

LANDFILL ALLOWANCE TRADING SCHEME: GUIDANCE ON TRADING, BANKING AND BORROWING LANDFILL ALLOWANCES

Introduction

1. The purpose of this guidance is to set out the procedure for transferring landfill allowances (whether by trade or otherwise) and to answer some of the most frequently asked questions about allowance trading.
2. The guidance is divided into the following sections:
 - a) Developing a LATS Strategy & demonstrating Best Value
 - b) Using the Mass Balance Estimator and Allowance Manager
 - c) Agreeing the transfer of allowances
 - d) Forward Trading
 - e) Contractual Agreements
 - f) Registering the Transfer of Allowances
 - g) Banking and Borrowing
 - h) Financial Regulation
 - i) Value Added Tax
 - j) Budgeting and Accounting
 - k) Application of the Public Procurement Rules

a) Developing a LATS strategy & demonstrating Best Value

3. The Landfill Allowance Trading Scheme (LATS or the Scheme) has been designed to enable waste disposal authorities (WDAs) to meet the requirement to reduce the amount of biodegradable municipal waste (BMW) sent to landfill in the most cost-effective way. Strategic long-term planning is vital if authorities are to make the most effective use of the Scheme, and authorities are strongly encouraged to consider the flexibilities provided by LATS as a potential element of a comprehensive waste strategy.
4. In developing or reviewing its municipal waste management strategy, a WDA should demonstrate that it is making use of LATS to achieve Best Value in the way that it meets its obligations under the Landfill Directive and in managing its municipal waste. The following guidance has been discussed with ODPM and the Audit Commission and is structured according to the principles of Best Value - the 4C's - challenge, compare, consult and compete.¹
5. WDAs should challenge whether, and to what extent, it should use LATS to trade, bank or borrow allowances to enable it to meet its

¹ 'Local Government Act 1999: Part 1 Best Value' DETR, 14 December 1999
(http://www.odpm.gov.uk/stellent/groups/odpm_localgov/documents/page/odpm_locgov_605014.pdf)

obligations under the Waste and Emissions Trading Act 2003 (the WET Act).

6. The WDA will need to establish whether, taking into account its wider objectives for sustainable management of municipal waste and the potential for infrastructure development, the most cost-effective solution is to:
 - a) manage within its own allowances without banking or borrowing;
 - b) re-profile its own allowances, by banking and borrowing;
 - c) be a net buyer or be a net seller of allowances, or
 - d) a combination of the above.
7. This evaluation is likely to be pursued as part of the development or review of the WDA's long-term strategy for managing its municipal waste. It will involve comparing a number of different options for the use of LATS based on the waste strategy options available to the WDA (i.e. incorporating high, medium or low diversion of BMW from landfill).
8. To enable the overall cost (i.e. the total cost to the WDA of managing municipal waste, including the need to meet its obligations under the WET Act) of different options to be compared, the WDA should use a trading model such as the freely available Mass Balance Estimator and Allowance Manager (M-BEAM) (see paragraph 13).
9. As part of the process of developing its waste strategy, including any LATS trading strategy, the WDA will need to consult and engage with the local community and stakeholders². Engagement should start early and be sustained throughout the strategy development process.
10. If the WDA's strategy for using LATS within its overall Municipal Waste Management Strategy involves trading, the WDA will need to demonstrate that it has fully engaged with the market, looking for trading possibilities across the country (i.e. not just with other authorities in the locality) and not leaving large trades to the end of the reconciliation period³ (when the price of allowances may be subject to greater market pressures). Competing in this way should ensure that the WDA achieves the best price in its trades (both purchases and sales). One way of demonstrating this may be to use a broker who could engage in the market on behalf of a WDA.
11. To monitor achievement of Best Value, the WDA will need to review in retrospect and compare the price it paid for any allowances purchased with:
 - the average price for the year;

² S. 32(3) of the WET Act requires WDAs and waste collection authorities in two-tier areas to produce a Joint Municipal Waste Management Strategy to carry out appropriate consultation.

³ The reconciliation period is a period of six months following the end of a scheme year. This period ends on 30 September following the scheme year in question.

