

<b>Item No.</b>	<b>Classification:</b> Open	<b>Date:</b> 1 June 2006	<b>MEETING NAME</b> Chief Officer Report Strategic Director of Environment & Leisure
<b>Report title:</b>		Landfill Allowance Trading Scheme (LATS) Strategy	
<b>Ward(s) or groups affected:</b>		All wards in Southwark	
<b>From:</b>		Phil Davies Head of Waste Management & Transport	

## **RECOMMENDATIONS**

1. In order to meet, as a minimum, the Biodegradable Municipal Waste (BMW) diversion targets set for Southwark by the Landfill Allowance Trading Scheme (LATS) it is recommended that:
  - In the short-term (2005/6 – 2006/7) - i.e. the period of the Interim Waste Transfer and Disposal Contract - that the Council banks any surplus Landfill Allowances; or purchases Allowances to overcome any shortfalls against allocations or to avoid borrowing against future years.
  - In the medium-term (2007/8– 2009/10) - i.e. the period up until waste management facilities for Southwark obtained through the Integrated Waste Management Solutions Contract will become operational – the Council should seek to secure compliance through this contract where this is possible. Should this not be possible, the Council should seek to ensure compliance with its' allocations either through the purchase of necessary allowances or through securing alternative processing arrangements via further interim arrangements.
  - In the long-term (20010/11 – 2019/20), i.e. the period between the commencement of operation of new waste management facilities for Southwark procured via the Integrated Waste Management Solutions Contract and the end of the Council's Waste Management Strategy (2003-2020) - that the Council sells any excess allowances above those required to achieve compliance to offset the costs of providing the integrated waste service.
2. It is recommended that the Head of Waste Management and Transport be given Delegated Authority to trade Allowances on the Council's behalf in accordance with this strategy, in the event that trading is required and following consultation with the Director of Environment & Leisure, Director of Finance, Borough Solicitor and Head of Procurement.

## **BACKGROUND**

### Legislative framework

3. The European Union (EU) Landfill Directive (199/31/EC) includes a requirement for member states to achieve phased reductions in the quantity of Biodegradable Municipal Waste (BMW) disposed of to landfill. This Directive is aimed at reducing the contribution of waste management to global warming (methane emitted during the rotting of rubbish in landfill sites is a significant contributor), as well as reducing the possibility of local pollution and improving the use of raw materials.
4. The targets contained within the EU Landfill Directive take tonnage of BMW produced by member states in 1995 as their base year and set tonnage limits based on this figure. The main requirements are that:

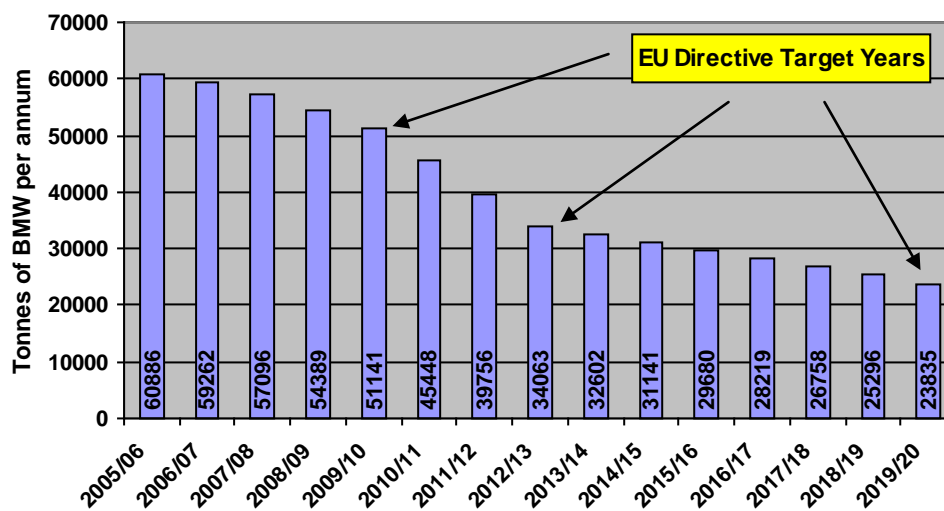
<u>EU Target Year</u>	<b>Landfill Directive targets for the reduction of biodegradable waste sent to landfill for disposal</b>
2010	To reduce the amount of biodegradable municipal waste landfilled to <b>75%</b> of that produced in 1995
2013	To reduce the amount of biodegradable municipal waste landfilled to <b>50%</b> of that produced in 1995
2020	To reduce the amount of biodegradable municipal waste landfilled to <b>35%</b> of that produced in 1995

