

## Council

Date: **Monday 28 October 2013**

Time: **10:00am**

Venue: **Council Chamber, County Hall, Norwich**

### Supplementary Agenda

#### 3. Energy from Waste – Revised Project Plan

##### a) To receive the following reports:

- i.) Energy From Waste: Independent Reports **(Page A3)**  
(Reports 3 and 4 in the attached report from the Head of Law and Monitoring Officer are 'To Follow' and will be circulated as soon as the Authority receives them).
- ii.) Residual Waste Treatment Contract – Contingency Arrangements in the Event of Significant Delay or Termination for Failure to Secure Planning Permission **(Page A23)**
- iii.) Comparison of the financial outcomes of the existing and alternative waste disposal proposals **(Page A41)**
- iv.) Financial and statutory implications of the treatment of waste contract **(Page A54)**
- v.) Financial Report by Dr C Edwards comparing the Willows incinerator with an alternative proposal offered by Rebel Group **(Page A57)**
- vi.) High Level Validation of Rebel Group Proposal to Norfolk County Council **(Page A72)**

##### b) To consider whether to accept or reject the Revised Project Plan for the Energy from Waste contract and to recommend to Cabinet that they accept and act on the decision so made.

- i.) Residual Waste Treatment Contract – Revised Project Plan **(Page A82)**

**For further details and general enquiries about this Agenda  
please contact the Committee Officer:**

Greg Insull on 01603 223100  
or email [greg.insull@norfolk.gov.uk](mailto:greg.insull@norfolk.gov.uk)

**Chris Walton  
Head of Democratic Services**

County Hall  
Martineau Lane  
Norwich  
NR1 2DH

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## **Energy from Waste – Independent Reports**

Report by the Head of Law and Monitoring Officer

This report attaches the Independent Reports commissioned by Cabinet on 10 June 2013.

### **1. Introduction**

- 1.1 At its meeting on 10 June 2013 Cabinet considered recommendations from the Cabinet Scrutiny Committee and resolved to appoint a QC and a financial advisor to carry out an independent review in relation to the aspects of the Waste Contract.
- 1.2 A panel comprising the Leader of the Borough Council of King's Lynn and West Norfolk, the Chair of KLWIN and the local Member for Clenchwarton and King's Lynn, selected a range of suitably qualified QCs and invited them for interview. Jonathan Acton Davis QC was selected as the QC to write the independent report.
- 1.3 The same panel asked the QC to recommend a firm of accountants to provide the financial report. He recommended that PWC was instructed.
- 1.4 Conflict checks were carried out with both legal and financial experts to ensure that the particular experts instructed had not had any other involvement with the Waste Project.

### **2. The Reports**

- 2.1 In total four reports were commissioned:-
  - (1) A report on the legal implications on each penalty scenario in the contract, identifying how the Council could extract itself from the Contract while keeping the costs as low as possible, also identifying any legal risks of continuing with the Contract such as potential conflicts with statutory duties. (Report 1)
  - (2) A review of the process of how the Contract was entered into. The resulting report should be a critical examination whether the correct advice was given at each stage, whether the Council took undue risk in signing the contract when it did, whether the Council's advisers could be held to account, and whether Cabinet was acting within its authority in authorising the contract. (Report 2)
  - (3) Bespoke costings for each penalty scenario in the Contract as laid out in the Cabinet Scrutiny Committee report. (Report 3)

- (4) A waste management report, being a specific report which identifies potential costs or savings associated with terminating the contract in order to pursue alternative waste management solutions. (Report 4)

2.2 Report 1 of the QC is attached. Report 2, which the QC informs us involves a much wider review, will be available at the end of November. Reports 3 and 4 will follow.

2.3 The attached report is capable of public disclosure. Reports 3 and 4 will also be capable of public disclosure but will be backed by more detailed reports containing confidential information. As with the unredacted Contract, the confidential information will be made available to Group Leaders and Cabinet Scrutiny Group Leaders.

### 3. **Recommendation**

That Council notes the three reports.

Victoria McNeill  
Head of Law and Monitoring Officer  
01603 223415  
Email: victoria.mcneill@norfolk.gov.uk

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## **RE: THE WILLOWS POWER AND RECYCLING CENTRE**

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### **ADVICE**

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1. By a Contract dated 7<sup>th</sup> February 2012 the Norfolk County Council (“The Authority”) agreed with Willows Power and Recycling Limited (“the Contractor”) that the Contractor would build and operate for 25 years a power and recycling centre on an industrial site at Saddlebow, near King’s Lynn. The Authority was then a Conservative administration. In the local Government elections held on 2<sup>nd</sup> May 2013, the Conservatives lost their overall majority. The administration is now run by a Labour/Liberal Democrat coalition.
2. I am instructed that the decision to build and then operate a power and recycling centre was always controversial on political grounds.
3. At the meeting of the full council on 13<sup>th</sup> May 2013, Members requested that a report concerning the contractual penalty arising in the event of a withdrawal from the Contract be discussed at the next Cabinet Scrutiny Committee.

4. That Committee met on 4<sup>th</sup> June 2013. The Cabinet Scrutiny Committee discussed a report about the contractual penalties provided for in the event of the Council bringing an end to the Contract and considered a Briefing Note from the Head of Finance on the finance and funding implications of termination.
  
5. Consequent upon that meeting the Cabinet agreed to instruct Queen's Counsel:
  - (a) to consider the contractual powers to terminate the Contract and the contractual provisions concerning compensation for termination, and
  - (b) to conduct a review of the process of the manner in which the Contract was entered into.

In addition the Cabinet decided to obtain from an Accountant advice on the cost of the Authority of it extricating itself from the Contract.

6. I am instructed that there is urgency in the first part of my task, namely to consider the contractual provisions. That is because a Public Inquiry to consider the grant or refusal of planning permission ended on the 17<sup>th</sup> May 2013. The Inspector is expected to complete his report and submit it to the Department for Communities and Local Government in September 2013. It is possible, therefore, that the Minister's decision will be published in September. I have been instructed to provide this Advice by 20<sup>th</sup> September 2013.
  
7. In order to carry out the review of the process (see paragraph 5(b) above) I will need to see all relevant Committee papers, to have access to the relevant officers and to see the files of the Authority's legal advisers, Messrs Sharpe, Pritchard. In fact, I have seen a limited amount of the Authority paperwork but nothing else. I am not at

present in a position to carry out a review of the process. In any event, that should not be a matter which is hurried through. Councillor Kemp has sent a limited number of additional documents. One of them is a Member Briefing Note dated 24<sup>th</sup> July 2014, which consists of a draft revised Project Plan Process.

8. From that I understand that the Public Inquiry Process and its time requirements made it evident that the Contractor would not have planning permission by the contractual planning longstop date of 10<sup>th</sup> June 2013. Under the Contract provisions this led to the need to either request a draft revised Project Plan or to terminate the Contract for failure to obtain planning permission. On 31<sup>st</sup> January 2013 the Authority requested a draft revised Project Plan. That document was received on 30<sup>th</sup> April 2013. It can be agreed or rejected by the Authority on any date before 29<sup>th</sup> October 2013.
9. The critical issue for the new administration is the cost to the Authority of it extricating itself from the Contract. A further issue will be the source of the funds which will have to be paid to the Contractor. Additionally, it may be that the issue will arise as to the appropriateness of the use of public money for such a purpose. All of those matters are beyond my remit. My role is to consider the Contract and to identify the potential exit routes. I set out in full below the clauses which seem to me to be those which Officers and Members will need to consider.
10. Clause 10.5 provides:

**“If this Contract is terminated for any reason prior to the Expiry Date:-**

**10.5.1 The Lease granted to the Contractor and any Underlease and/or any Sub-Underlease shall automatically and cease and determine with effect from the date of termination of this Contract (or, if not granted at the time, the obligation to grant the Lease)”**

11. The effect of termination (for any reason) is thus that the Contractor loses its right to go onto and occupy the Site.