- the average price at the time it bought its allowances (as prices could fluctuate throughout the year).
 - any penalty to which it would have been liable had it not obtained the allowances.
12. It may also wish to benchmark its 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 within the WDA's waste strategy. Guidance on BVPI87 will be revised in due course to reflect the introduction of LATS.

b) Using the Mass Balance Estimator and Allowance Manager

13. Defra has developed a tool, the Mass Balance Estimator and Allowance Manager (M-BEAM), to help WDAs to use LATS in the most effective way for their locality. By running different scenarios of their waste plans through M-BEAM, WDAs can determine which waste strategy and LATS strategy combination represent the best outcome. This will be an iterative process, with the results of running a given scenario through M-BEAM providing feedback for future waste strategy development. M-BEAM:

- estimates how many landfill allowances a WDA needs to hold;
- identifies any surpluses or shortfalls, by comparing the number of allowances the WDA needs to hold with the number of allowances allocated to it;
- deals with any surpluses or shortfalls identified, by modelling the impact of:
 - re-profiling the WDA's allocated allowances through banking and borrowing; and/or
 - buying or selling allowances from/to other authorities; and
- shows the financial consequences of the WDA's LATS strategy based on the WDA's assumptions of LATS prices,.

14. M-BEAM is available on the Local Authority Support Unit website <http://lasupport.defra.gov.uk>.

c) Agreeing the Transfer of Allowances

15. Transferring landfill allowances (through trade or otherwise) is not mandatory. The advantage of transferring allowances is that it helps to overcome the fact that different WDAs will face different additional costs of diversion from landfill depending on their particular circumstances. For example, WDAs with comparatively low additional diversion costs will have an incentive to divert as much BMW from landfill as possible, selling their surplus allowances to WDAs that face higher costs of diversion. Conversely, authorities with comparatively high diversion costs might chose to continue with lower cost landfilling,

using the money it saves from the cheaper disposal option to purchase the necessary quantity of allowances.

16. If an authority wishes to buy or sell allowances it may choose to advertise on the LATS Bulletin Board, so that other authorities are aware that allowances are available/required. The Bulletin Board is available within the LATS Register website at <http://lats.defra.gov.uk>. Authorities wishing to respond to a notice on the LATS Bulletin Board should contact the authority that has submitted the notice directly to negotiate the sale of allowances. Defra will endeavour to post all notices submitted on the website within 48 hours of receipt by Defra, subject to approval by a Defra administrator. Notices will not be posted onto the website if the content does not relate to the sale or purchase of landfill allowances. This website will also display a transfer log, which will list the number of allowances traded and their price.
17. Alternatively, an authority may wish to contact other authorities directly to see if they are interested in a trade or use a broker to make arrangements. To ensure that authorities get the maximum benefit from using the Scheme and to demonstrate Best Value, they are advised to look for trading opportunities across the country and not just within their region. Defra is considering displaying a contact list (subject to the agreement of each individual) giving the details for each authority's trading officer, in order to facilitate the process of contacting other authorities.
18. WDAs may also choose to use brokers to make arrangements for trading, although there is no requirement in the Scheme to do so. Brokers can act as intermediaries, linking buyers and sellers. Brokers are not able to hold landfill allowances themselves, as the Scheme is not intended to be speculative. If an authority chooses to use a broker, it can also give the broker access to the authority's accounts on the electronic register if it wishes to do so.

d) Forward Trading

19. Authorities may agree in advance to transfer allowances relating to any scheme year. For example, authorities may agree in 2005/06 to transfer allowances for 2008/09, with payment (if appropriate) made either when the trade is agreed or in the year in which it relates. It is important to note that all transfers must be registered before the end of the reconciliation period for the scheme year in which the agreement is made⁴ (see paragraphs 23 - 25).

e) Contractual Agreements

⁴ Regulation 8(3) of the 2004 Regulations – see Annex A for full details.