5. These targets are being enforced in England through the Landfill Allowance Trading Scheme (LATS), implemented under the Waste & Emissions Trading Act (2003). This scheme, which came into force on 1<sup>st</sup> April 2005, assigns a limited number of allowances for landfilling BMW to each Waste Disposal Authority (WDA) in England. The overall quantity of allowances will reduce from year to year, thus ensuring that the EU Directive's overall limits are met.

#### Landfill Allowance allocations

6. The Council has been informed of its allocation of Allowances under the LATS, which is shown in the graph below. These Allowances will require a decreasing proportion of the Council's residual waste to be landfilled directly. The three key years for the Council are the target years, namely 2009/10, 2012/13 and 2019/20, as it is in these years that the Government may receive fines from the EU for missing national targets and the Government has indicated it may pass these to any Waste Disposal Authorities which are not compliant with LATS allocations.

#### **Southwark's LATS Allowances**



#### How the LATS works

7. There are several ways of ensuring compliance with the LATS. Southwark could plan to landfill exactly the same amount as its allocation; customise its operations to meet its needs through banking and borrowing; or by buying or selling Allowances.
8. The Council is permitted to purchase or sell Allowances to other waste disposal authorities and can borrow or bank Allowances up until 2009/10 – the first national target year and between future national target years. The value of the Allowances is unknown and the Government do not propose to set price floors or ceilings. The actual price will be determined by the interaction of supply and demand for Allowances. In theory, the price of Allowances could fall to £0 per tonne (excess supply) or rise to the level of the penalty for exceeding the allocation, £150 per tonne (excess demand).

9. Unlimited banking will be allowed between target years. However, Allowances cannot be banked across target years i.e. Allowances not used or sold in 2009/10, 2012/13 and 2019/2020 respectively will be lost.
10. Borrowing will be limited to 5% of the next year's Allowances, however, borrowing is not allowed in or across target years. Whilst banking will happen automatically, borrowing has to be entered onto the electronic registration system run by the Environment Agency during the trading year or within a 6-month reconciliation period.
11. There is no compulsion to trade, but Landfill Allowance Trading is an opportunity. If the cost of diversion from landfill is higher than the cost of landfill plus the cost of Allowances, it would be cheaper to continue to landfill and buy allowances from other Local authorities. To facilitate trading, Southwark will be able to advertise, via the Environment Agency Internet Bulletin Board, allowances it has to sell and post requests for Allowances it wishes to acquire.
12. Southwark will be able to trade with another WDA in advance of any scheme year up to 2019/20. It is possible to pay either now for a future trade, or in the year of the trade. This could help long term planning and overcome some of the uncertainties of buying Allowances at a future time.

#### Penalties for non-compliance

13. In the event that a WDA misses its target for a year which is not a target year (i.e. a year other than 2009/10, 2012/13 and 2019/20), the Government has indicated that it will fine that authority at a rate of £150 for each tonne by which the target is missed.
14. The Government has made it clear that in target years, (2009/10, 2012/13 and 2019/20) the Government may pass to WDA's any fines the Government receives from the European Union for missing the national targets (indicated at £500,000 per day at a national level) in proportion to their contribution to the missed target.
15. In addition, WDA's may also be liable to a further supplementary penalty for a scheme year (other than a target year) from 2010/11 onwards. Such a penalty may be levied where the amount of biodegradable municipal waste sent to landfill in that year is greater than the amount sent in the previous target year. The aim of this appears to be to ensure continual improvement in reductions in landfill following the first target year.

This is to prevent Authorities only meeting targets in the scheme years and reverting to landfilling high tonnages of BMW in the years between; thus to encourage a gradual decrease in the landfill of BMW, rather than peaks and troughs around scheme years purely to avoid penalties. However, the precise level of this type of supplementary penalties is as yet unknown.