12. Clause 62 provides:

**“62.1 Common Law Rights of the Contractor.**

**62.1.1 Without prejudice to any entitlement of the Contractor:**

(a) to specific performance of any obligation under this Contract; or

(b) to injunctive relief;

**The Contractor’s sole remedy in relation to matters for which an express right or remedy is stated in this Contract shall be that right or remedy and the Contractor shall have no additional right or remedy arising by common law, in equity, by statute or otherwise.”**

13. Through that clause the Contractor’s claim for compensation or damages is limited to the formulae set out in the Contract wherever the Contract provides for an express right or remedy. The Contractor’s right to apply for specific performance or an injunction is unaffected.

14. Further, Clause 62.5 provides:

**“Save where stated to the contrary, the indemnities under this Contract shall not apply and (without prejudice to the Authority’s rights under Schedule 4 (Payment Mechanism) there shall be no right to claim damages for breach of this Contract, in tort or on any other basis whatsoever, to the extent that any loss claimed by either Party is for Indirect Losses. The Authority agrees that, notwithstanding the foregoing, any Losses of the Contractor arising under the Sub-Contracts as originally executed (or as amended in accordance with the terms of this Contract) which are not of themselves Indirect Losses shall not be excluded from such a claim by virtue of this clause.”**

15. In Schedule 1 “Indirect Losses” are defined as,

**“..... loss of profits, loss of use, loss of production, loss of business, loss of business opportunity, or any claim for consequential loss or for indirect loss of any nature, provided that notwithstanding the foregoing any loss of Unitary Charge or Third Party Income or any breakage costs incurred by the Contractor under any Third Party Waste Contracts and/or Off Take Contracts**



**meeting their requirements of Clause 51 (Off Take Contracts and Third Party Waste Contracts) shall not be excluded from any claim by reason of this definition.”**

16. That clause, save in relation to losses arising under Sub-Contracts, reinforces clause 62.1.1. The Contractor’s remedies are limited to those defined in the relevant Contract clauses.

17. Clause 62.6 provides:

**“Notwithstanding any other provision of this Contract, neither Party shall be entitled to recover compensation under this Contract or any Ancillary document or any other agreement in relation to the Project in respect of any loss that it has incurred (or any failure of the other Party) to the extent that it has already been compensated in respect of that loss or failure pursuant to this Contract, any Ancillary document or otherwise.”**

18. The effect of that clause is to prohibit any form of double recovery.

19. Clause 62.11.1 provides:

**“This Contract shall only terminate in accordance with the express provisions of this Contract.”**

20. The provisions for termination pursuant to the provisions of the Contract available to the Authority through that clause are limited to those expressly set out in the Contract.

21. Clause 67 provides:

**“Subject to Clause 67.1 (Rectification), if a Contractor Default has occurred and the Authority wishes to terminate the Contract it must serve a Termination Notice on the Contractor.”**

22. A Contractor Default is defined in Schedule 1 by reference to one or more of 17 Events. It is unnecessary for me to consider those Events or their definition because there is no suggestion of which I am aware that a Contractor Default has occurred.

For the same reason it is unnecessary for me to consider the termination procedures to be brought into play on the ground of Contractor Default.

23. Clause 69 provides for termination on the ground of occurrence of a *Force Majeure* Event. A *Force Majeure* Event is defined in Schedule 1 as:

**“the occurrence after the date of this Contract of:**

- (a) war, civil war, armed conflict or terrorism; or**
- (b) nuclear, chemical or biological contamination...”**

24. I am aware of no suggestion that a *Force Majeure* Event has occurred. It is unnecessary for me to give any further consideration to Clause 69.

25. Clause 71 provides for termination on the ground of the Contractor having either breached its warranty (set out in Clause 71.1) that it has not committed a Prohibited Act or the commission of a Prohibited Act by the Contractor (Clause 71.2.2).

26. A Prohibited Act is defined in Schedule 1. Again, I do not set out the definition because I am aware of no suggestion that termination on the ground of breach of the warranty in Clause 71.1 or the commission of a Prohibited Act is available to our Client.

27. Clause 73.1 provides for termination by our Client voluntarily. The relevant Clauses are as follows:

**“73.1 The Authority may terminate this Contract at any time on or before the Expiry Date by complying with its obligations under Clause 73.2 (Voluntary Termination by the Authority).**

**73.2 If the Authority wishes to terminate this Contract under this Clause 73 (Voluntary Termination by the Authority) it must give a notice to the Contractor stating:-**

**73.2.1 that the Authority is terminating this Contract under this Clause 73 (Voluntary Termination by the Authority);**

**73.2.2 that this Contract will terminate as soon as reasonably practicable and in any event no later than the date falling three (3) Months after the date of receipt of the Notice: and**

**73.2.3 whether the Authority has chosen to exercise its option under Clause 73.3 (Voluntary Termination by the Authority) below.**

**73.3 On termination, subject to Clauses 80.6 and 80.7 the Authority shall have the option to require the Contractor to transfer its rights, title and interest in and to the assets to the Authority or as directed by the Authority.**

**73.4 This Contract will terminate on the date falling no later than three (3) Months after the date of receipt of the Notice referred to in Clause 73.2 (Voluntary Termination by the Authority) above.”**

28. As I read Clause 73, the Authority has an absolute discretion to terminate voluntarily the Contract at any time prior to the Expiry Date which is defined in Schedule 1 as the 31<sup>st</sup> March 2014. All that is required is for the Authority to service a Notice under Clause 73.2. The Contract will then terminate as soon as reasonably practicable but no later than 3 Months after date of receipt of the Notice by the Contractor.

29. If the Authority decides to act in that way the Contract provides for the payment of compensation by our Client to the Contractor. The relevant provisions are Part 2 of Schedule 17; see Clauses 66 and 74 of the Contract. I consider those provisions below.

30. Clause 98.1 of the Contract provides for the method of serving notices and details of the addressee. Notices served upon the Contractor must be simultaneously copied to WTI Holdco at a given address.
31. Clause 65 provides for termination on the ground of Authority Default. Authority Default is defined in Schedule 1 relevantly as:
- (a) a failure by the Authority to make payment of any amount of money or
  - (b) **“a breach by the Authority of its obligations under this Contract which substantially frustrates or renders it impossible for the Contractor to perform its obligations under this Contract for a continuous period of 2 months”.**
32. Compensation is payable on the ground of Authority Default. Compensation is calculated by reference to Part 2 of Schedule 17. Part 2 of Schedule 17 also provides after termination on voluntary termination by the Authority (see below and Clause 74 of the Contract).
33. Clause 75 is permissive of termination by the Authority on the ground of wilful breach by the Contractor of paragraph 2 of Schedule 16, the Re-financing Provisions. I am unaware of any suggestion that there has been any such breach. The Re-financing Provisions are set out in Schedule 16. It is unnecessary for me to give Clause 75 any further consideration.
34. There is an additional ground for termination which is not found in Part XII of the Contract. It is found in Schedule 26 **“Planning”**.

