

To: Cabinet – 16 April 2007

From: Keith Ferrin, Portfolio Holder for Environment, Highways,
and Waste; and
Pete Raine, Director of Environment & Regeneration

Subject: **Landfill Allowance Trading Scheme Operating Plan**

Classification: Unrestricted

SUMMARY

This report deals with the Council's current position with regard to the Landfill Allowance Trading Scheme. It makes recommendations on the approval of a KCC Operating Plan under the provisions of that Scheme to ensure KCC maximises the potential future trading benefits, and the provision of delegated authority to agree future trades. The report also asks Cabinet to note details of the single "trade" which has occurred to date.

REPORT

1.0 Introduction

- 1.1 The Landfill Allowance Trading Scheme (LATS) was introduced under the Waste Emissions Trading Act 2003. This report proposes an Operating Plan, setting out the way in which Kent County Council will engage with comply with the national scheme. See Appendix 1.
- 1.2 The Operating Plan addresses the practical issues concerning the Council's ability to act decisively to maximise income. With this in mind, the decision making process includes provisions for delegated authority to the Director of Finance and the Director of Environment and Regeneration acting together.
- 1.3 The Plan describes the current state of the landfill allowance trading scheme and sets out how the Council will position itself to gain maximum benefit in this developing market. It considers Kent's diversion capacity (from landfill) in the context of the latest market analysis and draws attention to the significant increase in landfill tax announced in the Chancellor's budget speech.

2.0 LATS Scheme

- 2.1 The LATS scheme has been introduced to deliver UK diversion targets to meet the requirements of the EU Landfill Directive. The aim of the directive is to reduce the landfilling of bio-degradable waste from 1995 levels to reach 35% of that level by 2020. In order to deliver this, challenging incremental targets have been set for the intervening years. In common with all other waste disposal authorities, Kent County Council has been provided with an allowance for each

year. If a Council exceeds its allowances by disposing of more biodegradable waste to landfill than permitted it could face fines of up to £150 per tonne. Alternatively, waste disposal authorities can trade their allowances, using the LATS web trading board.

- 2.2 The current market for 2006/07 is flooded with a ratio of 70:1 allowances for sale compared to buyers. This is because current allocations (set to achieve an interim target by 2010) are less challenging in these early years. Secondly, allowances can be rolled forward in the run up to 2010. Achieving LATS targets at the present time is not very challenging and therefore few trades are taking place and the price is low. In fact, some trades have occurred at a nil monetary value within partnerships. However, trading in defined years (09/10 12/13 and 19/20) is likely to be more focused because the LATS scheme has created those as ring-fenced years when banked or borrowed allowances from other years are not permitted to offset in-year deficits.
- 2.3 Although it is very difficult to anticipate how the market will mature, it is essential that the County Council makes the most of its existing robust trading position – one to which many other disposal authorities currently aspire.

3.0 Current Trading and Delegated Authority

- 3.1 With the agreement of the Portfolio-holder, Keith Ferrin, and both the Directors of Finance and Environment & Regeneration, sale of allowances to the value of £100,000 has been agreed from KCC's surplus 06/07 allowances. It is hoped that a long-term trading relationship can be established with the purchasing waste disposal authority.
- 3.2 It is possible that trading may also be secured through potential purchasers taking options on LATS allowances to secure their position in future years. With this in mind the LATS Operating Plan provides a balance between flexibility to be opportunistic in securing trading with appropriate governance controls.
- 3.3 The plan proposes that future trades are agreed by the Director of Finance and the Director of Environment & Regeneration, on the recommendation of two members of the officers' LATS advisory group (at least one of whom will be from Finance). Additionally, no trades either singly or cumulatively in a year will exceed the level for a key decision without separate authority.

4.0 RECOMMENDATION

It is recommended that:

- i) the attached Landfill Allowance Operating Plan is approved, and
- ii) the Director of Finance and the Director of Environment and Regeneration together be authorised to enter into future Landfill Allowance trading agreements, and
- iii) the single "trade" which has occurred is noted.

Background Information: None

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Landfill Allowance Operating Plan 2007-2020

1.0 LATS Operating Plan

1.1 The purpose of this plan is to comply with the Waste Emissions Trading Act 2003. The plan covers the period set out in the primary legislation and the EU Landfill Directive but will be subject to reviews during the period due to the emerging nature of the LATS market.