#### Options to achieve the targets

16. The LATS diversion targets can be achieved in a number of ways;
  - Reducing the amount of MSW collected (for example, through encouraging home composting and other forms of waste minimisation)
  - Increasing recycling or composting
  - Treating waste in an energy recovery process (for example Mechanical and Biological Treatment and Incineration).
17. The Government has set the amount of Biodegradable Waste in Municipal Waste (i.e. waste the Council manages) at the outset of the LATS as being 68% i.e. for each 100 tonnes of Municipal Solid Waste (MSW) disposed of, 68 tonnes would be deemed Biodegradable. The Government has indicated the biodegradability of different materials (for example, organic waste and paper are considered to be 100% biodegradeable, textiles are considered 50% biodegradeable and glass 0%) and the Environment Agency has indicated a process for assessing the amount of diversion of BMW by different waste treatment processes to be assessed.

18. The Council's achievement against the LATS targets will be monitored by means of a mass balance approach, calculating the amount of biodegradable diversion contributed by recycling, composting or recovering energy from different waste streams, enabling the amount of biodegradable municipal waste sent to landfill to be known.

#### Southwark's strategic position

19. Southwark has an approved Waste Management Strategy (2003-2020), which sets out the future strategic direction of the Authority with regard to its waste activities. Officers have undertaken further strategic planning as part of the development of the Outline Business Case for the Integrated Waste Management Solutions Contract. This Outline Business Case included a detailed assessment of how the implementation of the Waste Management Strategy would enable LATS compliance and a sensitivity analysis around the value of LATS to generate a financial profile of the Waste Management PFI Reference Project. A budget planning process in relation to Landfill Allowance compliance was also undertaken in 2004/5 to enable the 2005/6 – 2007/8 LATS implications of the Interim Waste Transfer and Disposal Contract to be assessed.
20. Officers have subsequently undertaken a comprehensive exercise to determine whether, and to what extent, Southwark should trade, bank or borrow allowances to enable us to meet its obligations under the LATS.

## **PROPOSALS**

#### General LATS strategy position

21. Taking into account the Council's wider objectives for sustainable waste management – in particular the desire for self-sufficiency and management of waste in accordance with the proximity principle – together with the many remaining uncertainties about the availability, value and trading of landfill Allowances, the most cost-effective solution is likely to be for the Council to attempt to meet or exceed its LATS targets and to avoid the need to borrow or buy LATS wherever possible. However, it may be that some buying or borrowing of landfill Allowances will be necessary to overcome unforeseen events or where securing longer-term certainty in LATS compliance offers overall advantages in terms of value for money. In line with Proposal 38 of the Mayor of London's Waste Management Strategy, the Council will seek to trade landfill allowances within London in the first instance.

#### **Short-term strategy (2005/6 – September 2007)**

##### (The period of the current Interim Waste Transfer and Disposal Contract)

22. The Council commenced an Interim Waste Transfer and Disposal Contract on 1<sup>st</sup> April 2005 (awarded for a period of 18 months with an option to extend the contract for up to three 6 monthly extension periods),
23. Officers sought, through the interim waste contract, to secure a guaranteed amount of landfill diversion to ensure its LATS position was clear. However, all bidders proposed the use of the South East London Combined Heat and Power facility (SELCHP) as their main source of landfill diversion. SELCHP's operators would not guarantee tonnage acceptance for non-long term partners. The Council has therefore been unable to secure a guaranteed amount of landfill diversion in the short term and as such the Council's LATS position remains provisional and uncertain.
24. However, the successful contractor – Waste Recycling Group Limited - have indicated a tonnage level to be sent to SELCHP which, if achieved, would not only ensure the Council is LATS compliant in the short term, but also has a surplus of landfill Allowances during the proposed contract period.
25. The Council remains at risk of not being able to meet its LATS obligations in the short-term should access to SELCHP be denied for whatever reason, or should waste generation increase or recycling not reach the levels assumed in the projections undertaken by officers.
26. Borrowing Allowances beyond the proposed commencement date of the Integrated Waste Management Solutions Contract, anticipated to be September 2007, could detrimentally affect the affordability and negotiating flexibility of the Council.

