contractor and accepted by Contractor that changes or modifies the terms of this Agreement.

- 1.8 Contract Period: **January 1, 2004 to December 31, 2005** for completion of the Work, unless otherwise terminated pursuant to the terms and conditions of this Agreement.
- 1.9 CPUC: the California Public Utilities Commission.
- 1.10 Disposition Code: Code assigned to each customer appliance turn-in order form (ATO) that identifies whether a working or non-working Refrigerator or Freezer was collected, or disabled with the customer's permission, if the order was cancelled by the customer, which incentive was selected, and other similar details regarding each order.
- 1.11 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.
- 1.12 Eligible Customer: For purposes of this Agreement, an Eligible Customer is a resident in SCE's service territory who occupies an existing single-family residential (Domestic Rate) or multi-unit dwelling or mobile home, or is the owner or authorized representative of existing multifamily housing and who may qualify for the 2004-05 Statewide Residential Appliance Recycling Program. Eligible Customers include customers who reside in the SCE's service territory but who take distribution services from an entity other than SCE. (See Section 7 of this Agreement.)
- 1.13 Eligible Refrigerators and Freezers: Refrigerators and freezers that meet the 2004-05 Statewide Residential Appliance Recycling Program refrigerator and freezer eligibility criteria as set forth in Section 7 of this Agreement.
- 1.14 Hard-to-Reach: Eligible Customers who are residents of areas other than the Los Angeles basin and/or are moderate income and/or multifamily or mobile home tenants and are within the zip codes listed.

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- 1.15 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 or other applicable code, rule or regulation, which is contained in or is derived from the Eligible Refrigerators or Freezers.
- 1.16 HCFCs and HFCs: hydrochlorofluorocarbons, and hydrofluorocarbons. (See also CFCs.)
- 1.17 PCB: Polychlorinated Biphenyl.
- 1.18 PGC funds: Public Goods Charge Funds. The source of the funds used to pay Contractor for work performed pursuant to this Agreement.
- 1.19 Primary Refrigerator or Freezer: Refrigerator or freezer currently in use by customer as the main refrigerator or freezer.
- 1.20 Program Participants: Eligible Customers who turn in Eligible Refrigerators or Freezers during the Contract Period.
- 1.21 Program Year 2004: January 1, 2004 – December 31, 2004, unless otherwise directed by the CPUC.
- 1.22 Program Year 2005: January 1, 2005 – December 31, 2005, unless otherwise directed by the CPUC.
- 1.23 Purchase Order: Document issued by SCE to facilitate payment to Contractor for the Work described herein.
- 1.24 Recycling Center: The site at which Contractor will process Eligible Refrigerators and Freezers, remove CFCs, HCFCs, HFCs, PCBs and other Hazardous Materials, and recycle or legally dispose of Hazardous materials.
- 1.25 Recycling Charge: Per-unit price paid by SCE for services performed by Contractor for the Work. The Recycling Charge does not include marketing or incentive charges.

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- 1.26 Remote Area: A city or town that, because of its population and distance from the Contractor's base of operations, justifies the use of an extended timeframe (up to 25 Business Days from the initial customer contact) to complete collection when mutually agreed to by the Parties.

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- 1.27 Secondary Refrigerator or Freezer: Surplus refrigerator or freezer currently in use and utilized by customer concurrently with primary refrigerator or freezer.
- 1.28 2004-05 Statewide Residential Appliance Recycling Program: 2004-05 statewide appliance recycling program approved by the CPUC to be implemented in service territory of SCE.
- 1.29 Subcontractor: An entity contracting directly or indirectly with Contractor to furnish services or materials as part of or directly related to Contractor's Work.
- 1.30 Utility: SCE.
- 1.31 Work: Any and all obligations of Contractor to be performed for SCE and Eligible Customers of SCE pursuant to and during the Term of this Agreement, any Amendment to this Agreement, or a subsequent Purchase Order or Change Order incorporating this Agreement. The Work shall include the services described in Sections 4, 5, 6, and 10 of this Agreement, but is not limited to, Eligible Refrigerator and Freezer scheduling and collection, Eligible Refrigerator and Freezer processing, handling, storing, recycling, and legal disposal of Hazardous Materials and Documentation preparation, customer complaint resolution and other related activities.

2. GENERAL TERMS

Contractor shall perform the Work and its associated obligations described below as an independent contractor during the Term of this Agreement.

3. CONTRACT DOCUMENTS

This Agreement shall consist of the following documents: this Agreement, any amendments to this Agreement, Purchase Orders, and Change Orders. In the event of any conflict or apparent conflict between any of the provisions of the documents comprising this Agreement, the following order of construction of the documents shall apply:

- (i) Amendments to the Agreement in chronological order from the most recent to the earliest;
- (ii) Change Orders incorporating and reflecting any Amendments to the Agreement in chronological order from the most recent to the earliest;
- (iii) This Agreement; and
- (iv) Purchase Order incorporating this Agreement.

Each Party shall notify the other immediately upon the identification of any such conflict or inconsistency.

4. CONTRACTOR RECYCLING SERVICES

4.1 Contractor shall be responsible for Program Participant service activities in SCE's service territory, including providing an inbound 800 telephone number for customers to access in English or Spanish, a web page which allows statewide customer access for inquiries and/or qualification and to sign up for appointments 24 hours a day, seven days a week, all communication services, verification of customer and refrigerator or freezer eligibility, scheduling Eligible Refrigerator and Freezer collection appointments, documentation of Program Participant data, and other activities. The web site content shall be approved by SCE. Any changes to the content must be reviewed and approved by SCE prior to implementation.

4.2 Contractor shall be responsible for the following collection services in SCE's service territory:

- (i) Collect all Eligible Refrigerators and Freezers from Eligible Customers' residences within 20 Business Days from the date the Refrigerator or Freezer was scheduled for pickup (unless otherwise requested by the Eligible Customer). In Remote Areas of the service territory, or as approved by SCE's Program Manager, collection shall be no later than 25 Business Days from the date the Eligible Refrigerator or Freezer was scheduled for pickup, unless otherwise requested by the Eligible Customer. In the event of unanticipated high demand for Program services, Contractor and the SCE Program Manager shall, by mutual agreement, establish other appropriate time limitations as necessary.

Contractor shall dedicate 14 international straight trucks with 24' cargo boxes and hydraulic lift gates solely to performing the Work.

A twenty-five percent (25%) reduction in the Recycling Charge shall be made by SCE if Eligible Refrigerators and Freezers are collected later than 20 Business Days after the Eligible Refrigerator or Freezer was scheduled for pickup or 25 Business Days in Remote Areas of each Utility's service territory after the Eligible Refrigerator or Freezer was scheduled for pickup, unless the Eligible Customer requested the later collection date or the Contractor and the SCE Program Manager established, by mutual agreement, other appropriate time limitations.

- (ii) Ensure that the Eligible Refrigerator or Freezer is a working (cooling) unit before removing it from a residence;
- (iii) Ensure the Eligible Refrigerator or Freezer was manufactured prior to 1990;
- (iv) Disable the Eligible Refrigerator or Freezer by cutting through the electrical cord prior to leaving pick-up location; and
- (v) Transport and process the Eligible Refrigerator or Freezer at its Recycling Center.

Contractor represents and warrants that no refrigerator or freezer, nor any component thereof, picked up by Contractor or a Subcontractor in the performance of the Work, shall be resold or reused.

4.3 Contractor shall be solely responsible for all methods, techniques, sequences, and procedures for the dismantling of Eligible Refrigerators and Freezers, processing of metal panels and components, recycling of recovered scrap metal, glass and plastics, removal and management including, but not limited to, recycling or lawful disposal of Hazardous Materials.

4.4 Contractor shall be solely responsible for all methods, techniques, sequences, and procedures for the removal and management of all capacitors found in Eligible Refrigerators and Freezers, and the removal and disposal of compressor oil, CFCs, HCFCs, HFCs, PCBs, mercury and other Hazardous Materials from the time Contractor collects Eligible Refrigerators and Freezers pursuant to this Agreement.

4.5 Contractor and SCE shall establish and implement a financial incentive service as follows:

- 4.5.1 Each Program Participant will be entitled to receive a check in the amount of Thirty-five Dollars (\$35.00). The check is referred to as the "Incentive".
- 4.5.2 Contractor shall process and mail an Incentive check to each Program Participant via the U.S. Postal System within 15 Business Days of the date such Program Participant's Eligible Refrigerator or Freezer was picked up.
- 4.5.3 As required under Section 10, Contractor shall provide SCE with a weekly listing of Program Participants qualifying for an Incentive check for SCE's approval. The weekly listing shall include the Program Participants' names and addresses, ATO numbers, and dates of pickup.
- 4.5.4 Upon SCE's reimbursement of Contractor for the \$35.00 Incentive described in Section 4 of this Agreement, SCE 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 receive such Incentives. Moreover, upon SCE's payment to Contractor of such reimbursement, Contractor shall be deemed the holder of such property as far as the interests of the Program Participants 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. SCE shall not assume any responsibility for other disposition of the reimbursement payments after such reimbursement is paid to Contractor and shall not be entitled to the reversion of any amounts so paid.

- 4.7 Contractor's Customer Eligibility Inquiry List. Contractor shall provide SCE with its Customer Eligibility Inquiry Customer Eligibility Inquiry list within five (5) Business Days of receipt of SCE's relevant customer records provided to Contractor for purposes of identifying Eligible Customers.
- 4.8 Contractor services documentation and record maintenance services. Contractor shall document and maintain records for services performed under this Agreement as follows:
- 4.8.1 Appliance Turn-in Order Form (ATO) to collect data such as (a) customer name, address, home and work phone numbers, (b) SCE account number, (c) Eligible Refrigerator or Freezer manufacturer's name model and style, (d) defrost type, color, size, amperage, and age of unit; (e) location of Eligible Refrigerator or Freezer within the residence, (f) disposition code, (g) identification of units containing CFC-11, HCFCs and HFCs, (h) special pick-up instructions (if applicable), and (i) in all cases each participating Eligible Customer's signature, when Contractor picks up an Eligible Refrigerator or Freezer. Contractor shall obtain the signature of customer in the event refrigerator or freezer is discovered not to be an Eligible Refrigerator or Freezer.