2.0 Background

2.1 DEFRA introduced the Landfill Allowance Trading Scheme as a means of helping to ensure that England could meet its targets for the landfilling of biodegradable waste under the EU Landfill Directive as below:

Date diversion to be achieved (by end of)	% diversion from landfill (from 1995 level)
2010	35%
2013	50%
2020	75%

2.2 If the Government fails to meet these targets then it faces national fines of up to £500k a day. Waste Disposal Authorities (WDAs) implicated in failure to meet national targets could face unspecified fines. There is speculation that these fines would be up to £150 per tonne. Each WDA has been allocated annual landfill allowances, i.e. permits enabling the authority to landfill up to a certain tonnage of biodegradable waste. WDAs are required to ensure that they have sufficient allowances for the annual tonnage of biodegradable municipal waste proposed to be sent to landfill.

2.3 Allowances can be bought and sold or exchanged between WDAs. In some years a surplus can be banked for use in future years or 5% may be borrowed from the following year's allocation. A six month reconciliation period is allowed after the end of each trading year, with trades recorded through DEFRA's WasteDataFlow website. See Table 1 appended to this report.

2.4 In set target years (which are 2009/10, 2012/13, and 2019/20) an authority cannot borrow allowances from future years nor use allowances banked in previous years.

2.5 It is noted that in the Chancellor's budget speech of 21 March 2007, the standard rate for landfill tax will increase by £8 per year from 2008. The rate for 2007/08 is

£24/tonne. This will increase the pressure on local authorities to move away from landfill and, as anticipated, brings forward the advantage to KCC of the diversion capacity provided by the Energy from Waste plant.

3.0 Kent's Diversion Capacity and Trading Position

- 3.1 For the year 05/06, before the commissioning of the Allington Energy from Waste plant, the Environment Agency assessed Kent as being one of the bottom three WDAs nationally in terms of projected LATS compliance.
- 3.2 The Allington Waste to Energy plant completely reverses that situation and now places Kent in a position of operating with surplus LATS allowances in current and future years. In the period, including the target years of 2009/10 and 2012/13, Kent will be in a position to sell allowances. In this respect it has considerable market advantage over many other WDAs.
- 3.3 In 2006, Kent advertised a trade to test the market of 7,000 allowances at £16 per tonne to test the market. Despite Kent being the lowest priced 'provider' of allowances, one authority purchased at a higher price from a partner authority while Kent's allowances remained unsold. Limited numbers of transactions been posted on the EA/DEFRA website (which is not necessarily a complete listing), including some free transfers evident within partnerships.

4.0 Market Analysis

- 4.1 The market has been immature and trading limited. The average trading price is £0 -15 per allowance, but few trades have occurred. The market is currently flooded by a ratio of 70:1. This is because the allowances for the period have been comparatively generous and, secondly, because the risk of fines was not perceived to be imminent. Although the allowances have been marketed there has been very little interest over the last 6 months. This may continue until 2009/10 which is a ring-fenced target year. The market could then weaken again through 2010/11 and 2011/12 before firming up again towards 2012/13 (the second target year). However, recent trading by KCC with Cornwall County Council identifies potential for a future trading relationship. On this basis, trading may need to take place in respect of future years, with options being secured by other waste disposal authorities from Kent.
- 4.2 One key risk to KCC in selling its surplus allowances is that it fails to achieve the best price e.g. it sells too early. Given the uncertainty in the market, the recommendation for the years 2007/08 to 2009/10 is that Kent offers a varying proportion of the projected surplus allowances for sale. With some trades at £0 and a flooded market, the current position is that any trading is worth considering, but this situation will almost certainly change. For this reason, it is likely to be necessary to vary both the amount of surplus allowances posted and prices during the year. This will be agreed by both of the Directors. For clarity, an offer to trade posted on the DEFRA trading board does not have to be accepted so no commitment on the part of this Council is made at the time of posting.
- 4.3 The calculation of the number of spare allowances for the purpose of the Operating Plan relies on a 1% growth assumption in municipal waste arisings, based on the 2005/06 EA data for Kent. This provides a prudent approach and additionally includes retention of allowances to use as a buffer and mitigate

market risk. Unlike many other WDAs there is almost no prospect of a LATS deficit arising in Kent in the medium term.

- 4.4 The following table sets out the proposed initial restricted approach. The rationale is that the cumulative available tonnage can be estimated with some confidence, based on the current waste diversion performance (away from landfill) over the short term i.e. for 07/08. The position for 08/09 is less clear so retaining a 40% buffer is an initially cautious approach, while 09/10 is known to be a ring-fenced year and so prices can be expected to rise. With this in mind advance sales should be limited to 25% of those available. It is also noteworthy that there is likely to be substantial cumulative allowances available for sale up to the end of September 2009.