35. Paragraph 2.1.1 of Schedule 26 provides for an undertaking from the Contractor that it will use “All Reasonable Endeavour to obtain a Satisfactory Planning Permission and use reasonable endeavours to follow and meet the Key Due Dates. Reasonable Endeavours are defined in paragraph 2.2 of Schedule 26. Paragraphs 2.1.3 – 2.1.7 of Schedule 23 sets out the procedure to be followed which allows the Authority to police and monitor the steps taken by the Contractor to comply with paragraph 2.1.1 of Schedule 26.
36. I had very little information on the planning history. I understand that the Contractor failed to get planning permission in the expected timeframe so as to give rise to the need for a revised project plan as mentioned in paragraph 3.3 of the Contract. From the document which I received from Councillor Kemp, mentioned in paragraph 7 above, I understand that the revised Project Plan was received on 30<sup>th</sup> April 2013.
37. Paragraph 3.3.7 of Schedule 26 provides that within 6 months of receipt the Authority may either accept it (3.3.7 (x) (sic)) or reject it (paragraph 3.3.7 (y) (sic)). Both (x) and (y) are mis-numbered and should be (a) and (b)). No response to the revised Project Plan by the Authority is deemed to be a rejection. (Clause 3.3.7 (y)).
38. The Authority has until 29<sup>th</sup> October 2013 to accept the revised Project Plan. If the decision of the Secretary of State on the Planning Permission is not received until after 30<sup>th</sup> October 2013 they will be deemed to have rejected the Revised Project Plans unless before that date it has been accepted.

39. Under paragraph 3.5 of Schedule 26 either Party may serve a written Notice specifying a wish to terminate any contract if there is a Planning Failure or if the Authority rejects or is deemed to have rejected the revised Project Plan. The Contract Period terminates 15 business days from the date of such Notice of Termination.
40. By paragraph 3.5.2 of Schedule 26, if it is agreed or determined that there has been a failure by the Contractor to use All Reasonable Endeavours the provisions for compensation shall not apply and the Authority shall not be liable to the Contractor for any compensation on termination. That is described as the sole remedy of the Authority in respect of a failure by the Contractor to use All Reasonable Endeavours.
41. Alternatively, if there has been no such failure, compensation is payable. By paragraph 3.5.1 of Schedule 26 the provisions of Clause 7 (Compensation on Termination for *Force Majeure*) shall apply as if such termination constituted a *Force Majeure* Event.
42. Compensation on termination for *Force Majeure* is calculated by reference to Part 5 of Schedule 17: see Clause 70.
43. One further route to termination is found within Schedule 27 of the Contract. In the event that the Contractor fails to obtain an Environmental Permit the Authority may serve a Notice of Termination: see paragraph 11 of Schedule 27. I understand that the Contractor has obtained such a permit. It is unnecessary for me to give Schedule 27 any further consideration.

44. Clause 90 provides that,

**“Each Party shall and shall procure that any representative(s) appointed upon its behalf pursuant to this Contract shall act in good faith and deal in a timely and diligent manner in relation to the carrying out of any service, duty or obligation under this Contract and any Ancillary Document.”**

45. That Clause might be relied upon for an argument that a decision to reject the Revised Project Plan should be taken in good faith and not, for example, because of the compensation payable on rejection of the revised Project Plan is less than where there has been Voluntary Termination.

46. Clause 101 provides that:

**“The Contract and any non-contractual obligations arising out of or in connection with it shall be governed and construed in all respects in accordance with the Laws of England and Wales. Subject to Schedule 22 (Dispute Resolution Procedure) the Parties submit to the exclusive jurisdiction of the Courts of England and Wales.”**

47. The Dispute Resolution Procedure in Schedule 22 provides for adjudication: see paragraph 3. That is subject to paragraph 12 which provides for referral of the dispute to the English Court within 20 business days of receipt of the Adjudicator’s decision in the case of a dispute *inter alia* in respect of compensation on termination for *Force Majeure* or compensation on Voluntary Termination by the Authority. Having regard to the express reference to the *Force Majeure* provision in paragraph 3.5 of Schedule 26, I expect paragraph 12 of Schedule 22 to be construed so that a dispute in respect of termination under paragraph 3.5 can also be referred to the English Court.

48. The provisions for payment of compensation on termination are within Schedule 17. Part 2 of Schedule 17 provides for the calculation of compensation following Authority Voluntary Termination under Clause 73.

49. Paragraph 1.1.2 provides that the Authority shall pay the Contractor the “Authority Default Termination Sum” in accordance with paragraph 4 (Method of Payment of Compensation on Termination) of Part 7 (General) of this Schedule 17 (Compensation on Termination).

50. The provisions are as follows:

**“1.2 Subject to paragraphs 1.2.4 and 1.4 to 1.6 below, the Authority Default Termination Sum shall be an amount equal to the aggregate of without double-counting:**

**1.2.1 The Base Senior Debt Termination Amount;**

**1.2.2 The SDF Debt;**

**1.2.3 Redundancy payments for employees of the Contractor that have been or will be reasonably incurred by the Contractor as a direct result of termination of this Contract;**

**1.2.3A Any Sub-Contractor Breakage Costs pursuant to limb (A) of that definition;**

**1.2.3B Any Sub-Contractor Breakage Costs pursuant to limb (B) of that definition; and**

**1.2.4 An amount which when taken together with:**

**(a) Dividends (or other distributions) paid by the Contractor on its share capital on or before the Termination Date; and**

**(b) Interest paid and principal repaid by the Contractor under the Subordinated Financing Agreements other than in respect of Tranche A Subordinated Debt on or before the Termination Date;**



taking into account the actual the actual timing of all such payments, gives a real internal rate of return on the share capital subscribed and amounts advanced under the Subordinated Financing Agreements (excluding the amount advanced for SDF repayment or on a conversion of SDF to Tranche AA Subordinated Debt (which shall be compensated pursuant to paragraph 1.2.2 above) and any payments made in respect of an Equity Cure) equal to the Base Case Equity IRR.”

51. Paragraph 1.4 of Part 2 Schedule 17 provides:

**“1.4 If the Aggregate of the amounts referred to in paragraph 1.2.1, paragraph 1.2.2, paragraph 1.23(B) and paragraph 1.2.4 is less than the Revised Senior Debt Termination Amount, then the Authority Default Termination Sum shall be increased so that it is equal to the aggregate of the Revised Senior Debt Termination Amount and the amounts referred to in paragraphs 1.23 and 1.2.3A ... provided always that:-**

**1.4.1 The amount referred to in paragraph 1.2.3 and 1.2.3A shall only be paid to the extent that the Contractor has demonstrated to the reasonable satisfaction of the Authority that the amount will not be paid in payment (in whole or in part) of any distribution; and**

**1.4.2 If, at the time of termination, there are any Additional Permitted Borrowings outstanding, no Sub-Contractor Breakage Costs shall be paid in respect of any such sub-contract in circumstances where there is an event of default under such sub-contract which would entitle the Contractor to terminate such sub-contract.”**

52. Paragraphs 1.5 and 1.6 contain provisions to protect the Authority if in particular circumstances, which I assume do not apply, the Contractor is at fault.

53. The Base Senior Debt Termination Amount is a defined term found within Part 1 of Schedule 17, as is the SDF Debt. Similarly the meaning of Sub-Contractor Breakage Costs is found in the same sections.