20. Once two authorities have agreed to transfer allowances and have negotiated a price, they may wish to sign a contract. After careful consideration, Defra has decided that it would not be practical to produce a standard contract at this stage as the need to allow for a number of scenarios or eventualities means that such a contract would be unlikely to achieve its purpose of simplifying the trading process. However, Defra is aware that this would be a useful tool for authorities and will keep the situation under review.
21. Authorities drawing up a contract to agree a landfill allowance trade, might consider including the following:
 - the scheme year to which the trade relates;
 - the price of the allowances;
 - the date on which the balance is to be paid; and
 - a provision for the return of allowances in respect of conditional forward trades (see below).
22. If a contract is conditional on a certain event or circumstance occurring⁵, WDAs should ensure that the contract takes account of this and provides for a transfer to take place to return the allowances, should the relevant condition(s) not be satisfied. If this situation arises, a new transfer request (transferring the allowance back from original transferee to original transferor) will need to be registered before the end of the reconciliation period for the scheme year in which the transfer back is made (see paragraph 25 for details of registering the transfer of allowances).

f) Registering the transfer of allowances

23. Defra has established an electronic register of landfill allowances, which (amongst other things) will record the number of allowances held by each WDA. The electronic register, known as the LATS Register, is an online computerised data system which will track each allowance from issue through to its eventual utilisation and will only be accessible to nominated users from each WDA.
24. Where two authorities have agreed to transfer landfill allowances, the transferor must submit a transfer request to the Environment Agency (EA) (as the monitoring authority) through the LATS Register before the end of the reconciliation period for the scheme year in which the agreement is made. To do this, the transferor will need to obtain the transferee's WDA ID code and landfill allowance account number relating to the relevant scheme year from the transferee. The transferee will be able to obtain these details from the LATS Register.
25. Provided the transfer request complies with the requirements of regulation 8 of the Landfill Allowance and Trading Scheme (England)

⁵ For example, successful commissioning of an MBT plant on schedule.

Regulations 2004 (the 2004 Regulations)⁶, notification of acceptance of the transfer will be sent to both parties. Until a transfer has been effected in accordance with regulation 8 of the 2004 Regulations, the allowances will continue to be included in the transferor's landfill allowance account.

26. The LATS Register will be available at <http://lats.defra.gov.uk> from 1 April 2005. The nominated trading officer from each WDA will be allocated a username and password to access the register. Once the nominated trading officer has logged on for the first time he/she will be able to create other users for the WDA. It is important to note that the LATS Register serves solely to administer the Scheme and will not act as a vehicle for payment. (See paragraph 33 for details of how to register the borrowing of allowances.)

g) Banking and Borrowing Allowances

27. LATS also includes the flexibility to bank or borrow allowances to enable authorities to tailor the required reduction in BMW to landfill to their specific waste strategies and circumstances:
- Authorities that have already put in place diversion systems and/or do not need all of their allowances in a particular year can bank (or save) those unused allowances. Banked allowances can then be used in future years to meet the expected landfill requirement, or can be traded to provide income.
 - Alternatively, authorities that are planning to bring diversion infrastructure on line in future years can borrow (bring forward) allowances from their future allocation to help bridge any gap between the expected landfill requirement in the preceding years and the number of allowances available.
28. The 2004 Regulations do, however, place some restrictions on the banking and borrowing of allowances to ensure these flexibilities do not cause England to fail to meet its overall targets in Landfill Directive target years or the years following target years.
29. Borrowing may not be used to supplement allowances in either target years or the years immediately preceding target years, to avoid the number of allowances available for use exceeding the target. Similarly, banking may not be used to supplement allowances in either the target years or the years immediately following target years.
30. In the years in which it is permitted, borrowing is limited to a maximum of 5% of the allowances available to the WDA for the following scheme

⁶ See Annex A for details of regulation 8.

year⁷. For example, in 2005/06 an authority may borrow up to 5% of the allowances originally allocated to 2006/07 (provided those allowances have not subsequently been transferred or withdrawn). In the years in which it is permitted, the banking of allowances is unlimited. The table below summarises the maximum permitted levels of banking and borrowing in each year of the Scheme. Target years are shown shaded.