ATO data shall be compiled in electronic mode, employing a software program suitable for exchange of information with SCE, subject to the approval of SCE's Program Manager.

Contractor shall utilize a computer software program designed to assign a Disposition Code to each ATO for each Program Participant.

ATO originals shall be maintained at the Contractor's Recycling Center and made available to SCE in accordance with Section 14 of this Agreement.

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- 4.9 Contractor Survey. Contractor shall conduct a Program Participant telephone survey throughout the year, using a stratified purposeful sample of 5% to 20% of the total number of Program Participants. The stratification and frequency of the survey may be modified periodically by SCE, 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 Recycling Charge. The purpose of the survey shall be to elicit information such as refrigerator or freezer use, customer demographics and customer satisfaction. Survey questions, stratification and frequency of survey may be modified periodically as determined by SCE provided modified survey is reasonably comparable.

5. CONTRACTOR REPORTS

- 5.1 Contractor shall provide SCE with reports on the Work performed under this Agreement. Required data shall be compiled in electronic mode, employing software suitable to exchange information with SCE, subject to approval of SCE's Program Manager. SCE requests that Contractor submit program documentation, including invoices, electronically.
- 5.1.1 A weekly invoice report as described below in Section 10;
- 5.1.2 A weekly check disbursement report that corresponds to a weekly invoice that shall include the Program Participants names and addresses, ATO numbers, dates of pickup, and the dates the Incentive checks were mailed
- 5.1.3 A weekly program status report which shall contain scheduled, cancelled and billed pickups delineating such by hard-to-reach (HTR) and non-HTR.
- 5.1.4 A monthly report, provided no later than the 15th Calendar Day of the preceding month's activity which shall contain the following:
- (i) Number of Eligible Refrigerators and Freezers processed through the Recycling Center during the previous month and the manufacturer's name, model and style, color, size in cubic feet, age of unit, and defrost type.
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- (ii) Environmental data such as an estimated breakdown of amount of CFCs/HCFCs/HFCs recovered; number of pounds of PCB articles removed; number of pounds of mercury articles removed, number and size of recycled Eligible Refrigerators and Freezers containing CFC-11; amount of compressor oil recycled; and weight of metals materials sold for recycling; and the weight of non-recyclable materials disposed.
- 5.1.5 An annual Program report summarizing Program Year 2004 information shall be submitted to SCE within 30 days after final collection of outstanding 2004 scheduled pickups.
- 5.1.6 An annual Program report summarizing Program Year 2005 information shall be submitted to SCE within 30 days after final collection of outstanding 2005 scheduled pickups.
- 5.1.7 Customer Comments and Complaints Report. Contractor shall provide SCE with a monthly status report on customer comments and status of customer complaints (on a cumulative basis) as described below in Section 6.
- 5.1.8 Appliance Collection Reports. A report indicating the number of Eligible Refrigerators and Freezers that were collected during the preceding month and that were scheduled for collection from Eligible Customers during that month, the date of the initial contact with the Eligible Customer, any subsequent rescheduled dates initiated by Eligible Customer, the date or dates the Eligible Refrigerator or Freezer was scheduled for collection, and the actual collection date.
- 5.1.9 Upon reasonable oral or written request from an authorized representative of SCE, special and nonrecurring reports during the course of the 2004-05 Statewide Residential Appliance Recycling Program. Such report content will be developed by the Parties in anticipation of or response to requests from the CPUC, SCE internal audits, or compilation of data relevant to the 2004-05 Statewide Residential Appliance Recycling Program activities. An amendment to this Agreement or a separate agreement shall be entered into only if any

such report necessitates a substantial change in labor, as substantiated by Contractor, requiring the negotiation of a charge separate from the Recycling Charge.

6. CONTRACTOR CUSTOMER COMPLAINT AND DISPUTE RESOLUTION PROCESS

6.1 Contractor shall be responsible, to the complete satisfaction of SCE, for developing and implementing a process for the management of customer complaints. Contractor shall undertake activities to resolve customer complaints in an expedited manner including, but not limited to: (a) ensuring adequate levels of professional customer service staff, (b) direct access of customer complaints to supervisory and/or management personnel, and (c) ensuring sufficient levels of delivery personnel expected during times of high volume.

Any customer questions or disputes that cannot be answered or resolved by Contractor shall be referred to SCE's program manager within 24 hours of occurrence.

6.2 A Customer Comment Tracking System for recording customer inquiries, complaints, and positive feedback. This Customer Comment Tracking System is to include, but is not limited to, dates of customer complaints, information on the number, characterization, resolution of customer complaints, date of each complaint resolution, and tracking of the total number of telephone calls, duration of calls, number of calls placed on hold, duration of time calls are on hold, and number of cancelled calls (hang-ups).

7. ELIGIBLE CUSTOMERS AND REFRIGERATORS AND FREEZERS

7.1 *Eligible Customers* shall include the following:

7.1.1 Customer is a resident in SCE's service territory and occupies an existing single-family residential (Domestic Rate) or multi-unit dwelling or mobile home, or is the owner or authorized representative of existing multifamily housing and who may qualify for the 2004-05 Statewide Residential Appliance Recycling Program. Eligible customers include customers who reside in SCE's service territory but who take distribution services from an entity other than SCE.

- (i) Contractor shall determine a customer's eligibility status **before** Contractor picks up a unit from a customer.
- (ii) Failure to verify customer eligibility shall result in nonpayment of fees.

7.1.2 Customer is the owner of the Eligible Refrigerator or Freezer or possesses written consent from the actual owner to turn in the Eligible Refrigerator or Freezer.

7.1.3 Customer turns in no more than two Eligible Refrigerators or Freezers or one each Eligible Refrigerator and Freezer per year unless written SCE approval is obtained for any additional Eligible Refrigerator or Freezer. SCE shall not be obligated to pay Contractor the Incentive check amount or Recycling Charge for any Eligible Refrigerator or Freezer picked up from an Eligible Customer that exceeds the limit of two Eligible Refrigerators or Freezers.

7.2 *Eligible Refrigerators and Freezers* for the 2004-05 Statewide Residential Appliance Recycling Program shall depend on the following:

- 7.2.1 Refrigerator or freezer must be capable of cooling or freezing, or both, as applicable, at time of collection.
- 7.2.2 Refrigerator or freezer minimum size is 14 cubic feet and maximum size is 27 cubic feet.
- 7.2.3 Refrigerator or freezer was manufactured prior to 1990.

8. INELIGIBLE CUSTOMERS AND REFRIGERATORS AND FREEZERS

8.1 Ineligible Customers

- 8.1.2 Low income customers who participate in a SCE's refrigerator replacement program for low-income customers in 2004-05.
- 8.1.3 Commercial customers who are on commercial SCE rates
- 8.1.4 A resident in a non-participating utility service territory.

8.2 Ineligible Refrigerators and Freezers

- 8.2.1 Refrigerators or freezers sizes less than 14 cubic feet or greater than 27 cubic feet.
- 8.2.2 Refrigerators or freezers containing sulphur dioxide (SO₂) or ammonia.
- 8.2.3 Commercial refrigerators or freezers, ammonia-containing gas refrigerators, commercial freezers, and room air conditioners
- 8.2.4 Refrigerators or freezers not capable of cooling or freezing or both, as applicable.
- 8.2.5 Refrigerators or freezers manufactured during or after 1990.

9. CONTRACTOR'S COMPENSATION

9.1 Summary of Fees Payable to Contractor

Program Year 2004. SCE shall pay Contractor as full compensation for completing the Work during 2004. The total amount to be paid to Contractor for Work performed in accordance with the terms and conditions of this Agreement shall not exceed the 2004 Maximum Aggregate Amount.

Program Year 2005. SCE shall pay Contractor as full compensation for completing the Work during 2005. The total amount to be paid to Contractor for Work performed in accordance with the terms and conditions of this Agreement shall not exceed the 2005 Maximum Aggregate Amount.

9.1.1 Recycling Charge. SCE shall pay to Contractor a per-unit Recycling Charge for the number of units collected pursuant to this Agreement.

9.1.2 Incentive Cost. SCE shall reimburse Contractor \$35 for each Incentive check payment distributed to Program Participants under the terms and conditions of this Agreement.

9.2 Payment schedule.

SCE shall transmit payments to Contractor for the Work (subject to offset by SCE for any amount that is unsubstantiated or found to be incorrect) as follows:

(i) For Incentive check reimbursement, within thirty (30) Calendar Days of receipt in SCE's Accounts Payable Division and Energy Efficiency Division of Contractor's weekly invoice and approval by SCE;

(ii) For Recycling Charges incurred, within thirty (30) Calendar Days of receipt in SCE's Accounts Payable Division and Energy Efficiency Division of Contractor's weekly invoice and approval by SCE;

SCE shall attempt to review and approve all weekly invoices within 5 Business Days of receipt in SCE's Accounts Payable Division and Energy Efficiency Division of a properly documented invoice. Contractor shall submit its invoices to Energy Efficiency Division via SCE's Program Manager at the contact information set forth in Section 23 below. Contractor shall submit its invoices to SCE's Accounts Payable Division in accordance with the instructions in the Purchase Order.

10. CONTRACTOR BILLING

10.1 On a weekly basis, in arrears, Contractor shall prepare and electronically submit two weekly invoices to SCE as specified above to substantiate the Recycling Charges, and Incentive check amounts due for Contractor's recycling services and payments to Program Participants for the prior week. Contractor shall provide SCE with a weekly listing of prospective Program Participants. The weekly listing shall include the Program Participants' names and addresses, dates of unit pickups, and the dates the Incentive checks were mailed.

The weekly Recycling Charges invoice shall include the Refrigerators and Freezers collected, processed, and recycled during the invoice period and the total invoice amount. Contractor shall provide with each invoice Program Participants' weekly listing including ATO number, service date, recycling charge for the first unit, recycling charge for second unit, if applicable, and total number of units and total recycling charge amount invoiced.

The weekly Participants Incentive Checks invoice shall include the per-unit Incentive for the Eligible Refrigerators and Freezers payments to Program Participants. Contractor shall provide with each invoice Program Participants' weekly listing including participants' names, ATO numbers, appliance type, pickup date, and total number of units and total Incentives amount invoiced.