54. On the material which I have it is impossible to form any view on the amount of Compensation which would be payable on Authority Voluntary Termination. Accordingly I have not added to the length of this Advice by setting out the definitions in full. Those definitions will have to be considered by a forensic accountant.
55. If there is termination as a result of Planning Failure, that is to say either a failure to obtain Planning Permission or rejection or deemed rejection of the revised Project Plan under paragraph 3.5 of Schedule 26, in such circumstances the provisions of Clause 70 apply: see paragraph 41 above.
56. Paragraph 1.7 of Part 5 of Schedule 17 provides:

**“If a force majeure termination occurs as a result of the operation of paragraph 3.5 of Schedule 26 (planning) then, provided the Contractor has used All Reasonable Endeavours in accordance with Schedule 26 (planning) the Force Majeure termination shall be auditable and evidenced costs against the following heads:-**

**Bank arrangement fees  
Bank commitment fees  
EPC termination costs  
Rolled-up interest  
Bank Agency fees  
Letter of credit costs  
Bid and development costs  
Hedge breakage(?)  
Costs or receipts arising under any interest hedging arrangement.”**

57. Compensation under paragraph 1.7 is capped at £20.3 million in total save in respect of interest rate hedge, forex hedge breakage and Overhedging payments.

58. I suspect that much of that information is only in the knowledge of the Contractor. It will be necessary for an accountant to obtain such material from the Contractor with the supporting evidence so that an audit can be carried out.
59. By paragraph 4.1 of Part 7 of Schedule 17 payment of the Termination Sum is due 40 Business Days after the Notice date although there is provision for payment in Instalment (see paragraph 4.2).
60. I have set out above the relevant clauses in relation to the termination of the Contract and calculation under the Contract of compensation for termination. However, if the agreed sum, (that is the sum calculated by reference to the Contract) is a penalty it will not be enforced by the courts. It is sometimes a matter of some difficulty to determine whether agreed damages, are in the particular circumstances of the case, penalties or liquidated damages, but the principles are well established. The onus of showing that a clause is a penalty clause lies upon the party who is sued upon it.
61. *“The classic form of penalty clause is one which provides that upon breach of a primary obligation under the contract a secondary obligation shall arise on the part of the party in breach which does not represent a genuine pre-estimate of any loss likely to be sustained by him as the result of the breach of primary obligation but is substantially in excess of that sum”*: Lord Diplock in **Scandinavian Trading v Flota** [1983] 2 AC 694 at 702.
62. *“The essence of a penalty clause is a payment of money stipulated as in terrorem of the offending party: the essence of liquidated damages is a genuine covenanted pre-*

*estimate of damage*”: Lord Dunedin in **Dunlop v New Garage** [1915 AC 79 at 86.

Thus the test is whether as a matter of construction the predominant contractual function of the provision is to deter a party from breaking the contract or to compensate the innocent party for the breach.

63. The comparison to be drawn is between the stipulated sum and the range of losses that it could reasonable be anticipated that the sum would have to cover at the time the Contract was made.

64. In **Philips Hong Kong v AG of Hong Kong** [1993] 61 BLR 41 a calculation based partly on a formula applied to the total value of the contract was held to be a perfectly sensible approach in a situation where it would be obvious that substantial loss would be suffered in the event of delay but what the loss would be would be virtually impossible to calculate precisely in advance.

65. Prima facie, the loss suffered by the Contractor on termination by the Authority will be loss of the profit it would have made had the Contract lasted full term plus any irrecoverable expenditure not caught up in the loss of profit calculation. The Forensic Accountant will have to advise on whether the sum payable under the Contract is disproportionately excessive and on whether it was feasible to provide for a formulaic calculation of that sum at date of entry in to the Contract. It would be helpful to have full details of the negotiations, if any, concerning the contractual formulae.

**Summary**

66. In practice there are two alternative routes to Termination. The first is voluntary termination by the Authority under Clauses 73 and 74. The second is in relation to planning under Schedule 26. Both have onerous compensation clauses, the full scale of which I am not in a position to determine. It may be that the argument summarised in paragraph 60 -65 above will be of assistance to dilute the effect of the contractual compensation provisions.

67. Those who instruct me should consider with the Authority the content of this Advice. There is an urgent need to quantify the Compensation Provisions so that an informed view can be taken. I would be delighted to assist the accountant in consideration of the meaning of the compensation provisions.

**15<sup>th</sup> September 2013**

**JONATHAN ACTON DAVIS QC**

1 Atkin Building  
Gray's Inn

- 2013 -

**Re: THE WILLOWS POWER AND  
RECYCLING CENTRE**

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**ADVICE**

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## **Residual Waste Treatment Contract – Contingency Arrangements in the Event of Significant Delay or Termination for Failure to Secure Planning Permission**

Report by the Director of Environment, Transport and Development

### **Summary**

The County Council is responsible for dealing with around 210,000 tonnes of household waste and commercial waste collected by Norfolk authorities that is left over after recycling. This is referred to as 'residual' municipal solid waste. This waste is predominately sent to landfill and this is getting more expensive due to increasing fees charged by operators and landfill tax which will cost £80 per tonne from 2014. The cost of dealing with this waste next year is expected to be more than £20 million.

Contingency arrangements are already in place that could extend to March 2016 should the Residual Waste Treatment Contract experienced further delay or be terminated for planning failure. This includes arrangements for landfill, energy from waste and mechanical biological treatment.

The Residual Waste Treatment Contract is cheaper than the projected costs of landfill. This may not be the case with any required alternatives or for waste which is not covered by this contract (which is to treat around 170,000 tonnes of the 210,000 tonnes of waste the County Council is responsible for). So in any event the County Council will have to start securing short to medium term alternatives in 2014 for dealing with waste not covered by the existing contracts.

Securing supplementary services or alternatives requires the setting up of a project board and team. This would need to secure short term (up to 2020) treatment and disposal services via either service level agreement contracts with News or by direct procurement. The same project could oversee delivery of a longer term solution and any additional services required beyond 2020, which could be continued reliance on treatment capacity outside Norfolk, landfill or delivery of infrastructure in Norfolk or a mix.

Any alternatives would have to be provided for from the County Council's revenue budget as Defra confirmed on 10 July 2013 there is no other available funding option from central Government.

## 1. **Background**

1.1 At its meeting on 17 June 2013 Full Council resolved that:

*'Full Council recognises that Cabinet will be drawing up contingency arrangements, involving officers, including looking at alternatives to Energy from Waste, in case the contract does not go ahead (including exploring funding options from Central Government).'*

This report is provided to this meeting for information and explores alternative arrangements in the event of further delay or termination relating to planning failure and provides an update on the funding options from Government.

## 2. **The County Council's Role As A Waste Disposal Authority**

### 2.1 **Waste Disposal Responsibilities**

Norfolk County Council is the Waste Disposal Authority for Norfolk. It has two main waste duties in this statutory function:

- (a) To put in place arrangements or deliver services to deal with residual waste (the waste left over after recycling, sometime referred to as black bag waste) collected by the Waste Collection Authorities (local councils) within its area.
- (b) To provide places (recycling centres) where residents of Norfolk can dispose of their waste.

#### 2.2.1 **Residual Waste Contracts**

To fulfil part of its function as a Waste Disposal Authority the County Council has in place contracts with waste management companies that have been procured through a competitive process. Sitting alongside these the County Council also has in place a number of Service Level Agreement Contracts with the Norse group delivered by one of its companies, Norfolk Environmental Waste Services Limited (News).

These contracts with Norse and the private sector companies provide facilities where Norfolk's local councils can deliver their collected residual household and business waste and where non recyclable waste from the County Council's 20 Recycling Centres can be accepted as required.