Operating Plan 07/08 (April 07)	2007/08	2008/09	2009/10
% of projected surplus allowances for sale	N/A	60%	25%
Allowances / Tonnes for sale	150,000	-	-

5.0 Risk management

- 5.1 It is essential that there is a timely decision making capability. Whilst this must comply with the constraints of sound corporate governance it is important that the ability to “play the market” is not fettered to the detriment of the potential income stream. Conversely, it is important that there is confidence that trading is being carried out using the principles of best endeavours based on the latest market information. This is challenging, therefore this operating plan must provide the necessary checks and balances as a defined framework but contain the necessary flexibility to be responsive to the market. The risk management plan set out in Appendix 1 addresses these issues.
- 5.2 This operating plan is confined to administration of the scheme. It does not extend to issues regarding the minimisation or diversion of municipal biodegradable waste away from landfill, which remains within the purview of the Kent Joint Municipal Waste Management Strategy. Additionally, a revision to the National Waste Strategy is due to be published shortly and any implications for this LATS Operating Plan will be taken into account at that time.

6.0 The LATS Advisory Group

- 6.1 This group comprises officers from Corporate Finance, E&R Resources and Waste Management. Its terms of reference are to monitor and analyse the LATS market, to make projections of Kent’s position, to advise on trading and recommend individual trades. It reports through the Director of Finance and the Director of Environment and Regeneration.

7.0 **Main issues and conclusions**

- 7.1 The following list summarises the operating process:-

- i) the LATS Operating Plan forms the trading framework and sales of allowances recommended by the Advisory Group will not exceed the surpluses set out in 4.4 above, without a revision to the Operating Plan;
- ii) all trades will comply with the risk management controls (set out in the appendix) which form part of the Operating Plan;
- iii) the LATS Advisory Group will report regularly to the Portfolioholder for Environment Highways and Waste on market position;
- iv) an annual report on the trading position will be submitted to Cabinet together any proposals for changes to the Operating Plan and including projections for future years;
- v) the authority for individual trades (i.e. selling or buying allowances or options on allowances as a single transaction with a WDA) will be recommended by two officers of the Advisory Group (at least one to be from Finance) and signed off as agreed by both the Managing Director (Environment & Regeneration) and the Director of Finance (or in their absence by nominated deputies);
- vi) trades which include any exchange of goods or services will be treated as falling outside the Operating Plan and will be the subject of a separate Member level decision; and
- vii) individual or cumulative trades in any one year will not exceed the value of a key decision (currently £1m) unless the provisions of the Forward Plan process have been utilised.

Table 1 : Posted trades

Total Transferred	Transfer Fee	Requested Date	Price	Scheme Year
5,263	£99,997	28/09/2006	£19.00	2005/06
15,000	£300,000	25/09/2006	£20.00	2005/06
575	£0	21/09/2006	£0.00	2005/06
5,000	£0	15/09/2006	£0.00	2005/06
5,412	£0	05/09/2006	£0.00	2005/06
11,194	£0	31/08/2006	£0.00	2005/06
23,633	£0	31/08/2006	£0.00	2005/06
6,000	£100,000	27/07/2006	£16.67	2005/06
1,632	£0	03/07/2006	£0.00	2005/06
20,000	£360,000	03/07/2006	£18.00	2005/06
500	£0	16/05/2006	£0.00	2005/06
13,500	£243,000	19/04/2006	£18.00	2005/06
66,822	£0	11/04/2006	£0.00	2005/06
21,341	£350,000	04/04/2006	£16.40	2005/06
2,000	£40,000	29/03/2006	£20.00	2005/06
2,000	£0	22/03/2006	£0.00	2005/06
55,412	£0	16/02/2006	£0.00	2005/06
23,500	£446,500	13/01/2006	£19.00	2005/06
10,000	£200,000	09/12/2005	£20.00	2005/06
18,000	£360,000	23/11/2005	£20.00	2005/06
10,000	£200,000	31/10/2005	£20.00	2005/06
280	£5,600	11/10/2005	£20.00	2005/06
17,500	£350,000	06/10/2005	£20.00	2005/06
12,500	£250,000	20/09/2005	£20.00	2005/06
20,000	£380,000	14/09/2005	£19.00	2005/06
15,100	£302,000	11/08/2005	£20.00	2005/06
10,000	£200,000	27/07/2005	£20.00	2005/06
5,000	£200,000	15/07/2005	£40.00	2005/06
15,000	£300,000	12/07/2005	£20.00	2005/06
100,000	£2,000,000	17/06/2005	£20.00	2005/06
20,000	£400,000	20/05/2005	£20.00	2005/06
3,500	£70,000	20/05/2005	£20.00	2005/06
14,000	£210,000	11/10/2006	£15.00	2006/07
37,000	£629,000	29/09/2006	£17.00	2006/07
680	£0	01/09/2006	£0.00	2006/07
312	£5,616	29/08/2006	£18.00	2006/07
5,350	£90,950	11/08/2006	£17.00	2006/07
5,000	£110,000	12/05/2006	£22.00	2006/07
28,190	£676,560	09/12/2005	£24.00	2006/07
20,000	£380,000	14/09/2005	£19.00	2006/07
8,755	£192,610	12/08/2005	£22.00	2006/07
20,000	£400,000	20/05/2005	£20.00	2006/07
5,000	£120,000	07/07/2006	£24.00	2007/08
47,474	£1,139,376	09/12/2005	£24.00	2007/08
20,000	£380,000	14/09/2005	£19.00	2007/08
8,266	£198,384	12/08/2005	£24.00	2007/08
45,000	£1,170,000	07/07/2006	£26.00	2008/09
37,051	£963,326	09/12/2005	£26.00	2008/09
7,859	£204,334	12/08/2005	£26.00	2008/09
5,000	£0	15/09/2006	£0.00	2012/13
Year	Average Price	Total Trades		
2005/06	£13.94	32		
2006/07	£17.40	10		
2007/08	£22.75	4		
2008/09	£26.00	3		