	2005/06	2006/07	2007/08	2008/09	2009/10
Banking Into Following Year	Unlimited	Unlimited	Unlimited	None	None
Borrowing From Following Year	Up to 5% of following year's allocated allowances	Up to 5% of following year's allocated allowances	Up to 5% of following year's allocated allowances	None	None

	2010/11	2011/12	2012/13	2013/4	2014/15
Banking Into Following Year	Unlimited	None	None	Unlimited	Unlimited
Borrowing From Following Year	Up to 5% of following year's allocated allowances	None	None	Up to 5% of following year's allocated allowances	Up to 5% of following year's allocated allowances

	2015/16	2016/17	2017/18	2018/19	2019/20
Banking Into Following Year	Unlimited	Unlimited	Unlimited	None	None
Borrowing From Following Year	Up to 5% of following year's allocated allowances	Up to 5% of following year's allocated allowances	Up to 5% of following year's allocated allowances	None	None

31. Banking will occur automatically (any unutilised allowances will be banked into the following year's account, by the Environment Agency) at the end of the reconciliation period, so no specific action by the WDA is required.
32. Where a WDA intends to borrow any landfill allowances it must submit a borrowing request to the EA through the LATS Register (see

⁷ 'Available' in this context means allowances which have been allocated to a WDA and not subsequently transferred or withdrawn, see regulations 2(3)(a) and 7(1) of the 2004 Regulations.

paragraph 24) before the end of the reconciliation period for the scheme year *into* which the allowances are to be borrowed⁸.

33. To submit a borrowing request a WDA should select the 'borrowing' function from the menu on the electronic register. It should then ensure that the correct account is selected (i.e. the year the authority wishes to borrow into) and enter the number of allowances it wishes to borrow from the following scheme year. Provided the transfer request complies with the requirements of regulation 7 of the 2004 Regulations, notification will be sent that the request has been accepted.⁹

h) Financial Regulation

34. Financial markets are regulated, where provided for in the Financial Services and Markets Act 2000 (FSMA), by the Financial Services Authority (FSA).
35. The issue of how the FSMA will be interpreted in relation to trading of landfill allowances is ultimately a matter for the courts. Prior to legal precedent being set, it is therefore not possible to give definitive guidance on how the FSMA will be interpreted for landfill allowance trading. Crucially, the individual circumstances of each party and the nature of its intended trades will effect the extent to which it is regulated. Participants in the LATS are therefore advised to seek their own legal advice. The information provided below should therefore be treated as indicative only.
36. Trading for immediate (spot) delivery of landfill allowances will not ordinarily require authorisation by the FSA since a landfill allowances is not a specified investment. However, trading for forward physical delivery, i.e. a contract under which delivery is to be made at a future date at a price agreed when the contract is made, can be a specified investment and thus trading may require authorisation. There is currently an exclusion which suggests that if the contract is made for commercial and not investment purposes then it will not constitute a regulated activity. The distinction between commercial and investment purposes is not clearly defined and caution is advised if relying on this exclusion. Caution is also advised in relation to trading derivatives. Participants should seek their own specialist advice on these issues.

i) Value Added Tax (VAT)

37. 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

⁸ Regulation 7(3) of the 2004 Regulations – see Annex A for full details.

⁹ See Annex A for details of regulation 7.

outside the scope of VAT unless there is potential for distorting competition. Distortion of competition arises when similar services are provided by both private companies and public authorities. 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.

j) Budgeting & Accounting Practices

38. The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Treasury are currently considering the correct accounting practices for landfill allowances and aim to issue guidance shortly.

k) The Application of Public Procurement Rules

39. This section sets out Defra's *informal* views on competition and procurement issues in relation to LATS as they appear at present. It is not possible to offer an authoritative view on the legal position, which could only be determined by the Courts. The guidance has been produced in consultation with the Office of the Deputy Prime Minister (ODPM), the IDeA and the 4Ps. WDAs may wish to seek their own legal advice and are strongly advised to do so in complex cases. Defra would be pleased to receive any comments on the guidance set out in this section.
40. 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; what is being traded is the means to landfill in a scheme year more BMW than would otherwise be authorised by the allowances available to a WDA for that year. (Similarly, state aid rules are not engaged as LATS only applies to WDAs exercising their public functions and there is no potential for the Scheme itself to affect trade between undertakings in the EU.) Therefore, we believe that it would not be necessary for authorities to go out to tender for the purchase of allowances.
41. The situation is more complex if two authorities agree to exchange allowances in return for services. All WDAs 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 £153,376 (ex VAT) for supplies and most Part A services (and £129,462 ex VAT for Part B and all other Part A services) and, where the rules or principles of the EC 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.