10.2 SCE will not pay any invoice which does not contain all required documentation and information.

10.3 SCE will not pay any invoice that includes charges (Recycling Charges Incentive check amounts) for Work performed or services rendered more than 60 days prior to the date the invoice is received by SCE unless the delay is solely attributable to SCE's failure to timely furnish the information referenced in Section 11.

10.4 Contractor shall apply a per-unit Recycling Charge on units that have been disabled, and only for the following transactions:

10.4.1 Collection of an Eligible Refrigerator or Freezer.

10.4.2 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.

10.5 Contractor shall submit a final invoice as specified in Section 9.2 above for the Contract Period within 15 Calendar Days after the termination or expiration of this Agreement or final Eligible Refrigerator or Freezer pickup, whichever occurs later, in hard copy and in electronic format acceptable to SCE. Failure to submit the invoice and required documentation to SCE within 15 Calendar Days may result in nonpayment of the invoice by SCE.

11. SCE RESPONSIBILITIES

11.1 SCE shall provide to Contractor the following services:

11.1.1 Weekly updates of SCE's Customer Records for purposes of identifying Eligible Customers.

11.1.2 Customer lookups within five (5) Business Days of receipt of Contractor's Customer Eligibility Inquiry list.

11.1.3 If SCE fails to provide Contractor the required data within the time frames specified above in this section, then the reporting time frames stipulated in Section 5 shall be extended by the number of Business Days the information is delayed.

12. OWNERSHIP AND CUSTOMER CONFIDENTIALITY REQUIREMENTS

12.1 Contractor, its employees, and any Subcontractors shall not disclose any Confidential Customer Information (defined below) to any person other than SCE's personnel either during the Term of this Agreement or after its completion, without Contractor having obtained the prior written consent of SCE, except as provided by lawful court order or subpoena and provided Contractor gives SCE advance written notice of such order or subpoena.

12.1.1 "Confidential Customer Information" includes, but is not limited to, the customer's name, address, account number and all billing and usage

information. If Contractor is uncertain whether any information concerning a customer should be considered Confidential Customer Information, Contractor shall contact SCE prior to disclosing the customer information.

12.1.3 Prior to any approved disclosure of Confidential Customer Information, Contractor must enter into a nondisclosure agreement with SCE.

12.1.3 This provision does not prohibit Contractor from disclosing non-confidential information concerning the Work to the CPUC in any CPUC proceeding, or any CPUC-sanctioned meeting or proceeding or other public forum.

12.2 All materials provided by SCE to Contractor during the performance of this Agreement shall be returned to SCE after this Agreement is terminated or at the request of SCE. Contractor shall not duplicate any material furnished by SCE without prior written approval from SCE.

12.3 All new, original information, material, and documents prepared or caused to be prepared under this Agreement by Contractor using PGC funds shall become the property of the CPUC. Such information, or derivative information, materials, and documents, shall be used by Contractor only for work performed pursuant to this Agreement, and shall not be used in Contractor's general course of business, disclosed nor revealed in

any way to a third party without the prior express written consent of SCE.

12.4 Contractor Confidential Information

12.4.1 Except as required by the CPUC, SCE, its employees and any Subcontractors of SCE shall not disclose any confidential or proprietary information provided to SCE by 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 and HCFC and HCF and PCB recovery and Contractor's computer software. Prior to any approved disclosure, persons to receive Contractor's Confidential Information, including SCE, its employees or any third-party, must enter into a nondisclosure agreement with Contractor. SCE agrees to require its employees to execute appropriate nondisclosure agreements prior to any contact with, or evaluation of Contractor's Confidential Information

12.4.2 SCE agrees that, except as otherwise required by the CPUC, without the prior written consent of Contractor, SCE will not, during the Term or after termination or expiration 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:

- (i) Is not generally known to the public or in the industry;
- (ii) Has been treated by Contractor or any of its subsidiaries as confidential or proprietary; and
- (iii) Is of a competitive advantage to Contractor or any of its subsidiaries and in the confidentiality of which Contractor or any of its subsidiaries has a legally protectable interest.

12.4.3 Contractor's Confidential Information which becomes generally known to the public or in the industry, or, in the

confidentiality of which, Contractor and its subsidiaries cease to have a legally protectable interest, shall cease to be subject to the restrictions of this Section 12.

13. CONFLICT OF INTEREST

Contractor agrees that time is of the essence for the Work described herein. Contractor further agrees that any agreement it has, or in which it may enter with other parties (e.g., utilities or government agencies) for a recycling program, shall not detrimentally affect the quality or timeliness of Contractor's performance of the Work required under this Agreement.

14. RIGHT TO AUDIT AND INSPECT; RECORDKEEPING

14.1 SCE and/or its designated representatives shall have the right to periodically audit, during normal business hours, the records and documents in Contractor's possession or under its control, relating to the Work, upon reasonable advance written notice to Contractor. This right to audit shall extend for a period of five (5) years beyond the termination or expiration of this Agreement. Contractor agrees to allow SCE or its designated representatives reasonable access to such records during normal business hours and to allow interviews of any employees who might reasonably have information related to such records. Further, Contractor represents and warrants that Contractor shall contractually require all Subcontractors to provide SCE reasonable access to relevant records and staff of all Subcontractors concerning the Work.

14.2 SCE and/or its designated representatives shall have the right to periodically inspect, during normal business hours, Contractor's facilities, including trucks, used in performing the Work, upon reasonable advance written notice to Contractor. This right to inspect shall extend for a period of five (5) years beyond the termination or expiration of this Agreement. Contractor agrees to allow SCE and/or its designated representatives reasonable access to such facilities during normal business hours and to allow interviews of any employees who might reasonably have information related to such facilities. Further, Contractor represents and warrants that Contractor shall contractually require all Subcontractors to provide SCE reasonable access to facilities and staff of all Subcontractors used in performing the Work.

14.3 Contractor shall retain, and shall cause its Subcontractors to retain, all records and documents pertaining to the Work for a

period of not less than 5 years beyond the termination or expiration of this Agreement.

15. CHANGES

Changes to this Agreement shall be made by mutual agreement of the Parties through a written amendment to the Agreement. Such written amendment may be incorporated into this Agreement through a subsequent Purchase Order or Change Order.

16. PERMITS, CODES, AND STATUTES

- 16.1 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.
- 16.2 Contractor shall comply with all applicable local, state, and federal safety and health laws in effect at 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 SCE shall, in good faith, negotiate an amendment to this Agreement reasonably compensating Contractor for its additional costs.

17. REPRESENTATIONS AND WARRANTIES

Contractor represents and warrants to SCE 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 Eligible 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.

18. TITLE

- 18.1 Title to the Hazardous Materials shall pass to Contractor when Contractor collects Eligible Refrigerators and Freezers from customers.
- 18.2 Title of collected Eligible Refrigerators and Freezers shall pass to Contractor.

19. INSURANCE

19.1 Without limiting Contractor's liability to SCE, including the requirements of Section 20, Indemnity, Contractor shall maintain for the Work, and shall require that each Subcontractor 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, or materially altered except on thirty (30) Calendar Days prior written notice to SCE. Contractor shall furnish SCE with certificates of insurance and forms acceptable to SCE and shall require each Subcontractor to furnish Contractor with certificates of insurance, as evidence that policies do provide the required coverage and limits of insurance listed below. Such certificates shall be furnished to SCE's Program Manager by Contractor **within 30 days of execution of this Agreement** and by Subcontractor upon receipt of its subcontract, but in any event prior to start of its portion of the Work. Any other insurance carried by SCE, 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 SCE, 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 SCE and their officers, agents, and employees, as additional insureds; (b) be primary for all purposes; and (c) contain standard cross-liability 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 SCE 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 SCE as an additional insured and be primary for all purposes.

Contractor shall report immediately to SCE 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 19, Contractor shall, at its own cost, defend, indemnify, and hold harmless SCE and their respective 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

20. INDEMNITY

- 20.1 Contractor shall, at its own cost, indemnify, defend, reimburse, and hold harmless SCE and its officers, directors, employees, agents, assigns, and successors in interest, (1) 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; and (2) for any breach of any representation or warranty made by Contractor in this Agreement.

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

- 20.2 Contractor shall, at its own cost, indemnify, defend, reimburse, and hold harmless SCE, their officers, directors, employees, and agents, assigns, and successors in interest, from and against any and all liability imposed upon, or to be imposed upon SCE as applicable, under any law imposing liability for the environmental clean-up of the Hazardous Materials at any location (other than SCE'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.
- 20.3 The indemnities set forth in this Section 20 shall not be limited by the insurance requirements set forth in Section 19.
-

21. TERM AND TERMINATION

- 21.1 This Agreement shall commence on January 1, 2004 and continue in effect until one of the following occurs: (a) December 31, 2005; (b) SCE determines that Contractor has picked up all units called in prior to December 31, 2005; (c) SCE determines that Contractor has exhausted all available funding; (d) SCE learns that Contractor has filed a petition in bankruptcy or that an involuntary petition has been filed against Contractor and said petition(s); or (e) the CPUC discontinues funding for the 2004-05 Statewide Residential Appliance Recycling Program or this Agreement (the "Term").
- 21.2 Either Party may terminate the Agreement for any reason by providing thirty (30) Calendar Days advance written notice to the other Party. The termination shall become effective on the last day of said notice period ("Termination Date"). Contractor shall be paid for all Work performed prior to the Termination Date. In such event, SCE shall only be obligated to pay contractor for such Eligible 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.
- 21.3 In the event of termination pursuant to this Section 21, Contractor and SCE shall work cooperatively to facilitate the termination of the 2004-05 Statewide Residential Appliance Recycling Program.
- 21.4 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 affect the 2004-05 Statewide Residential Appliance Recycling Program or which addresses it in any manner.

22. STOP WORK

SCE may suspend the Work for good cause, such as safety concerns, fraud, or excessive customer complaints, by orally notifying Contractor to suspend the Work. Contractor shall stop work immediately, and may resume the Work only upon receiving written notice from SCE to resume the Work.