27. It is therefore proposed that the Council's short term LATS strategy should be to avoid borrowing from the year's following the commencement of the Integrated Waste Management Solutions Contract and to bank any excess landfill Allowances to assist in reducing the Council's need to purchase Allowances in the medium term. Should a shortfall occur in the short-term period it is proposed to buy the amount of Allowances required to ensure compliance within the scheme year.

**Medium-term strategy (September 2007 – August 2010)**

(The period up until waste management facilities for Southwark obtained through the Integrated Waste Management Solutions Contract will become operational.)

28. The Council is working to award a long-term integrated waste management solutions contract via a Private Finance Initiative (PFI) Procurement which is due to commence in September 2007. It is most likely that the preferred approach will be to construct new waste management facilities at the Council's proposed site at the Old Kent Road Gasworks to enable achievement of the Council's LATS diversion targets. It is likely to take a minimum of two years from contract award to operation of new waste management facilities.
29. In the event that the solution that offers best value to the Council provides LATS compliance only once a facility is constructed, there is the potential for a medium-term shortfall against the Council's Landfill Allowance targets, including the possibility that, were the proposed facility not to be operational in time, that the Council would need to secure additional recovery capacity or landfill Allowances to meet the 2009/10 target year requirements.
30. Any medium term shortfall in LATS compliance will be assessed as part of the evaluation of the various stages of the Waste Management PFI procurement process. Any decision to accept a bid, which involves a medium term shortfall, would have to balance the risks of not being able to secure sufficient Landfill Allowances on the open market to enable compliance against the cost and advantages of the solution proposed.
31. It is anticipated that through increasing recycling to the maximum reasonable level in the initial years of the Integrated Waste Management Solutions Contract and by banking as many surplus Allowances as possible in the short term that exposure to a medium term shortfall can be minimised.
32. However, the potential exposure is still significant, and therefore it is proposed that the Council should adopt a medium term strategy of assessing the likely shortfall emerging from applicant's proposals for the Integrated Waste Management Solutions Contract against the emerging availability and market for LATS to determine when and whether to purchase LATS to overcome the potential medium term shortfall or whether to seek a separate short term contract for recovery and disposal capacity.
33. A review of the likely cost of either purchasing Allowances under the Integrated Waste Management Solutions Contract or securing capacity at known market rates through a separate short term recovery and disposal contract indicated that a separate contract could result in savings of up to 8% over a solution which involved purchasing capacity. This indicates that it may be in the Council's interests to run a procurement exercise for such a contract to identify the least cost compliance solution in this period.

**Long-term strategy (September 2010 - March 2020)**

(The period between the commencement of operation of waste management facilities for Southwark and the end of the Council's Waste Management Strategy in 2019/2020)

34. The output specification for the Integrated Waste Management Solutions Contract has been drafted and the contract will be procured in such a way as to attempt to make Southwark LATS compliant in the key LATS target years. However, the Government issued a consultation on its' review of Mayoral Powers in November 2005 which required the Council to review its business case for continuing the Integrated Waste management Solution Contract procurement. At its meeting on 31<sup>st</sup> January 2006 the Council's Executive agreed to progress the Resource Programme, however a six month delay to the Programme has occurred as a result. It is now anticipated that Southwark will achieve either a neutral or LATS surplus position from 20010/11 onwards when the proposed Old Kent Road facilities should become fully operational.

35. It is currently anticipated that the amount of waste arising in Southwark will increase over the period of the Council's Waste Management Strategy (2003-2020) – largely as a result of the development of new housing - from approximately 135,000 tonnes of MSW per annum in 2004/5 to approximately 202,000 tonnes MSW per annum in 2020/2021. The Council's waste management Reference Project therefore proposes waste management facilities with sufficient capacity and capability to accept this level of waste. This means that it is envisaged that there will be surplus capacity and therefore the ability to generate surplus Landfill Allowances once the facilities are operational.
36. It is therefore proposed that the Council's long-term strategy should be to endeavour to exceed its allowances through the construction of waste management facilities with sufficient capacity and capability to enable the Council to sell Allowances in the longer term.