In 2012/13 the County Council had contracts in place to manage some 210,000 tonnes of residual household and business waste collected by local councils or delivered in from the recycling centres.

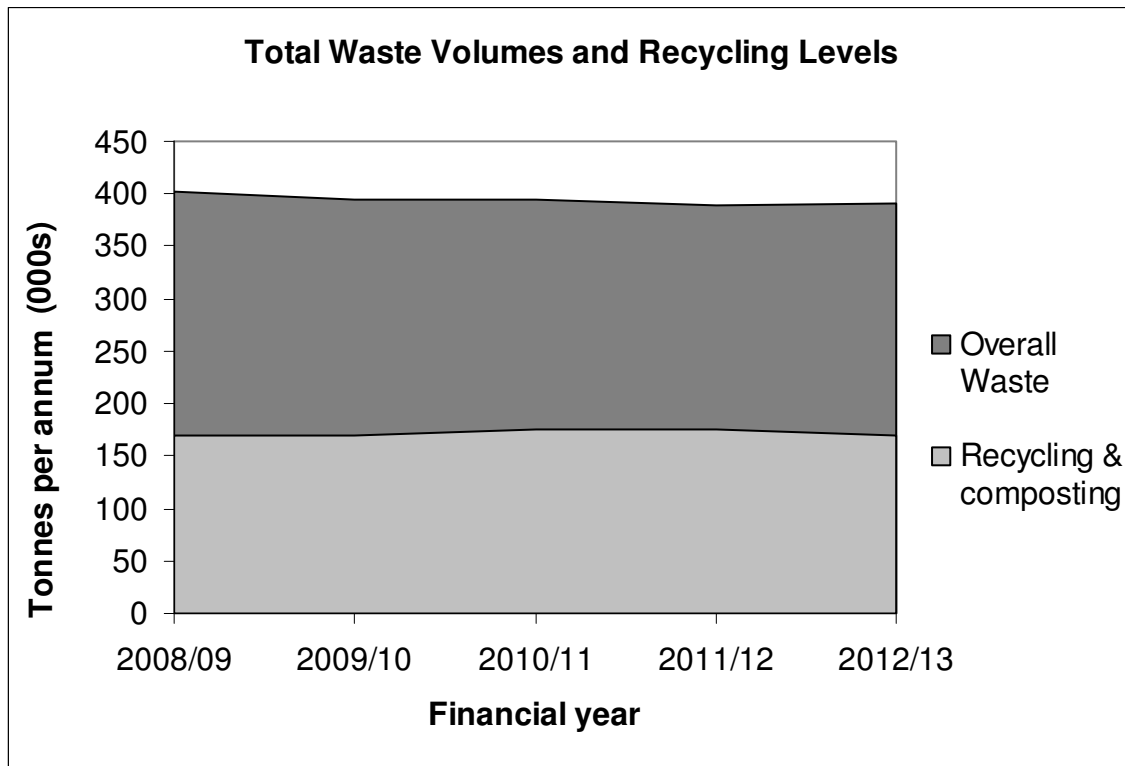
2.2.2 These contracts are predominately landfill contracts. In 2012/13 approximately 175,000 tonnes of this waste was disposed of in landfill sites in Norfolk at Aldeby, Blackborough End and Edgefield, whilst 34,000 tonnes was sent to Kent to be incinerated in an Energy From Waste Plant. In 2013/14 the projection is that 170,000 tonnes will be sent to landfill and 40,000 tonnes will be incinerated. A contract in place with a Mechanical Biological Treatment facility in Cambridge has



not been used as the facility is currently out of operation. The County Council also has a Residual Waste Treatment Contract in place with Cory Wheelabrator which was for services that were originally expected to start in 2015 which are subject to a significant delay.

### 2.3 Waste Levels

There is uncertainty about the future growth in waste volumes, as the economy returns to normal growth levels. A number of authorities have already seen an upturn in waste volumes and this is being experienced in Norfolk where the reduction experienced in previous years has slowed as shown in the graph below and is now, based on early data for 2013/14, appearing to reverse.



### 2.4 Recycling

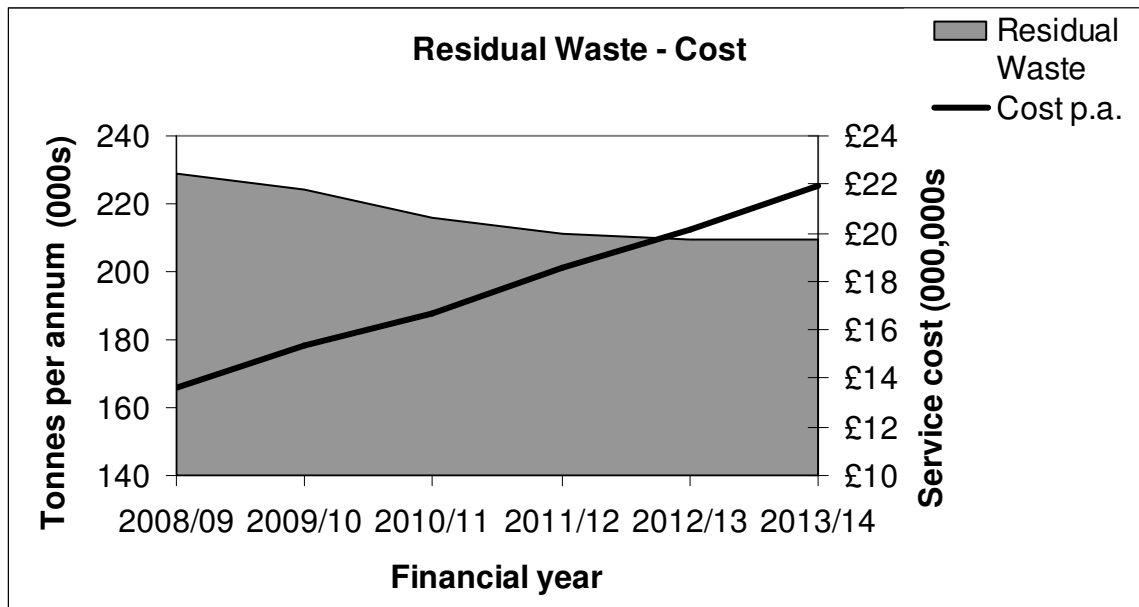
Recycling performance of household waste is currently around 44% (for 2012/13) which represents a small drop from the previous year which was around 45.3%.

A combination of new food waste collections delivered in 2013 combined with an expected increase to materials householders can recycle could be expected to lift the existing countywide recycling figure to around 50% by 2015.

### 2.5 Cost

A more immediate driver for local authorities, as indicated in the graph below, is one of increasing cost which is split in to two heads, the cost paid to the landfill operator of a facility generally between £20 and £30 per tonne, and the tax per tonne applied to the waste which will be an additional £80 per tonne from 2014. The cost of dealing with this waste next year in Norfolk is expected to be over £20 million.

The graph below is focussed just on the residual waste that is left over, currently around 210,000 tonnes per annum. This is in contrast to the graph above which is focussed on all the local authority collected waste, i.e. including dry recyclables, compost and food waste which is 391,000 tonnes.



### 3. Pre-Procurement and Market Testing

- 3.1 If a medium or long term contingency plan were required it would be advisable to undertake a soft market testing exercise before starting any procurement, to gather information on what proposals the industry has available to help inform the approach adopted by the County Council.

The County Council has previously undertaken such exercises and details on this are provided in Appendix A.