23. WRITTEN NOTICES

- 23.1 Any written notice, demand or request required or authorized in connection with this Agreement, shall be deemed properly given if delivered in person or sent by facsimile, nationally recognized overnight courier, or first class mail, postage prepaid, to the address specified below, or to another address specified in writing by SCE as follows:

SCE:

Southern California Edison Company
Refrigerator /Freezer Recycling Program
Tom Schober
2244 Walnut Grove Avenue - Quad 2A
Rosemead, CA 91770
(626) 302-8626 telephone
(626) 302-1834 facsimile
tom.schober@sce.com

Contractor:

ARCA CALIFORNIA Inc.
Jack Cameron, President
7400 Excelsior Boulevard
Minneapolis, MN 55426
(952) 930-1717 telephone
(612) 889-6600 cellular
(952) 930-1800 facsimile
jcameron@arcainc.com

- 23.2 Notices shall be deemed received (a) if personally or hand-delivered, upon the date of delivery to the address of the person to receive such notice if delivered

before 5:00 p.m., or otherwise on the Business Day following personal delivery; (b) if mailed, three (3) Business Days after the date the notice is postmarked; (c) if by facsimile, upon electronic confirmation of transmission, followed by telephone notification of transmission by the noticing Party; or (d) if by overnight courier: on the Business Day following delivery to the overnight courier within the time limits set by that courier for next-day delivery.

24. SUBCONTRACTS

- 24.1 Contractor represents and warrants that Contractor shall contractually require each Subcontractor to be bound by general terms and conditions protecting each participating Utility which are equivalent to the terms and conditions of this Agreement.
- 24.2 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. This Agreement shall not constitute a contractual relationship between any Subcontractor and SCE nor any obligation for payment by SCE to any Subcontractor.

25. INDEPENDENT CONTRACTOR

The Contractor, and its employees, Subcontractors, and agents of Contractor in the performance of this Agreement, shall act in an independent capacity and not as officers or employees or agents of SCE.

26. NON-DISCRIMINATION CLAUSE

Contractor and its Subcontractors shall not unlawfully discriminate, harass, or allow harassment against any employee or applicant for employment because of sex, race, color, ancestry, religious creed, national origin, physical disability (including HIV and AIDS), mental disability, medical condition (cancer), age (over 40), marital status, and denial of family care leave. Contractor and Subcontractors shall insure that the evaluation and treatment of their employees and applicants for employment are free from such discrimination and harassment. Contractor and its Subcontractors shall comply with the provisions of the Fair Employment and Housing Act (Government Code Section 12990 (a-f) et seq.) and the applicable regulations promulgated thereunder (California Code of Regulations, Title 2, Section 7285 et seq.). The applicable regulations of the Fair Employment and Housing Commission implementing Government Code Section 12990 (a-f), set forth in Chapter 5 of Division 4 of Title 2 of the California Code of Regulations, are incorporated into this Agreement by reference and made a part hereof as if set forth in full. Contractor and its Subcontractors shall give written notice of their

obligations under this clause to labor organizations with which they have a collective bargaining or other Agreement.

Contractor shall include the nondiscrimination and compliance provisions of this clause in all subcontracts for the Work.

27. CPUC AUTHORITY TO MODIFY

This Agreement shall at all times be subject to review and change or modification by the CPUC in the exercise of its jurisdiction.

28. NON-WAIVER

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

29. ASSIGNMENT

In the event SCE is required to assign its rights, duties and obligations under this Agreement to the CPUC and/or its designee, Contractor agrees to consent to such an assignment. Other than the aforementioned assignment, neither Party shall delegate or assign 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.

30. 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.

31. DISPUTE RESOLUTION

- 31.1 Should any dispute arise between the Parties regarding this Agreement, the Parties agree to enter into good faith negotiations as soon as practicable to resolve such disputes within five (5) Business Days of receipt of a written notice describing the dispute. If the Parties are unable to resolve the dispute, the Parties agree to refer the matter to the Energy Division for resolution by the CPUC.

- 31.2 All negotiations, mediation and/or arbitration conducted pursuant to this clause are confidential and shall be treated as compromise and settlement negotiations, to which Section 1119 of the California Evidence Code shall apply, and Section 1119 is incorporated herein by reference.

- 31.3 Notwithstanding the foregoing provisions, a Party may seek a preliminary injunction or other provisional judicial remedy if in its judgment such action is necessary to avoid irreparable damage or to preserve the status quo.

- 31.4 Each Party is required to continue to perform their obligations under this Agreement that are not related to the dispute, pending final resolution of a dispute arising out of or relating to this Agreement.

32. SEVERABILITY

In the event that any of the terms, covenants or conditions of this Agreement, or the application of any such term, covenant or condition, shall be held invalid as to any person or circumstance by any court, regulatory agency, or other regulatory body having jurisdiction, all other terms, covenants, or conditions of this Agreement and

their application shall not be affected thereby, but shall remain in full force and effect, unless a court, regulatory agency, or other regulatory body holds that the provisions are not separable from all other provisions of this Agreement.

33. GOVERNING LAW

This Agreement 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. Any action brought to enforce or interpret this Agreement shall be filed in Los Angeles County, California.

34. SECTION HEADINGS

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

35. SURVIVAL

Notwithstanding completion or of this Agreement, the Parties shall continue to be bound by the provisions of this Agreement which by their nature survive such completion or termination. Such provisions shall include, but not be limited to, Sections 12, 14, and 20 of this Agreement.

36. NONRELIANCE

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

37. 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.

38. COOPERATION

Each Party agrees to cooperate with the other Party in whatever manner reasonably required to facilitate the successful completion of this Agreement.

39. ENTIRE AGREEMENT

This Agreement contains the entire agreement and understanding between the Parties and merges and supersedes all prior agreements, representations and discussions pertaining to the subject matter of this Agreement, including Contractor's proposals. Any changes, exceptions, or different terms and conditions proposed by Contractor are hereby rejected unless expressly stated in this Agreement.

40. COUNTERPARTS

This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original, but all of which together shall be deemed to be one and the same instrument.

IN WITNESS WHEREOF, the Parties hereto have caused this Agreement to be executed by their duly authorized representatives.

CONTRACTOR:

ARCA CALIFORNIA, INC.

By: /s/Jack Cameron

Its: President

CSBU

Name Printed: Jack Cameron

Date: January 17, 2004

SCE:

SOUTHERN CALIFORNIA EDISON COMPANY

By: /s/Pamela A. Bass

Its: Sr. Vice President

Name Printed: Pamela A. Bass

Date: January 22, 2004

AGREEMENT
for
GENERAL SERVICES
between
SAN DIEGO GAS & ELECTRIC COMPANY
And
APPLIANCE RECYCLING CENTERS OF AMERICA - CALIFORNIA, INC.
for
2004 Statewide Appliance Recycling Program

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GENERAL SERVICES AGREEMENT

This General Services Agreement ("Agreement") is made effective as of March 1, 2004 ("Effective Date") between **SAN DIEGO GAS & ELECTRIC COMPANY** ("Company") and **APPLIANCE RECYCLING CENTERS OF AMERICA - CALIFORNIA, INC.** ("Contractor").

The Parties hereby agree as follows:

1. SCOPE

Contractor shall perform, at its own proper cost and expense, in the most substantial and skillful manner, to the satisfaction of Company, the following

generally describe General Services (hereinafter, the "Services"):

The scheduling, pick-up, and recycling of residential refrigerators and freezers.

2. COMMENCEMENT AND COMPLETION OF SERVICES

This Agreement shall commence as of the Effective Date and shall be in full force and effect through 12/31/2004, unless terminated earlier in accordance with Article 27. Contractor agrees to commence and perform the Services in accordance with the requests of Company Representative. The nature of the Services is such that timely performance is critical to the orderly progress of related work and to the operating schedule of Company.

3. REPRESENTATIVES

3.1. Company Representative: Neil Sybert

Company designates, and Contractor accepts, the individual named above as Company Representative for all matters relating to Contractor's performance of Services under this Agreement. The actions taken by the Company Representative regarding such performance shall be deemed the acts of Company. Company may at any time upon written notice to Contractor, pursuant to Article 6 hereof, change the designated Company Representative.

3.2. Contractor Representative: Edward Cameron

Contractor designates, and Company accepts, the individual named above as Contractor Representative for all matters relating to Contractor's performance of Services under this Agreement. The actions taken by Contractor Representative shall be deemed the acts of Contractor.

4. COMPENSATION

Contractor hereby agrees to accept as full compensation for satisfactory performance of the Services as described in Article 1. All payments shall be made in accordance with Article 5.

5. PAYMENT

5.1. Contractor shall invoice Company on a monthly basis for Services performed in the previous calendar month, or in accordance with an established milestone completion schedule. All invoices submitted shall have complete support documentation of all

charges incurred, including any data required to calculate fees or variable rate charges, plus support documentation for any authorized reimbursable expenses by category.

5.2. Company may upon written notice to Contractor, setoff any amount due from Contractor, whether or not under this Agreement, against any amount due Contractor or claimed to be due by Contractor under this Agreement. In addition, Company may withhold from Contractor any amount sufficient to reimburse Company for any loss, damage, expense or liability for Contractor's actual, alleged or reasonably probable failure, based on factual evidence, to comply with the terms and conditions of this Agreement.

5.3. Contractor shall submit invoices in duplicate in a format approved by Company and as set forth in this Article 5 to:

Original to: San Diego Gas & Electric Company
Attention: Accounts Payable
PO Box 129007
San Diego, CA 92112-9007

Copy to: San Diego Gas & Electric Company
Attention: Neil Sybert
8335 Century Park Court
San Diego, CA 92123-1569

5.4. Company shall make payment within thirty (30) days after receipt and approval of an invoice to the following address:

**Appliance Recycling Centers of America
7400 Excelsior Blvd
Minneapolis, MN 55426**

6. NOTICES OR DEMANDS

Any notice, request, demand or other communication required or permitted under this Agreement, shall be deemed to be properly given by the sender and received by the addressee if made in writing and (1) if personally delivered; (2) as of date of signed return receipt after deposit with the U.S. Postal Service by certified or registered mail, postage prepaid, with a return receipt requested; or (3) if sent by facsimile with confirmation sent as provided in (2) above. All correspondence shall reference the contract number specified on the cover page of this Agreement. Notices shall be addressed as follows to:

Company: Hal Snider
101 Ash Street
San Diego, CA 92101-3017
Facsimile No: (619) 699-5177
Attention: Director - Procurement Department

Contractor: Edward Cameron
Appliance Recycling Centers of America
7400 Excelsior Blvd
Minneapolis, MN 55426
Facsimile No: 952-930-1800
Attention: President & CEO

7. RESPONSIBILITY OF CONTRACTOR

Contractor shall perform the Services in accordance with established professional and business standards and ethics, and in conformity with each and every term of this Agreement. Contractor shall remedy any and all deficiencies in its Services which result from Contractor's failure to adhere to the Scope of Work.