#### Monitoring compliance with LATS

37. To enable Southwark to determine the overall cost (i.e. the total cost of managing municipal waste, including the need to meet our obligations under the LATS), officers have developed models that enable the Council to determine its LATS compliance position.
38. The Council is required to report its compliance against its LATS allocations to the Environment Agency. An officer has been allocated the role of entering data onto the Environment Agencies database and reporting to the Agency on a quarterly basis. The Head of Waste Management and Transport also holds a monthly LATS compliance monitoring meeting. This will allow any unforeseen change in the Council's LATS position to be identified at the earliest possible stage and remedial action taken.
39. The Head of Waste Management and Transport has been nominated as the Trading Officer for the Council for the LATS. It is proposed that should the need for trading occur in accordance with this strategy, the responsibility for doing so should be delegated to the Head of Waste Management and Transport in consultation with the Director of Environment and Leisure, Director of Finance, Borough Solicitor and Head of Procurement. Should the need for trading landfill Allowances occur not in accordance with this strategy, the Head of Waste Management and Transport should consult with the Director of Environment and the Lead Member for Environment and Transport before amending the strategy.

#### Consultation

40. As part of the process of developing the LATS trading strategy, there is a requirement to consult and engage with the local community and stakeholders. It is therefore proposed to consult with key stakeholders (the Government Office for London, the Greater London Authority, the Association of London Government, London Waste Action, London Remade and London Community Recycling Network) regarding the Council's LATS strategy.

#### Best Value

41. Should Southwark find itself in a position of needing to trade Allowances, we will monitor achievement value for money in retrospect by comparing the price paid for any allowances purchased with:
- the average price for the year;
  - the average price at the time Allowances were purchased (as prices could fluctuate throughout the year).
  - any penalty to which Southwark would have been liable had we not obtained the allowances.

The Council will also assess Best Value by benchmarking our performance under Best Value Performance Indicator 87 (cost of disposal of municipal waste, per tonne) against the performance of comparable WDAs, to review the overall cost of waste disposal to the Authority.

## Procurement Implications

42. The purpose of the public procurement and state aid rules is to restrict anti-competitive practices, which could distort the market and hinder the free movement of goods and services. It is Defra's view that if landfill Allowances are traded for cash, the public procurement rules are not engaged because there is no acquisition of supplies or services; as what is being traded is the means to exceed a specified landfill allocation in order to demonstrate compliance with the Landfill Allowance Trading Scheme. (Similarly, state aid rules are not engaged as the Landfill Allowance Trading Scheme only applies to local authorities exercising their public functions and there is no potential for the Scheme itself to affect trade between undertakings in the EU.) Therefore, Defra believe that it would not be necessary for authorities to go out to tender for the purchase of Allowances.
43. The situation is more complex if two authorities agree to exchange Allowances in return for services. All local authorities are required to achieve Best Value when acquiring goods and services. They must comply with the public procurement rules where the contract value is over £144,459 (ex VAT) for supplies and most Part A services and, where the rules or principles of the EU Treaty do not require open competition, authorities must nevertheless ensure that they obtain value for money and do not discriminate against firms on the grounds of nationality.
44. HM Customs and Excise have confirmed that Allowances traded for cash will be outside the scope of VAT. However, the trading of Allowances for non-monetary consideration (e.g. Allowances exchanged for a supply of services) could be taxable. Arrangements between public bodies are treated as non-business activities and outside the scope of VAT unless there is potential for distorting competition. Distortion of competition arises when both private companies and public authorities provide similar services. Therefore if Allowances are exchanged for a supply of services that could be provided by the private sector VAT will be payable. In such cases, if arrangements between public bodies were not treated as business activities, the provision of the services by the public authorities would always undercut similar services provided by the private sector.
45. It is therefore at this stage not considered applicable for the Council to seek to obtain or sell any allowances it requires or has in surplus through the exchange of services.
46. It should be noted that this strategy may need to be amended depending on the outcome of the Government's Mayoral Powers review.