### 4. Procuring Residual Waste Services

- 4.1 Procuring short and medium term services to treat waste may take several months or more. The procurement of longer term solutions, particularly where it is linked to the delivery of new infrastructure, generally takes more than two years and often a lot longer.

To illustrate, the procurement of the Residual Waste Treatment Contract started in April 2009. On 07 March 2011 Cabinet resolved to award a contract to Cory Wheelabrator and the contract was subsequently signed on 07 February 2012. This decision was in line with the recommendations from the Project Board and the Overview and Scrutiny Panel which supported contract award.

### 5. What Are Other Local Authorities Doing?

- 5.1 Local Authorities across the country have put or are putting in place plans to divert waste from landfill through procuring solutions that are supported by the

Government grant process (i.e. the PFI or Waste Infrastructure grant process) or through other funding routes.

5.2 Below is a list of Authorities that have projects in procurement, construction or are operational and their respective processes:

- Energy From Waste: Central Berkshire, Bradford and Calderdale, Buckinghamshire, Cornwall, East Sussex, Hampshire, Hertfordshire and Worcestershire, Isle of Man, Kent, Kirklees, Leeds, Lincolnshire, Merseyside, North East Lincolnshire, Northumberland, Nottinghamshire, Oxfordshire, Peterborough, Sheffield, Shetland Isles, Shropshire, South Gloucestershire, South Tyne & Wear, South West Devon, Staffordshire, Suffolk.
- Energy From Waste and Mechanical Biological Treatment: Arc21 (Northern Ireland), Barnsley Rotherham & Doncaster, Greater Manchester, Southwark, York and North Yorkshire, Wiltshire.
- Gasification: Isle of White, Surrey.
- Mechanical Biological Treatment: Cambridgeshire, Cumbria, East London, Essex, Lancashire, Leicester, Wakefield.

5.3 These solutions are based mainly on Energy From Waste as a process, however a number of local authorities have awarded contracts to companies offering different technology solutions – generally where they have made it clear processes based on thermal treatment would be unacceptable. Some early projects were also more focused on diverting the *biodegradable* fraction of waste from landfill, as a strategy to meet Landfill Allowances, and not about diverting waste from landfill. This led to some solutions being adopted that generate large volumes of outputs considered to be stabilized (i.e. that are not expected to biodegrade / rot down much further) that still require landfill, often referred to as ‘compost like output’.

## 6. **Processes for Dealing With Residual Waste**

6.1 As a general observation there have been no significant and fundamental changes to what treatment options are available in the last few years. The main processes are still:

- Energy from Waste / Incineration - thermal treatment in the presence of oxygen.
- Gasification - thermal treatment in the presence of oxygen at high temperature.
- Pyrolysis - thermal treatment in the absence of oxygen at lower temperature.
- Plasma Gasification - thermal treatment in the presence of oxygen at very high temperature.
- Mechanical and Biological Treatment processes.
- Creating a Fuel - Refuse Derived Fuel or Solid Recovered Fuel.
- Autoclaving - steam processing.

A short explanation of these processes is provided in Appendix B.

The County Council has also met with developers of an emerging approach based on turning waste in to ethanol and kept abreast with projects across the country

involving a range of different approaches so that it is aware of the possible refinements and emerging issues and opportunities associate with processes across the country that are in operation.

## 7. **Contingency Arrangements Already In Place**

- 7.1 If the Residual Waste Treatment Contract is terminated as a result of planning failure, or experiences further significant delay, some existing arrangements can be extended to 2016, but the County Council will need to put alternative arrangements in place for disposal and treatment of Norfolk's residual municipal waste.
- 7.2 A range of separate arrangements are already in place that give the County Council the ability to accommodate changing waste tonnages and any need for a phased move to subsequent service arrangements including the Residual Waste Treatment Contract. The arrangements are also in place to provide services for waste in excess of 170,000 tonnes which is the limit of the Residual Waste Treatment Contract arrangements. This is despite the Willows being sized at 275,000 tonnes per annum, which was a decision by the Contractor to allow income from waste from private sector waste treated at the facility to be used to keep the cost of the service to the County Council down.
- 7.3 Five contracts last to March 2015. This includes treatment using Energy From Waste at Allington in Kent and Mechanical Biological Treatment at Waterbeach in Cambridgeshire (currently this facility is not operational) as well as landfill.

A separate Aldeby Landfill contract with FCC (Fomento de Construcciones y Contratas) ends in July 2014 and arrangements at Edgefield Landfill with News are expected to end in late 2013 and these changes are being addressed by Service Level Agreement Contracts with News to provide services as required to allow waste to be received at other locations in Norfolk where it can be bulked up before being transported to a treatment or disposal site.

- 7.4 The five contracts that end in 2015 can be extended to March 2016. This flexibility was built in to allow for minor delays to the service from the Residual Waste Treatment Contract and to allow for a phased move to commissioning a facility.

## 8. **Addressing Significant Delay or Termination of the Residual Waste Treatment Contract**

- 8.1 The County Council would need to establish a project board and team in 2014 to oversee the provision of local delivery points and the medium term and long term provision of treatment services in response to a significant delay or termination of the Residual Waste Treatment Contract.

This project, informed by lessons learnt from earlier procurements, and knowing the status of the Residual Waste Treatment Contract, would be able to secure the appropriate mix of short term arrangements, i.e. up to five to seven years, starting in 2015/16 and longer term arrangements, i.e. seven years plus, as required.

There are two main options to do this, either using News via a Service Level Contract to secure flexible options for treatment and disposal, or securing treatment

capacity directly, i.e. by procurement or via other authorities on an agency basis.

## 9. **What Alternatives May Come Forward?**

- 9.1 The focus is likely to be treatment facilities in the region, e.g. Great Blakenham Energy From Waste facility procured by Suffolk County Council (expected to come on stream in 2014), or the Mechanical Biological Treatment facility at Waterbeach procured by Cambridgeshire County Council, which whilst it has experienced a catastrophic failure is expected to be operational again in late 2013. However landfill in Norfolk and treatment facilities further afield, including export to facilities in the Netherlands or Germany, may be options that would come forward.

## 10. **What Might Alternatives Cost?**

- 10.1 It should be noted that whilst the Residual Waste Treatment Contract is cheaper than landfill other solutions may not deliver the same level of savings or any savings at all compared to the projected cost of landfill, or may be associated with a different risk profile and reduced opportunities for further savings, e.g. through income from sales of electricity or the residual value of a facility (at the end of the Residual Waste Treatment Contract the County Council would own the facility).
- 10.2 However, it is possible that short term deals, particularly for smaller tonnages (i.e. possibly not meeting all the County Council's needs), could be secured at a cost cheaper than landfill price, i.e. as low as around £80 per tonne.

## 11. **Budget Considerations**

- 11.1 Termination for planning failure of the Residual Waste Treatment Contract would lose anticipated service savings. These were previously calculated as more than £8 million in 2016 and more than £200 million over the life of the contract. This related to the lower guaranteed cost of the contract combined with the benefit of a Government grant on the original timetable.

With the removal of the grant, and taking in to account the effect of delay, in year 2017/18 the savings compared to landfill are currently expected to be around £174,000 and around £20 million over the life of the contract to 2040.

With the potential for additional income from electricity sales that would be lost is taken in to account, this loss of savings could potentially rise by some £2 million a year.

It is expected that any reliance on alternatives in the short and long term will not be as cheap to Norfolk as the Residual Waste Treatment Contract for two main reasons. Firstly there will be no Government grant to help meet the cost, and secondly as the County Council would be securing spare capacity as a third party, this means it does not share the benefits of income share in the same way and would have to pay the market rate.