8. INSPECTION

All Services performed by Contractor shall be subject to the inspection and approval of Company at all times, but such right of inspection of the Services shall not relieve Contractor of responsibility for the proper performance of the Services, nor shall such inspection waive Company's right to reject the Services at a later date. Contractor shall provide to Company (or its designee) access to Contractor's facility or facilities where the Services are being performed and sufficient, safe and proper work conditions for such inspection. Contractor shall furnish to Company such information concerning its operations or the performance of the Services as Company shall reasonably request.

9. COMPANY RULES

9.1. Contractor shall conduct its operations in strict observation of access routes, entrance gates or doors, parking and temporary storage areas as designated by Company. Under no circumstances shall any of Contractor's personnel, vehicles or equipment enter, move or be stored upon any area not authorized by Company.

9.2. Contractor shall abide by all Company Security procedures, rules and regulations, and cooperate with Company Security personnel whenever on Company premises.

10. CHANGES

10.1. Either Company or Contractor may propose an amendment ("Amendment") in the Services by advising the other party in writing. As soon as practicable, Contractor shall prepare and forward to Company in writing the proposed changes to the Scope of Work and/or compensation payable under this Agreement as a result of the proposed Amendment.

10.2. Should the proposed Amendment be authorized by Company, Contractor shall perform the Services as changed. All authorized changes in the Services and the compensation shall be confirmed and directed through a written Amendment. The compensation shall be negotiated by the parties in good faith to achieve a commercially reasonable result which include all costs associated with the deletion or performance of the additional or changed Services, including the impact on the original Scope of Work, inefficiencies created by the additional, deleted or changed Services, and overhead associated with the additional, deleted or changed Services.

10.3. If any proposed Amendment is rejected by Company, Contractor shall provide Company Representative with the details of the estimate of its proposed change. If the parties fail to agree on an Amendment to this Agreement, Company reserves the option to retain the services of others to perform such Services.

10.4. Company may request in writing from time to time, minor changes or revisions within the existing Scope of Work, if the changes do not materially affect the cost of providing such Services, without Company having to process an Amendment and without such changes altering the compensation payable under this Agreement.

10.5. Contractor shall implement a change in the Services only after Contractor has received a written Amendment to this Agreement executed by an authorized representative of Company. All changes shall be performed under the terms and conditions of this Agreement. Contractor hereby expressly waives any compensation, reimbursement of expenses and any other right to receive payment with respect to any proposed Amendment not authorized by a written Amendment to this Agreement.

11. EXCUSABLE DELAYS

Contractor shall notify Company in writing immediately of any delay, or anticipated delay in Contractor's performance of this Agreement due to causes or circumstances beyond the reasonable control of Contractor, and the reason for and anticipated length of such delay. Company may determine, in its sole judgment, to extend the date of performance for a period equal to the time lost by reason of the delay. Contractor shall not be eligible under any circumstances for additional compensation due to any such extension of time. Any extension to the contract term pursuant to this Article 11 shall be documented by a written Amendment to this Agreement signed by both parties. Examples of such possibly excusable delays are natural calamities, strikes and boycotts, war or civil unrest or governmental actions, and other events which are commonly deemed Force Majeure. None of the foregoing, however, shall require Company to grant any extension.

12. SUSPENSION OF SERVICES

Company may, at any time, by written notice, require Contractor to stop all, or any portion, of the Services for a period of ninety (90) days and any further period to which the parties mutually agree. Upon receipt of notice, Contractor shall immediately cease performance under this Agreement. Within ninety (90) days after a Suspension of Services order is delivered hereunder, Company shall either (a) cancel the Suspension of Services order, or (b) terminate this Agreement pursuant to the provisions of Article 27. If the Suspension of Services order is canceled, Contractor shall be granted a corresponding adjustment to all time periods and completion dates. Company shall not be liable for any payments to Contractor for expenses incurred during the Suspension of Services.

13. REPORTS

Contractor shall provide periodic status reports as requested by Company Representative. The status reports shall make periodic comparisons of the Services rendered to date against the Scope of Work, including any milestones and costs. Such reports shall include an explanation of any significant variations, an identification of any potential or known developments which may impact Company or the Services, and any corrective actions implemented.

14. SUBCONTRACTORS

All subcontractors utilized by Contractor under this Agreement, must be approved in advance, in writing by Company. Company shall not unreasonably refuse to approve Contractor's subcontractors if such subcontractors meet all Company's standard requirements. Contractor shall at all times be responsible the acts and omissions of subcontractors and agents employed directly or indirectly by Contractor. Contractor shall be responsible for performance of all the Services, whether performed by Contractor or its subcontractors or agents. This Agreement shall not give rise any contractual relationship between Company and any subcontractor or agent of Contractor. Company shall not undertake any obligation to pay or to be responsible for the payment of any sums to any subcontractor or

agent of Contractor. Upon request of Company, Contractor shall furnish to Company copies of any executed subcontracts entered into between Contractor and any subcontractor or agent.

Contractor shall utilize only those COMPANY approved final disposal sites, transporters and other approved environmental vendors (collectively "Environmental

Subcontractors”) for subcontracted services in furtherance of this Agreement. COMPANY reserves the right to approve and add additional Environmental Subcontractors in its sole discretion. Company also reserves the right to remove existing Environmental Subcontractors in its sole discretion.

15. SUPPLIER DIVERSITY

It is the policy of Company to provide maximum opportunity for women, minor and service disabled veteran business enterprises, hereinafter referred to as DBE (Diverse Business Enterprises), to participate in the performance of contracts. Company expects as performance to this Agreement, Contractor to utilize DBE subcontractors and suppliers and to make good faith efforts to set and attain goals in parity with Company goals when contracting for work with Company. Contractor shall submit on a timely basis all documentation required by Company to report such verified DBE expenditures.

16. AUDIT

16.1. Company reserves the right to designate its own employee representative(s) or its contracted representative with a certified public accounting firm, who shall have the right to audit and to examine any cost, payment, settlement or other supporting documentation from any Services performed under this Agreement. Any such audit(s) shall be undertaken by Company or its contracted representative at reasonable times during normal business hours and in conformance with generally accepted auditing standards. Contractor agrees to fully cooperate with any such audit(s).

16.2. Contractor shall include a similar clause in its agreements with its subcontractors reserving the right to designate Contractor’s own employee representative(s), its contracted representative from a certified public accounting firm, and/or representative(s) from Company, who shall have the right to audit and to examine any cost, payment, settlement or other supporting documentation resulting from any item related to the Services.

16.3. Contractor shall be notified in writing of any exception taken as a result of an audit of Contractor or a subcontractor. Contractor shall refund the amount of any exception to Company within ten (10) days. If Contractor fails to make such payment, Contractor shall pay interest on any unpaid portion of such payment, accruing monthly, at a rate equal to the lesser of ten percent (10%) per annum or the maximum lawful rate. Interest shall be computed from the date of written notification of exception(s) to the date Contractor reimburses Company in full for any exception(s). In the event an audit in accordance with this Article 16 discloses an overcharge of five percent (5%) or greater, then Contractor shall reimburse Company for the cost for the performance of such audit.

16.4. Company’s right to audit shall extend for a period of five (5) years following the date of final payment under this Agreement. Contractor and each subcontractor shall retain all necessary records and documentation for the entire length of this audit period.

17. TAXES

17.1. Contractor assumes exclusive liability for and shall pay before delinquency, all federal, state, regional, municipal or local sales, use, excise and other taxes, charges or contributions imposed on, or with respect to, or measured by the equipment,

materials, labor furnished hereunder, or the wages, salaries or other remunerations paid to individuals employed in connection with, the performance of the Services. Provided that the conditions of indemnification as set forth in Article 21 are satisfied, Contractor shall indemnify, defend and hold Company, and its current and future, direct and indirect parent Company(ies), subsidiaries, affiliates and their respective directors, officers, shareholders, employees, agents, representatives, successors and assigns harmless from and against any claim, liability, penalty, interest and expense arising by reason of Contractor’s failure to pay such taxes, charges or contributions.

17.2. Without limiting the generality of this Article 17, Contractor agrees to treat all individuals performing the Services under this Agreement as employees of Contractor for purposes of federal and state income taxes, Social Security and Medicare taxes, unemployment and disability insurance premiums. No exceptions shall be permitted under this Article 17 without a written Amendment to this Agreement prior to any individual performing any required Services under this Agreement. Contractor agrees that, at any time during the performance of this Agreement, Company shall have the right to audit Contractor’s compliance with this provision in accordance with Article 16.

17.3. To the extent any portion of the Services are performed in the State of California, either (a) Contractor represents that Contractor is a California resident and shall provide Company with an original and a copy of Form 590, Certificate of Residence, in accordance with California Revenue and Taxation Code Section 18662 and regulations thereunder; or (b) seven percent (7%) of all compensation payable to Contractor for Services performed in California shall be withheld in accordance with applicable California Franchise Tax Board (“FTB”) or successor regulations, unless Company has been notified in writing by FTB that withholding is waived or a lower rate or withholding is authorized.

17.4. Contractor and Company shall make commercially reasonable efforts to cooperate with each other to minimize the tax liability of both parties to the extent legally permissible (and with no duty to increase either parties tax liability), including separately stating taxable charges on Contractor’s invoices and supplying resale and exemption certificates, if applicable, and any other information as reasonably requested.

18. INDEPENDENT CONTRACTOR

18.1. It is agreed that Contractor shall perform the Services under this Agreement as an independent Contractor and no principal-agent or employer-employee relationship or joint- venture or partnership shall be created with Company.

18.2. Contractor represents to Company that Contractor and its subcontractors and agents are properly licensed, fully experienced and qualified to perform the class and type of the Services as specified in this Agreement, in addition to being properly insured, equipped, organized, staffed and financed to handle such Services.

18.3. Contractor shall perform the Services in an orderly and professional manner in accordance with industry standards. Contractor shall not employ on the Services any personnel, agent or subcontractor unskilled in the work assigned.

18.4. Contractor shall use prudent business practices in its relationships with subcontractors suppliers and agents.

18.5. Contractor, its subcontractors and agents shall not engage in any advertising, publicity or other promotional activities which in any way directly or indirectly refers to this Agreement.