Appendix 1
LATS : RISK MANAGEMENT

A) RISK Market risks	MITIGATION / DETAIL
1) Selling too many allowances (over-trading)	Operating Plan allows for advance trading for only a proportion of the likely available allowances maintaining a significant buffer as contingency. Over-selling may be made up by under-selling in successive years.
2) Failure to sell – allows allowances to time-expire	Continuous market monitoring to review posted “trades”. Additionally, a more pro-active sales/ marketing campaign will be pursued to target waste disposal authorities with potential deficits.
3) Sell too low/too early and not maximise income	Realistic nature of posted trades to be kept under review. The approach of advance trading of only a proportion of likely available allowances enables KCC to take advantage of any significant price increases at a later date as a proportion of the allowances are held-back.
4) Become too risk averse, or protectionist and buy allowances	Unlikely to occur in current market conditions, and contrary to current approach. No prospect of needing to buy allowances to correct over – selling will arise due to the KCC Operating Plan’s limits on trading.
5) Buyers do not complete deals	Robust trade agreement and options / contracts.
6) Over time new facilities for diversion nation-wide erode market for allowances, as other WDAs build Energy from Waste Plants etc.	Targeted trading with WDA’s in deficit. Long term risk to be kept under review in relation to Kent’s own waste procurement programme.

B) RISKS	
Corporate Governance	
1) Total trades exceed key decision	Sign-off form will track annual cumulative trading.
2) Extent of KCCs LATS compliance is ill-founded	Based on 1% growth in waste which is consistent with MTFP, and founded on 05/06 actuals.
3) CPA/Performance Management Framework. Impact on BVPIs	Unlikely to be subject to penalties for exceeding LATS allowances. Need to ensure Kent retains current potential market advantage
4) Authorisations/Corporate Governance	Compliance with Constitution
5) Other WDAs secure additional diversion capacity within Kent, reducing capacity available to KCC.	Input to Waste Development Framework
6) Immature LATS market affects KCCs income stream	Revenue budget not based on LATS income.

<p>C) RISKS</p> <p>EXTERNAL</p>	
<p>1) Deals and cartels between other traders</p>	<p>Watching brief. Noted that trades could be in kind/for other services.</p>
<p>2) Other authorities undermine future LATS capacity</p>	<p>See B5 above.</p> <p>Also, strong long-term relationships required with existing contractors providing diversion capacity.</p>
<p>3) DEFRA do not impose penalties/do not support LATS</p>	<p>Potential market collapse would prejudice income stream. Watching brief. DEFRA lobbying. Legal advice on wording of options agreements particularly where this is applied to future years.</p>
<p>4) District Councils collecting trade waste reducing available trading capacity</p>	<p>Seek to transfer costs to those collecting trade waste.</p>
<p>5) Changes to the National Waste Strategy affect the operation of LATS e.g. allocated allowances etc.</p>	<p>Monitoring of national policy. Strong links with DEFRA.</p>