## Financial Implications

47. The financial implications arising from this strategy are difficult to assess effectively due to the uncertainty relating to the cost of allowances and the Council's LATS position.
48. In the short term (2005/06-2006/07), subject to the Council being able to send the tonnage level to SELCHP that has been indicated in the bid by WRG for the Interim Waste Transfer and Disposal contract, the Council will have a surplus of allowances that will be able to be banked and as such there are no budget implications.
49. The financial implications in the medium term (September 2007 to August 2010) are dependant on the bids received for the Integrated Waste Management Solutions Contract and as such further analysis will need to be undertaken once these have been received, although indications are that there may be a 66,000 tonne shortfall during the medium-term period. The financial implication of such a shortfall could be as much as £1.98 million during the three years. However, It is envisaged that the value of surplus Allowances accrued during the short-term in conjunction with a successful growth bid being made in the forthcoming budget round would alleviate this situation.
50. With regard to the long-term (September 2010 to-2019/20), it is anticipated that through the development of new waste facilities as a product of the Integrated Waste Management Solutions Contract arrangements, Southwark will achieve either a neutral or LATS surplus position from September 2010 onwards. However, it should be noted that the financial projections in terms of affordability for this contract include an income derived from the sale of surplus LATS during the period 2010/11 to 2019/2020.

## **Community Impact Statement**

51. The strategy contained within this report is designed to meet, as a minimum, the Biodegradable Municipal Waste (BMW) diversion targets set for Southwark by the Landfill Allowance Trading Scheme (LATS).
52. The strategy concentrates on the treatment and disposal of municipal waste handled by the Council and contains no elements that would have a differential impact or unintended consequence that would disproportionately and unfairly benefit or disadvantage any members of the community. As such there are no equality, diversity or social cohesion implications.
53. The aims of the strategy are not in conflict with the Council's responsibility to eliminate discrimination, promote equality of opportunity, and to promote good relations between different groups.

## **SUPPLEMENTARY ADVICE FROM OTHER OFFICERS**

### The Borough Solicitor

54. The Council has a duty under the Waste Emissions Trading Act 2003 and associated Regulations not to exceed the authorized amount of waste sent to landfill. There are potential liabilities if these obligations are not met to pay penalties and supplementary penalties as set out in s9 of the Act; in particular:
  - Paragraph 13 of the report refers to fines of £150 per tonne; this is the penalty imposed by s 9(2) of the Waste and Emissions Trading Act 2003 and associated Regulations.
  - Paragraph 14 of the report refers to the supplementary penalties; these are imposed by s 9(3) of the Waste and Emissions Trading Act 2003 and associated Regulations.
  - Paragraph 15 of the report refers to further supplementary penalties; these are imposed by s 9(4) of the Waste and Emissions Trading Act 2003 and associated Regulations.
55. The report proposes that the Council should enter into trading of landfill allowances, in certain circumstances outlined in the report. The Borough Solicitor's department agrees with the view of Defra, that the EU procurement directives and the State Aid provisions are not applicable to the trading of landfill allowances.
56. In entering into any contractual arrangements (other than LATS trading) in consequence of the implementation of this strategy, if approved, action will need to be taken to ensure that Contract Standing Orders are complied with.

### Director of Finance

57. There is currently no agreed accounting treatment in place for LATS, either internationally or at local authority level. CIPFA have recently consulted local authorities on this matter in anticipation of the 2006/7 Statement of Recommended Practice (SORP) but the outcome of the consultation is still awaited. The uncertainty is centred on the valuation of LATS and whether any end of year balance of LATS should be treated either as an intangible asset or an investment. The balance sheet treatment will determine the revenue implications. The treatment of any LATS balance at the end of the current financial year will be discussed with the external auditor.

The decision to buy or sell LATS will require the prior approval of the Finance Director.



**FOR DELEGATED APPROVAL**

Under the powers delegated to me in accordance with the Council's Financial Regulations, I authorise action in accordance with the recommendation contained in the above report.

Signature .....

Date.....

Designation .....

**Audit Trail**

<b>Chief Officer</b>	Gill Davies	
<b>Report Author</b>	Phil Davies	
<b>Version</b>	2	
<b>Dated</b>	TBC	
<b>Key Decision?</b>	No	
<b>CONSULTATION WITH OTHER OFFICERS / DIRECTORATES</b>		
<b>Officer Title</b>	<b>Comments Sought</b>	<b>Comments included</b>
Borough Solicitor & Secretary	Yes	Yes
Chief Finance Officer	Yes	Yes
Head of Procurement	Yes	N/A