19. WARRANTY

Contractor expressly warrants that all the Services performed hereunder shall be in compliance with the performance standards, drawings, specifications and any other description of services set forth in the Scope of Work, and the terms and conditions of this Agreement. Company may reject any Services furnished hereunder failing to meet such standards, and require Contractor to repeat, correct or replace such defective Services, at NO charge to Company.

20. INSURANCE

Insurance requirements are set forth as follows, but shall not in any way limit the amount or scope of liability of Contractor under this Agreement. The following constitutes the minimum insurance and requirements relating thereto:

20.1. On or before the effective date of this Agreement, and thereafter during its term, Contractor shall provide Company with current certificates of insurance, executed by a duly authorized representative of each insurer, as evidence of all insurance policies required under this Article 20. No insurance policy may be canceled, materially revised, or subject to non-renewal without at least thirty (30) days prior written notice being given to Company. Insurance shall be maintained without lapse in coverage during the term of this Agreement. Company shall also be given certified copies of Contractor's policies of insurance, upon request.

20.2. Company shall be named as an additional insured in each general liability policy. Such general liability insurance shall provide a severability of interest or cross-liability clause.

20.3. The required policies, and any of Contractor's policies providing coverage excess of the required policies, shall provide that the coverage is primary for all purposes and Contractor shall not seek any contribution from any insurance or self-insurance maintained by Company.

20.4. All required policies of insurance shall be written by companies having an A.M. Best rating of "A-" or better, or equivalent.

20.5. Contractor shall be solely responsible for any deductible or self-insured retention on insurance required hereunder this Agreement.

20.6. At all times during this Agreement, Contractor shall provide and maintain, at Contractor's expense, the following types of insurance:

20.6.1. **General Liability Insurance:** Contractor shall maintain an occurrence form commercial general liability policy or policies, insuring against liability arising from bodily injury, property damage, personal and advertising injury, independent Contractors liability, products and completed operations and contractual liability. Such coverage shall be in an amount of not less than \$1,000,000.00 (One Million Dollars) combined single limit per occurrence.

20.6.2. **Automobile Liability Insurance:** Contractor shall maintain an automobile liability policy or policies insuring against liability for damages because of bodily

injury, death, or damage to property, (including loss of use thereof), and occurring in any way related to the use, loading or unloading of any of Contractor's automobiles (including owned, non-owned, leased, rented and/or hired vehicles). Such coverage shall be in an amount of not less than \$1,000,000.00 (One Million Dollars) each accident.

20.6.3. **Workers Compensation Insurance:** In accordance with the laws of the State(s) in which the Services shall be performed, Contractor shall maintain in force workers compensation insurance for all of its employees. If applicable, Contractor shall obtain U.S. Longshoremen's and Harbor Workers compensation insurance, separately, or as an endorsement to workers compensation insurance. Contractor shall also maintain employer's liability coverage in an amount of not less than \$1,000,000.00 (One Million Dollars) per accident and per employee for disease. In lieu of such insurance, Contractor may maintain a self-insurance program meeting the requirements of the State(s) in which the Services shall be performed along with the required employer's liability insurance.

20.6.4. **Environmental Impairment Liability Insurance:** Contractor shall maintain a comprehensive environmental impairment liability policy or policies insuring against liability for environmental activities contemplated under this Agreement as required by federal, state, regional, municipal and local laws, but not less than \$1,000,000.00 (One Million Dollars) each claim.

20.7. Each policy of property, general liability and automobile (including automobile physical damage) insurance maintained by Contractor shall contain a waiver of subrogation in favor of Company.

21. INDEMNITY

21.1. As between Company and Contractor, Contractor shall be solely responsible for and Contractor shall indemnify, defend and hold Company, and its current and future, direct and indirect parent Company(ies), subsidiaries, affiliates and their respective directors, officers, shareholders, employees, agents, representatives, successors and assigns harmless from and against any and all claims, actions, suits, proceedings, losses, liabilities, penalties, fines, damages, costs or expenses including without limitation, attorneys fees (including fees and disbursements of in-house and outside counsel) of any kind whatsoever resulting from (a) injuries to or death of any and all individuals, including, without limitation, members of the general public, or any employee, agent, independent Contractor or consultant or affiliate of either Company or Contractor, arising out of or connected in any manner with the performance of Services, whether or not the conduct of Contractor or any subcontractor was tortious and whether or not Company's tortious conduct contributed to the injuries or death, (b) damage to, loss, and/or destruction of property, including, without limitation, to, property of Company or Contractor arising out of or connected in any manner with the performance of Services, whether or not the conduct of Contractor or any subcontractor was tortious and whether or not Company's tortious conduct contributed to the property damages, or (c) third party claims of any kind, whether based upon negligence, strict liability or otherwise, arising out of or connected in any manner to Contractor's or any of its subcontractor's acts or omissions in breach of this Agreement. This indemnification obligation shall not apply to the extent that injuries, death, loss, damage or destruction is caused by either the willful misconduct of Company, its employees, agents or representatives, or Company's sole negligence.

21.2. Contractor shall indemnify, defend and hold Company, and its current and future, direct and indirect parent Company(ies), subsidiaries, affiliates and their respective directors, officers, shareholders, employees, agents, representatives, successors and assigns harmless from and against any and all claims, actions, suits, proceedings, losses, liabilities, penalties, fines, damages, costs or expenses including attorneys fees (including fees and

disbursements of in-house and outside counsel) of any kind whatsoever arising from (a) actual or alleged infringement or misappropriation by Contractor or any subcontractor of any patent, copyright, trade secret, trademark, service mark, trade name, or other intellectual property right in connection with the Services, including without limitation, any deliverable, and (b) Contractor's violation of any third party license to use intellectual property in connection with the Services, including, without limitation, any deliverable.

21.3. If any claim or action is brought against Company, then Contractor shall be entitled to participate in, and, unless in the opinion of counsel for Company a conflict of interest between Company and Contractor may exist with respect to such claim or action, assume the defense of such claim or action, with counsel reasonably acceptable to Company. If Contractor does not assume the defense of Company, or if a conflict precludes Contractor from assuming the defense, then Contractor shall reimburse Company on a monthly basis for Company's defense through separate counsel of Company's choice. Even if Contractor assumes the defense of Company with acceptable counsel, Company, at its sole option and expense, may participate in the defense with counsel of Company's own choice without relieving Contractor of any of its obligations hereunder.

21.4. Contractor's obligation to indemnify Company under this Article 21 shall not be limited in any way by any limitation on the amount or type of damages, compensation, penalty or benefits payable by or for Contractor under any statutory scheme, including without limitation, any Workers Compensation Acts, Disability Benefit Acts or other Employee Benefit Acts.

22. ENVIRONMENTAL TERMS

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

22.1.1. The term "Hazardous Material" means any chemical, substance, material, product, controlled substance, object, condition, solid or hazardous waste or any combination thereof, which is or may be hazardous to human health or safety or the environment due to its radioactivity, ignitability, reactivity, toxicity, or other harmful or potentially harmful properties or affects. Hazardous Material includes, without limitation, oil or petroleum and petroleum products, asbestos and any asbestos containing materials, radon, polychlorinated biphenyls ("PCBs"), urea formaldehyde insulation, lead paints and coatings, and all of those chemicals, substances, materials, products, controlled substances, objects, conditions and waste or any combinations thereof which are currently or become in the future listed, defined or regulated in any manner by any federal, state, regional, municipal or local Environmental Law (as that term is defined below).

22.1.2. The term "Environmental Law" means any and all applicable federal, state, regional, municipal or local law, regulation, decision of the courts, ordinance, rule, code, order, directive, guideline, authorization or approval, permit or permit condition, currently existing or as amended, enacted, issued or adopted in the future which relates in any way to worker or workplace safety, environmental conditions, environmental quality or policy, health and/or safety issues or concerns (including product safety). Environmental Law includes, without limitation, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (42 USC, Section 9601 et seq.), the Resource Conservation and Recovery Act (42 USC, Section 6901 et seq.), the Carpenter-Presley-Tanner Hazardous Substance Account Act (California Health & Safety Code, Section 25300 et seq.), the California Hazardous Waste Control Law (California Health & Safety Code, Section 25100 et seq.), the Occupational Safety and Health Act (29 USC Sections 651 et seq.), the California Occupational

Safety and Health Act (California Labor Code Sections 6300 et seq.), and any regulations or rules promulgated thereunder.

22.1.3. The term "Governmental Agency" shall mean any federal, state regional, municipal or local governmental agency or other public or political body having the jurisdiction, mandate, authority or power to regulate, implement, coordinate, administer or enforce any Environmental Law.

22.2. Contractor agrees to use, and agrees that it shall require each of its subcontractors, if any, to use only personnel who are qualified and properly trained and who possess every license, permit, registration, certificate or other approval required by any applicable Environmental Law or Governmental Agency to enable such personnel to perform their work involving any part of Contractor's obligations under this Agreement.

22.3. Contractor agrees that all materials and equipment to be supplied or used by Contractor, its subcontractors, if any, in the performance of its obligations under this Agreement, including, but not limited to vehicles, loading equipment, and containers, shall be in good condition and fit for the use(s) for which they are employed by Contractor or its subcontractor, if any. Such materials and equipment shall at all times be maintained, inspected and operated as required by applicable Environmental Law. Contractor further agrees that all licenses, permits, registrations and certificates or other approvals required by any Environmental Law or Governmental Agency shall be procured and maintained for such materials and equipment at all times during the use of the same by Contractor or its subcontractors, if any, in the performance of any of Contractor's obligations under this Agreement.

22.4. Contractor specifically agrees that in the performance of its obligations under this Agreement, Contractor shall at all times fully comply with and cause each of its subcontractors, if any, to fully comply with all applicable Environmental Laws. Contractor further specifically agrees that at all times during its performance of the Services, Contractor shall have and cause its subcontractors, if any, to have and keep in effect all licenses, permits, registrations, certificates, and approvals required by any Environmental Law or by any Governmental Agency for the Services undertaken by Contractor or its subcontractors, if any, in the performance of Contractor's obligations under this Agreement.