- 11.2 The County Council would have to meet costs relating to the termination of the Residual Waste Treatment Contract.

11.3 The costs of re-procurement would also need to be met and the site at the Willows Business Park either sold, used for the alternative arrangements or used for another purpose.

## 12. **Lack of Funding Options From Central Government**

12.1 Defra notified the County Council on 18 October 2013 that due to the delay experienced on the project it had decided to remove the grant it had allocated to Norfolk as it felt it was no longer under an obligation to provide the grant as planning permission had not been secured by 10 June 2013. Albeit that this only occurred due to the call in of the planning process by the Government, this is the breach that has been referred to.

Defra had undertaken a national review which in its view meant it did not have to continue to support the project to help meet national targets to move waste from landfill and was of the view that in the current financial circumstances the decision to withdraw the grant was justified.

12.2 There are no plans to award Waste Infrastructure Credits to new projects. Defra confirmed on 10 July 2013 that 'the Waste Infrastructure Credits are not transferrable and there is no other equivalent funding stream within Defra to support local authorities in the same way and to the same extent.'

Appendix A: Market Testing and Site Visits in the Residual Waste Treatment Procurement

A1. **Contract A, Formal Market Testing Meetings Prior to Procurement, October 2003**

This is a list of organisations that took the opportunity to meet with the County Council in October 2003:

1. Waste Recycling Group - Energy From Waste.
2. News - Mechanical Biological Treatment with Anaerobic Digestion.
3. Estech - Autoclave.
4. Compact Power - Gasification.
5. Global Olivine - Gasification/Vitrification.
6. Oaktech Ltd - Mechanical Biological Treatment with Anaerobic Digestion.
7. Biffa - Mechanical Biological Treatment/Ball Mill and Anaerobic Digestion.
8. Herhoff - Mechanical Biological Treatment.
9. Brightstar - Gasification.
10. Cyclerval - Energy From Waste.

A2. **Waste Contract, Round 1 Formal Market Testing Meetings Prior to Procurement, November 2005**

This is a list of organisations that took the opportunity to meet with the County Council in November 2005:

1. Edmund Nuttall - Energy From Waste.
2. Oaktech Ltd - Mechanical Biological Treatment with Anaerobic Digestion.
3. Onyx - Energy From Waste.
4. Total Waste - Recycling.
5. Singh UK - Send waste out of county to a Global Olivine facility.
6. Bedminster International - Mechanical Biological Treatment.
7. Shanks - Mechanical Biological Treatment.
8. WRG - Energy From Waste.
9. Biopower - Plasma Arc Gasification.
10. News - Advanced Mechanical Biological Treatment.
11. Laing O'Rourke - Mechanical Biological Treatment.
12. SRS Ltd – Mechanical Biological Treatment/ Refuse Derived Fuel.
13. Global Renewables - Mechanical Biological Treatment.
14. Donarbon - Mechanical Biological Treatment.
15. Amey Ventures Ltd - No process proposed.
16. Environmental Waste Controls - Autoclave.

A3. **Waste Contract, Round 2 Formal Market Testing Meetings prior to procurement, November 2007**

This is a list of organisations that took the opportunity to meet with the County Council in November 2007:

1. Amey/Cespa - Mechanical Biological Treatment.
2. Cyclerval - Energy from Waste.
3. Covanta - Energy from Waste.
4. Donarbon - Mechanical Biological Treatment.
5. Energy Power Resources - Energy from Waste.
6. Kier - No technology proposed.

## Appendix A: Market Testing and Site Visits in the Residual Waste Treatment Procurement

7. May Gurney - Mechanical Heat Treatment.
8. NCS/NEWS/Land Securities Trillium - No process proposed.
9. Shanks - No process proposed.
10. Singh UK - Mechanical Heat Treatment.
11. Sterecycle - Autoclaving.
12. Waste Recycling Group - Energy From Waste.

### A4. **Report to Project Board on Site Visits and Market Testing**

A4.1 A report to the Project Board dated 20 February 2008 provided details about arrangements being made for members to visit waste treatment facilities and feedback from the market testing exercise which is detailed below.

#### A4.2 Site Visits: Extract from Project Board Report

*'Site visits to existing residual waste treatment facilities in the UK have been arranged for members of the Waste Project Board together with members of the Review Panel together with other key individuals. The programme is currently:*

*The Shanks Mechanical Biological Treatment (MBT) facility at Frog Island, Dagenham.*

*Cyclerval's Combined Heat and Power (CHP) facility in North East Lincolnshire.*

*Veolia's Energy from Waste facility at Chineham, Basingstoke.*

*Other opportunities are also being pursued including Biffa's MBT and Anaerobic Digestion facilities near Leicester and Sterecycle's autoclaving facility in Rotheram. The intention is to supplement the site visits by the provision of videos of sites and facilities in DVD format.'*

#### A4.3 Market Testing: Extract from Project Board Report

*'The first round of market testing for Phase Two took place in November and December 2005 and January 2006 which supplemented a previous exercise in 2003. The sixteen companies that were met on a one to one basis were:*

*Amey Ventures*

*Bedminster*

*Biopower*

*Donarbon*

*Edmund Nuttall*

*Environmental Waste Controls*

*Global Renewables*

*Laing O'Rourke*

*Norfolk Environmental Waste Services*

*Oaktech*

*Onyx*

*Shanks*

*Singh UK*

*SRS*

*Total Waste*

*Waste Recycling Group*

*The first round of market testing confirmed that there was market interest for Phase Two but the level of interest would depend on how the contract was packaged, what outputs were required to be achieved and the certainty of how much tonnage would require treatment and when.*



## Appendix A: Market Testing and Site Visits in the Residual Waste Treatment Procurement

*A further round of one-to-one soft market testing with potential bidders was completed during November and December 2007. The twelve companies were:*

<i>Amey/Cespa</i>	<i>May Gurney</i>
<i>Cyclerval</i>	<i>NCS/NEWS/Land Securities Trillium</i>
<i>Covanta</i>	<i>Shanks</i>
<i>Donarbon</i>	<i>Singh UK</i>
<i>Energy Power Resources</i>	<i>Sterecycle</i>
<i>Kier</i>	<i>Waste Recycling Group</i>

*Various technology solutions were proposed:*

- (a) Three companies favoured autoclaving.*
- (b) Three would deliver an Energy from Waste solution.*
- (c) Three proposed a Mechanical Biological Treatment /Refuse Derived Fuel solution.*
- (d) Two would build a Mechanical Biological Treatment /Anaerobic Digestion facility similar to that being delivered by Phase One at Costessey.*

*One company specialising in gasification realised it would have to partner with someone to deliver the front-end technology.*

*The interest already established in 2006 was shown to have strengthened because of increased certainty in a number of areas and confirmation of previously held positions, particularly:*

- (a) Making a site available to all bidders, whilst recognising that bidders may bring their own sites to the procurement.*
- (b) That the County Council as the ultimate parent owner of Norfolk Environmental Waste Services (NEWS) has decided that NEWS will not be allowed to either bid or be part of a bid consortium as an equity partner.*
- (c) The technology neutral requirements for Phase Two.*
- (d) That Phase Two will be for residual waste treatment and disposal only ie not including recycling centre services.*
- (e) The procurement team including advisors, which is recognised as an experienced and respected team that understands the market and has already substantially completed a Public Private Partnership contact using Standardisation of PFI Contracts (SoPC) positions and documentation.*
- (f) The timing of the Phase Two procurement appears to fit in well with the industry's capacity to bid and deliver projects.'*

### **A5. 2008 Site Visits Prior to Procurement (Members and Officers)**

This is a list of site visits undertaken by Councillors and Officers in 2008:

1. 2008 Cyclerval, North East Lincolnshire - Energy From Waste (rotating kiln technology).
2. 2008 Shanks, Frog Island, Essex - Mechanical Biological Treatment.
3. 2008 Veolia, Chineham, Hampshire - Energy From Waste (moving grate)

technology).