42. Any authority which uses allowances to acquire services from another authority may be in breach of its public procurement obligations unless the allowance is simply a later substituted form of consideration for goods or services supplied by an authority that has won a public procurement process to supply. Adopting this route could give rise to suspicion of bias in favour of the other authority, since it might appear, despite the reality, that payment by allowances had been the intention all along. A competition which offered the allowances as the only form of consideration would not be permissible, since this would effectively disbar the private sector.

March 2005

Updated June 2005

Annex A – Extract from The Landfill Allowances and Trading Scheme (England) Regulations 2004.

Borrowing of landfill allowances

7. - (1) A waste disposal authority may borrow for use in a scheme year up to 5% of the landfill allowances available to it for the following scheme year (rounded down to the nearest whole allowance).

(2) Paragraph (1) does not apply -

- (a) in a target year,
- (b) where the following year is a target year.

(3) Where a waste disposal authority intends to borrow a landfill allowance it must submit a borrowing request to the monitoring authority before the end of the reconciliation period for the scheme year.

(4) A borrowing request must -

- (a) be made on the form provided by the monitoring authority;
- (b) specify -
 - (i) the name of the waste disposal authority,
 - (ii) the number of landfill allowances which it intends to borrow.

(5) The monitoring authority is not required to consider a borrowing request unless it is made in accordance with paragraph (4).

(6) If the conditions in paragraph (8) are satisfied the monitoring authority must -

- (a) remove the number of landfill allowances specified in the borrowing request from the part of the waste disposal authority's landfill allowance account relating to the following scheme year;
- (b) include those allowances in the part of the account relating to the scheme year;
- (c) notify the waste disposal authority which made the request -
 - (i) that its request has been accepted,
 - (ii) of the amendments that have been made to its landfill allowance account.

(7) If the conditions in paragraph (8) are not satisfied the monitoring authority must notify the waste disposal authority -

- (a) that its request has not been accepted,
- (b) of the reasons why.

(8) The conditions referred to in paragraphs (6) and (7) are that -

- (a) the borrowing request complies with paragraph (2),
- (b) the number of landfill allowances specified in the request are available to the waste disposal authority for the following scheme year,
- (c) accepting the borrowing request would not cause the waste disposal authority to exceed the limit on borrowing under paragraph (1), and
- (d) the authority is not suspended from borrowing landfill allowances under regulation 9.

Transfer of landfill allowances

8. - (1) A waste disposal authority may transfer to any other waste disposal authority, whether by way of trade or otherwise, landfill allowances which -

- (a) are available to the waste disposal authority for a scheme year, and
- (b) have not been utilised.

(2) But a waste disposal authority must not transfer an allowance from any scheme year for which the allowance is available to the authority unless the transfer is to that scheme year.

(3) Where a waste disposal authority ("the transferor") agrees to transfer a landfill allowance to another waste disposal authority ("the transferee") the transferor must submit a transfer request to the monitoring authority before the end of the reconciliation period for the scheme year in which the agreement is made.

(4) A transfer request must -

- (a) be made on the form provided by the monitoring authority;
- (b) specify-
 - (i) the names of the transferor and transferee,
 - (ii) the number of landfill allowances to be transferred,
 - (iii) for each landfill allowance the scheme year for which the allowance is available to the transferor,
 - (iv) the date the transfer was agreed,
 - (v) the price (if any) to be paid.

(5) The monitoring authority is not required to consider a transfer request unless it is made in accordance with paragraph (4).

(6) If the conditions in paragraph (8) are satisfied, the monitoring authority must -

- (a) delete the landfill allowances from the transferor's landfill allowance account;
- (b) allocate each landfill allowance to the transferee's landfill allowance account for the scheme year for which, immediately before the transfer, it was available to the transferor;
- (c) notify the transferor and transferee -

- (i) that the request has been accepted,
- (ii) of the amendments that have been made to their landfill allowance accounts.

(7) If the conditions in paragraph (8) are not satisfied the monitoring authority must notify the transferor and transferee -

- (a) that the request has not been accepted,
- (b) of the reasons why.

(8) The conditions referred to in paragraphs (6) and (7) are that -

- (a) the agreement complies with paragraphs (1) and (2),
- (b) all landfill allowances are available to the transferor for the scheme years specified pursuant to paragraph (4)(b)(iii), and
- (c) neither the transferor nor the transferee is suspended from transferring allowances under regulation 9.