22.5. Contractor hereby specifically agrees to indemnify, defend and hold Company, its current and future, direct and indirect parent Company(ies), subsidiaries, affiliates and their respective directors, officers, shareholders, employees, agents, representatives, successors and assigns (hereinafter, collectively the "Indemnitees") harmless from and against any and all claims, actions, suits, proceedings, losses, liabilities, penalties, fines, damages, demands, causes of action, costs and expenses including, but not limited to, all reasonable consulting, engineering, attorneys (in-house and outside counsel) or other professional fees including disbursements, which Indemnitees, or any of them, may incur or suffer by reason of:

- (1) any unauthorized release of a Hazardous Material,
 - (2) any enforcement or compliance proceeding commenced by or in the name of any Governmental Agency because of an alleged, threatened or actual violation of any Environmental Law,
 - (3) any action reasonably necessary to abate, remediate or prevent a violation or threatened violation of any Environmental Law, and/or
-
- (4) any other cause of whatsoever nature,

arising out of or in any way connected with Contractor's performance of its obligations under this Agreement and/or Contractor's willful or negligent acts or omissions in connection therewith; except to the extent the same were caused by the negligent or willful misconduct or omissions of the Indemnitees, or any of them. Contractor's obligation to indemnify Indemnitees under this Article 22 shall not be limited in any way by any limitation on the amount or type of damages, compensation, penalty or benefits payable by or for Contractor under any statutory scheme, including without limitation, any Workers Compensation Acts, Disability Benefit Acts or other Employee Benefit Acts.

22.6. In the event of any release of a Hazardous Material, Contractor shall perform the following actions:

- (1) Take all reasonable steps necessary to stop and contain said release
- (2) Make any report of such release as required under Environmental Law
- (3) Clean up such release as required by Governmental Agency

Contractor shall immediately notify Company Representative of the following information upon the occurrence of any release of Hazardous Material in connection with the performance of the Services:

- (1) A description of the release
- (2) The identification of the Hazardous Material and the volume released.
- (3) Death of any person

- (4) Property damage
- (5) Any communication from any Governmental Agency that alleges that Contractor is not acting in compliance with Environmental Law.
- (6) Any communication from any Governmental Agency that affects any permits or licenses necessary to perform the Services.

Contractor shall promptly submit within 36 hours to Company Representative a written report, in a format as required by Company, describing in detail any event of any release of a Hazardous Material of which shall include the following information:

- (1) Name and address of Contractor and, if applicable, any subcontractor(s) or agent(s) involved.
- (2) Name and address of Contractor's commercial and environmental liability insurance carrier.
- (3) Name and address of any injured or deceased persons, if applicable.
- (4) Name and address of any property damage, if applicable.

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- (5) A detailed description of the release including the identification of the Hazardous Material, the date and time of the release, the volume released, and the nature of the any environmental contamination.
 - (6) A determination of whether any of Company's personnel, equipment, tools or materials were involved.
 - (7) A detailed description of all reports made to any Governmental Agency, and a description of the actions taken to respond to the release.

22.7. Contractor shall NOT (a) transport any of Hazardous Material of which Company is the generator for purposes of treatment, storage, recycling and/or disposal; or (b) conduct any treatment, storage, recycling and/or disposal of any Hazardous Material of which Company is the generator, unless specifically authorized by Company to perform such activities under this Agreement. If Contractor is authorized by Company to perform such activities under this Agreement, then the following terms and conditions shall also apply:

22.7.1. Contractor shall not transport any Hazardous Material of which Company is the generator to any treatment, storage, recycling and/or disposal facility (hereinafter called "TSDF") not authorized by Company in writing. Moreover, notwithstanding the fact that Company has identified an authorized TSDF, Contractor agrees that before Contractor transports any Hazardous Material to any such TSDF, Contractor shall confirm that such TSDF has, as of the date of each shipment, procured and maintained in effect all licenses, permits, registrations, certificates or other authorizations required by any Environmental Law or Governmental Agency, for such TSDF to lawfully receive, handle, transport, store, treat, recycle, incinerate, dispose of, or otherwise manage or use such Hazardous Material as authorized by Company. Contractor shall not transport any Hazardous Material of which Company is the generator to any TSDF which is unable or fails to provide such confirmation, and immediately provide written notification of such condition to Company. Further, notwithstanding that Company has identified an authorized TSDF, Company reserves the right at any time, at Company's sole discretion, to cancel its authorization of any such TSDF upon written notification to Contractor.

22.7.2. Subject to the obligations of Contractor described in this Agreement, Company shall, when required by applicable Environmental Law, provide Contractor with a complete and executed Hazardous Waste Manifest or other shipping documentation for any Hazardous Material of which Company is the generator to be transported for treatment, storage, recycling and/or disposal under this Agreement. Contractor's transportation, recycling, treatment, storage, and/or disposal of any such Hazardous Material in accordance with this Agreement shall be fully documented by Contractor utilizing, among other things, the Hazardous Waste Manifest tracking system or other records as required by Environmental Law, copies of which documentation shall be promptly provided to Company.

23. HAZARDOUS SUBSTANCE INFORMATION

Contractor shall provide the following to Company for each material which Contractor furnishes to a Company facility, at any time, for use in fulfilling its obligations under this Agreement: (a) a completed Material Safety Data Sheet (MSDS) for each material which contains a *hazardous material* as defined by California Health and Safety Code Section 25501(o); and (b) a written statement for each such material that is a Mixture or Trade Name Product which contains a *Toxic Chemical* subject to the reporting requirements of Section 313 or EPCRA (40 CFR Section 372 et seq.) including: (1) the name and associated CAS (Chemical Abstract Services Registry) number of the *Toxic Chemical*; (2) the specific concentration at which each such *Toxic Chemical* is present in each such Mixture or Trade Name Product; and

(3) the weight of each such *Toxic Chemical* in each such Mixture or Trade Name Product. Contractor shall indemnify, defend and hold Company, and its current and future, direct and indirect parent Company(ies), subsidiaries, affiliates and their respective directors, officers, shareholders, employees, agents, representatives, successors and assigns harmless from and against any and all claims, actions, suits, proceedings, losses, liabilities, penalties, fines, damages, administrative actions, judgments, costs or expenses including expert witness, consulting and attorneys fees (including fees and disbursements of in-house and outside counsel) that Company may suffer as a result of Contractor's failure to comply with these requirements.

24. GOVERNING LAW

The formation, interpretation and performance of this Agreement shall be governed by and enforced under the laws of the State of California, without reference to principles of conflicts of laws.

25. COMPLIANCE WITH LAWS

Contractor and its subcontractors at all times during performance of the Services shall comply with and observe, all applicable federal, state, regional, municipal and local laws, ordinances, rules, codes, regulations, executive orders, all applicable employment, safety and environmental orders and all orders or decrees of administrative agencies, courts or other legally constituted authorities having jurisdiction or authority over Contractor, Company or the Services.

26. DEFAULT

Contractor agrees that if (a) Contractor abandons the Services, or (b) Contractor shall become bankrupt or insolvent, or shall assign this Agreement, or sublet any part thereof, without the express prior written authorization of Company, or (c) Contractor, in the sole opinion of Company Representative, violates any of the provisions of this Agreement, or (d) Contractor executes this Agreement in bad faith, or (e) Contractor, in the sole opinion of the Company Representative is not performing the Services in accordance with the terms of this Agreement, Company may notify Contractor, pursuant to Article 6, to discontinue all or any part of the Services and Contractor shall thereupon discontinue the Services or such parts thereof. Company shall thereupon have the right to continue and complete the Services or any part thereof, by contract or otherwise, and Contractor shall be liable to Company for any and all loss, penalties, fines, excess cost and consequential, special, incidental and indirect damages incurred by Company in completing the Services caused by Contractor's failure to execute the requirements of this Agreement. The remedies herein shall be

inclusive and additional to any other rights or remedies in law or equity, and no action by Company shall constitute a waiver of any such other rights or remedies. If it is determined for any reason by a tribunal of competent jurisdiction that Contractor was not in default, the parties rights and obligations shall be the same as if notice of termination had been issued pursuant to Article 27.

27. TERMINATION

It is also expressly agreed that Company shall have the right to terminate this Agreement, or any part thereof, at any time for its sole convenience upon two (2) business days written notice, pursuant to Article 6, to Contractor. Contractor shall fully justify and document to Company in writing any termination charges claimed by Contractor (which shall not exceed 110% of the reasonable and actual cost of direct labor, materials and overhead). In no event shall Contractor be entitled to payment for any Services which has not been authorized by Company, or is not yet performed, or any anticipated profits for any Services that have not been authorized or performed. Any payment of termination charges shall occur within thirty (30) days

of receipt of Contractor's written submittal of charges and justification to Company's satisfaction. Company shall have the right to review and verify by independent audit, any termination charges claimed by Contractor prior to payment.

28. LIENS

Without limiting the generality of Article 21, Contractor shall indemnify, defend, and hold Company, and its current and future, direct and indirect parent Company(ies), subsidiaries, affiliates and their respective directors, officers, shareholders, employees, agents, representatives, successors and assigns harmless from and against any mechanics lien or stop notice claim against Company by Contractor, subcontractors, employees or agents pertaining to the Services specified in this Agreement.

29. ASSIGNMENT

29.1. Contractor shall give personal attention to the execution of the Services herein provided for, and shall not permit this Agreement to be assigned voluntarily, involuntarily or by operation of law; nor employ any subcontractor for the execution of the same or any part thereof, without the express prior written authorization of Company. No such written authorization, however, shall be construed as discharging or releasing Contractor in the performance of the Services or the fulfillment of any obligation specified in this Agreement. Contractor shall remain jointly and severally liable with any permitted assignee for any failure to comply with all applicable obligations hereunder this Agreement.

29.2. Company may assign in whole or in part its rights and obligations under this Agreement at any time without the consent of Contractor.

30. NONWAIVER

The failure of Company to insist upon or enforce, in any instance, strict performance by Contractor of any of the terms or conditions of this Agreement, or to exercise any rights herein conferred shall not be construed as a waiver or relinquishment to any extent of its right to assert, or rely upon any such terms or rights on any future occasion. No waiver shall be valid unless stated in writing as set forth in Article 6.

31. DISPUTES

31.1. Any dispute that cannot be resolved between Contractor Representative and Company Representative shall be referred to Company Manager - Service Contracting and an officer of Contractor for resolution. If Company and Contractor cannot reach an agreement within a reasonable period of time, Company and Contractor shall have the right to pursue litigation as provided for herein.

31.2. In the event of any litigation to enforce or interpret any terms of this Agreement, unless the parties agree in writing otherwise, such action shall be brought in any Superior Court of California having jurisdiction (or, if the federal courts have exclusive jurisdiction over the subject matter of the dispute, in the U.S. District Court for the Southern District of California), and the parties hereby submit to the exclusive jurisdiction of said court.

31.3. In any action in litigation to enforce or interpret any of the terms of this Agreement, the prevailing party shall be entitled to recover from the unsuccessful party all costs, expenses, (including expert testimony) and reasonable attorneys fees (including fees and disbursements of in-house and outside counsel) incurred therein by the prevailing party.

31.4. In no event shall the litigation of any controversy or the settlement thereof delay the performance of this Agreement.

32. CONFIDENTIALITY

32.1. For purposes of this Agreement, the term "Confidential Information" means proprietary information concerning the business, operations and assets of Company, its parent Company(ies), subsidiaries and/or affiliates, including, without limitation, the terms and conditions of this Agreement or any related agreement, information or materials prepared in connection with the performance of Services under this Agreement, or any related subsequent agreement, designs, drawings, specifications, techniques, models, data, documentation, source code, object code, diagrams, flow charts, research, development, processes, procedures, know-how, manufacturing, development or marketing techniques and materials, development or marketing timetables, strategies and development plans, customer, supplier or personnel names and other information related to customers, suppliers or personnel, pricing policies and financial information, and other information of a similar nature, whether or not reduced to writing or other tangible form, and any other trade secrets. Confidential Information shall not include (a) information known to Contractor prior to obtaining the same from Company; (b) information in the public domain at the time of disclosure by Contractor; (c) information obtained by Contractor from a third party who did not receive same, directly or indirectly, from Company; or (d) information approved for release by express prior written consent of an authorized officer of Company.

32.2. Contractor hereby agrees that it shall use the Confidential Information solely for the purpose of performing Services under this Agreement and not in any way detrimental to Company, its parent Company(ies), subsidiaries and/or affiliates. Neither Contractor nor its directors, officers, employees, agents or representatives shall use the Confidential Information for their own benefit. Contractor agrees to use the higher of the same degree of care Contractor uses with respect to its own proprietary or confidential information, which in any event shall result in a reasonable standard of care to prevent unauthorized use or disclosure of the Confidential Information. Except as otherwise provided herein, Contractor shall keep confidential and not disclose the Confidential Information. Contractor shall cause each of its directors, officers, employees, agents, representatives, subcontractors and suppliers to become familiar with, and abide by, the terms of this Agreement.

32.3. Notwithstanding the provisions of this Article 33, Contractor may disclose any of the Confidential Information in the event, but only to the extent, that, based upon advice of counsel, Contractor is required to do so by the disclosure requirements of any law, rule, regulation or any order, decree, subpoena or ruling or other similar process of any court, governmental agency or regulatory authority. Prior to making or permitting any such disclosure, Contractor shall provide Company with prompt written notice of any such requirement so that Company (with Contractor's assistance if requested by Company) may seek a protective order or other appropriate remedy.

32.4. Subject to Article 33.3, Contractor shall not, without the prior written consent of Company, disclose to any third party the fact that such Confidential Information has been made available to Contractor.

32.5. At any time upon the request of Company, Contractor shall promptly deliver to Company or destroy if so directed by Company (with such destruction to be certified to Company) all documents (and all copies thereof, however stored) furnished to or prepared by Contractor that contain Confidential Information and all other documents in Contractor's possession that contain or that are based on or derived from Confidential Information.

32.6. Notwithstanding the return or destruction of all or any part of the Confidential Information, the confidentiality provisions set forth in this Agreement shall nevertheless remain in full force and effect with respect to specific Confidential Information until the date that is five (5) years after the date of disclosure of such Confidential Information.

32.7. The parties acknowledge that the Confidential Information is valuable and unique, and that damages would be an inadequate remedy for breach of this Agreement and the obligations of Contractor are specifically enforceable. Accordingly, the parties agree that in the event of a breach or threatened breach of this Agreement by Contractor, Company, its parent Company(ies), subsidiaries and/or affiliates, who shall be third party beneficiaries of this Agreement, shall be entitled to seek an injunction preventing such breach, without the necessity of proving damages or posting any bond. Any such relief shall be in addition to, and not in lieu of, monetary damages or any other legal or equitable remedy available to Company, its direct and indirect parent Company(ies), subsidiaries or affiliates.

33. GOVERNMENT CONTRACT CLAUSES INCORPORATED BY REFERENCE

Without limiting the generality of any other Article of this Agreement, Contractor shall comply with all applicable requirements set forth in the Federal Acquisition Regulations (or any successor thereto) in effect on the date of this Agreement, which are incorporated herein reference, with the same force and effect as if they were given in full text. The terms and conditions thereof shall be controlling over any conflicting terms and conditions set forth in this Agreement or any written Amendment hereto.

34. TIME OF ESSENCE

Time is expressly agreed to be of the essence of this Agreement and each, every and all of the terms, conditions and provisions herein.

35. VALIDITY

The invalidity, in whole or in part, of any provisions hereof shall not affect the validity of any other provisions hereof.

36. SURVIVAL

The obligations imposed on Contractor and Contractor's employees by and pursuant to each Article which, by its terms contains subject matter which relates to time periods subsequent to the term of this Agreement (including without limitation Articles 16, 17, 19, 20, 21 22, 23, 24, 25, 28, 31 and 33), shall survive termination of this Agreement.

37. NO ORAL MODIFICATIONS

No modification of any provisions of this Agreement shall be valid unless in writing and signed by duly authorized representatives of both parties. Company Representative is not the duly authorized representative for Amendments to this Agreement. Representatives of both parties internally authorized to execute such documents pursuant to its corporate policies shall sign any Amendments to this Agreement.

38. CAPTIONS

The captions in this Agreement are for convenience and reference only and the words contained therein shall in no way be held to explain, modify, amplify or aid in the interpretation, construction or meaning of the provisions of this Agreement.

39. COUNTERPARTS

This Agreement may be executed in counterparts which, taken together, constitute a single instrument.

40. AUTHORITY

Each individual executing this Agreement on behalf of Company and Contractor represents and warrants that he or she is duly authorized to execute and deliver this Agreement on behalf of said party, and that this Agreement is binding upon said party in accordance with its terms and conditions.

41. CONSTRUCTION OF AGREEMENT

Both parties have participated in the negotiating and drafting of this Agreement. Therefore, the terms and conditions of this Agreement shall not be construed against either party as the drafting party.

42. ORDER OF PRECEDENCE

In the event of conflicting provisions between any of the documents comprising this Agreement, the provisions shall govern in the following priority order:

- (1) Duly Executed Amendments (most recent has priority)
- (2) The General Conditions of this Agreement
- (3) The Special Conditions of this Agreement

43. COMPLETE AGREEMENT

This Agreement constitutes the complete and entire Agreement between the parties and supersedes any previous communications, representations or agreements, whether oral or written, with respect to the subject matter hereof. There are no additions to, or deletions from, or changes in, any of the provisions hereof, and no understandings, representations or agreements concerning any of the same, which are not expressed herein, unless stated below. THE PARTIES HEREBY AGREE THAT NO TRADE USAGE, PRIOR COURSE OF DEALING OR COURSE OF PERFORMANCE UNDER THIS AGREEMENT SHALL BE A PART OF THIS AGREEMENT OR SHALL BE USED IN THE INTERPRETATION OR CONSTRUCTION OF THIS AGREEMENT.

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

**SAN DIEGO GAS & ELECTRIC
COMPANY**

By: /s/Margot Kyd
Name: MARGOT KYD
Title: SVP Business Solutions
Date: 3/12/2004

**APPLIANCE RECYCLING CENTERS OF
AMERICA - CALIFORNIA, INC.**

By: /s/Edward R. Cameron
Name: Edward R. (Jack) Cameron
Title: Pres. & CEO
Date: 4/10/04

APPLIANCE RECYCLING CENTERS OF AMERICA, INC.

Subsidiaries as of January 3, 2004

<u>Name of Subsidiary</u>	<u>Jurisdiction of Incorporation</u>	<u>Percent Voting Securities Owned</u>
Appliance Recycling Centers of America-California, Inc.	California	100 %
ARCA of St. Louis, Inc.	Missouri	100 %

INDEPENDENT AUDITOR'S CONSENT

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (commission file No. 33-51584), on Form S-8 (commission file No. 33-68890), and on Form S-8 (commission file No. 333-28571) of our reports dated February 17, 2004 with respect to the consolidated financial statements and financial statement schedule of Appliance Recycling Centers of America, Inc., and Subsidiaries appearing in this Annual Report on Form 10-K for the year ended January 3, 2004.

McGLADREY & PULLEN, LLP

Minneapolis, Minnesota
March 26, 2004

FORM 10-K CEO CERTIFICATION**CERTIFICATIONS:**

I, Edward R. Cameron, certify that:

1. I have reviewed this annual report on Form 10-K of Appliance Recycling Centers of America, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements are made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of the filing date of this annual report (the "Evaluation Date"); and
 - (c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 16, 2004

By: /s/ Edward R. Cameron
Edward R. Cameron, President

FORM 10-K CFO CERTIFICATION**CERTIFICATIONS:**

I, Linda Koenig, certify that:

1. I have reviewed this annual report on Form 10-K of Appliance Recycling Centers of America, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements are made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of the filing date of this annual report (the "Evaluation Date"); and
 - (c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 16, 2004

By: /s/ Linda Koenig
Linda Koenig, Vice President of Finance

CERTIFICATION PURSUANT TO 18 U.S.C. 1350 ADOPTED

PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to their knowledge, the Annual Report on Form 10-K for the year ended January 3, 2004 of Appliance Recycling Centers of America, Inc. (Company) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in such periodic report fairly presents, in all material respects, the financial condition and results of operations of the Company as of, and for, the periods presented in such report.

Very truly yours,

Edward R. Cameron

/s/Edward R. Cameron
President

Linda Koenig

/s/Linda Koenig
Vice President of Finance

Date March 16, 2004

* A signed original of this written statement required by Section 906 or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