A6. **Lessons Learnt Report to Cabinet Scrutiny Including Technology Neutrality**

The report to Cabinet Scrutiny of 24 November 2009 included in a section 'Lessons Learned Applied to the Waste PFI' (at 4.1 c) a reference to the County Council needing to remaining technology neutral in its procurement of the PFI Contract:

*'Remaining technology neutral and also providing a site for bidders to use, this extends the range of potential bidders thereby improving competition.'*

A7. **2010 Site Visits During Procurement of the Residual Waste Treatment Contract**

During the procurement process bidders existing facilities were visited including:

1. Andorra Energy From Waste Facility.
2. Ecoparque IV Mechanical Biological Treatment Facility.
3. Ecoparque III Mechanical Biological Treatment Facility.
4. AEB Amsterdam Energy From Waste Facility.
5. Dordrecht Energy From Waste Facility.
6. Riverside Resource Recovery Park Energy From Waste Facility.
7. Millbury Energy From Waste Facility.
8. Baltimore Energy From Waste Facility
9. South Broward Energy From Waste Facility.
10. Fos-sur-Mer, Mechanical Biological Treatment Facility.
11. Mannheim Energy From Waste Facility.
12. Leuna Energy From Waste Facility.
13. Celje Gasification Facility.
14. Malagrotta II Mechanical Biological Treatment Facility.

A report of facilities visited was provided by the technical advisors to the procurement.

A8. **Board, Committee and Cabinet Reports Detailing Bidders Technologies for the Residual Waste Treatment Contract**

A8.1 The Project Board, Committee and Cabinet reports that detailed the technical solutions being put forward were essentially the same in content and level of detail.

When there were four detailed solutions being assessed, three Energy From Waste proposals and one Gasification, the public reports were approximately 40 pages long supported by confidential reports of the commercial detail that were approximately 60 pages long. For each detailed solution the confidential report provided:

- (a) Financial Information from Bids, i.e. the 25 year bid cost, the cost with Government grant, the capital cost, and the per tonne cost in 2015.
- (b) Evaluation Scores and Ranking across all criteria for all bidders.

## Appendix A: Market Testing and Site Visits in the Residual Waste Treatment Procurement

- (c) Technical elements of the solution.
- (d) Environmental considerations and performance.
- (e) Planning, Regulatory and Property including key attributes and concerns.
- (f) Legal considerations.
- (g) Cost over the life of the contract period.
- (h) Affordability over the first nine years of the appraisal period.
- (i) Financial Robustness of the solution.
- (j) Deliverability of funding for the solution.
- (k) Economic standing of the bidder.

This level of detail was also provided to the Board, Committee and Cabinet in relation to the decisions to select a preferred bidder and award a contract.

- A8.2 When there were two final tenders being assessed, both Energy From Waste proposals, the public reports to Committee and Cabinet were approximately 40 pages long supported by confidential reports of the commercial detail that were approximately 86 pages long.

The process could only reach this stage when Defra and Treasury were convinced that the commercial positions reached in negotiations across many detailed positions represented value for money. For each final tender the confidential report provided:

1. Financial information: adjusted cost at today's prices (01 April 2011 to 31 March 2040), 25 year cost indexed from 2015, 25 year cost indexed with grant support from 2015, capital cost, gate fee (April 2010 price), gate fee (April 2015 price), gate fee (average over 25 years), sensitivity of price to interest and foreign exchange rate changes, indexation treatment to prices, operating and maintenance costs, the level of guarantees and prospects for share of additional income.
2. Process details: process and technology used, performance levels for treatment, electricity generation levels, heat potential, experience, build time, sub-contractor details.
3. Cost robustness.
4. Technology deliverability: description of the proposed technology, construction phase, operational phase, handback, contingency and flexibility including calorific value ranges, deliverability risk.
5. Added value and innovation: e.g. community funds, visitor centre, heat export potential.
6. Environmental: treatment performance, diversion from landfill, recycling, carbon dioxide benefits, sustainable design and construction.
7. Partnership approach and working with Waste Collection Authorities: timescales for delivery, contract and service management, turnaround times for Waste Collection Authority vehicles.
8. Planning, regulatory and property: design, architecture and layout, traffic, utilities and connections, alternative sites, alternative technologies, planning approach and environmental considerations e.g. ecology and water.
9. Property issues.
10. Legal and contractual: contract documents and key commercial issues such as composition risk, delivering below 170,000 tonnes, change in law, performance

## Appendix A: Market Testing and Site Visits in the Residual Waste Treatment Procurement

issues, contractor default, Authority Default/Voluntary Termination, Compensation on termination for Planning failure, key dates in the contract, ancillary documents.

11. Economic cost: Net Present Cost of over a 29 year period from financial close (01 April 2011 to 31 March 2040).
12. Affordability: assessed by looking at the affordability over the first nine years of the appraisal period.
13. Financial robustness.
14. Deliverability of funding.
15. Economic standing of the bidder.
16. Overall integrity of the bid.
17. Budget implications for the service to 2020 including a year by year comparison with the cost of landfill for the contract price with or without a grant.
18. Principle contract risks.

After Cabinet made its decision Defra and Treasury then considered the Preferred Bidder appointment on the basis of a Pre-Preferred Bidder Final Business Case before approving it in December 2010.

- A8.3 At the contract award point the public reports to Committee and Cabinet were approximately 40 and 27 pages long respectively supported by confidential reports of the commercial detail that were approximately 40 pages long. For the Preferred Bidder the confidential report provided information on the bid as identified above in A8.2

After Cabinet made its decision approval was then required from Defra and Treasury on the basis of a Final Business Case before the contract award process could be concluded in February 2012.

### A9. **Ongoing Soft Market Testing and Site Visits**

Since the conclusion of the formal soft market testing exercises the County Council has kept an open door to any waste management company that wishes to discuss their potential plans with us. Companies met on this basis include:

1. BAM Nuttall.
2. Cory Environmental.
3. Energos - Gasification.
4. Global Renewables - Mechanical Biological Treatment with Anaerobic Digestion.
5. Green Planet - Mechanical Biological Treatment with Gasification.
6. Laing - Mechanical Biological Treatment with Gasification.
7. MVV Umwelt - Energy from Waste.
8. Peterborough Renewable Energy - Gasification.
9. Plasco Energy Group - Plasma Arc Gasification.
10. Sita - Energy from Waste.
11. United Utilities - Mechanical Biological Treatment with Gasification.
12. Waste Recycling Group - Energy from Waste.

The County Council has also taken opportunities for officers and members to visit and revisit operational waste treatment facilities in the UK including:

## Appendix A: Market Testing and Site Visits in the Residual Waste Treatment Procurement

Compact Power, Avonmouth - Plasma gasification and pyrolysis (officers).  
Sita, Great Blakenham - Energy from Waste (under construction) (officers).  
FCC Environment, Costessey - Refuse Derived Fuel processing (officers).  
Veolia, Chineham and Portsmouth - Energy from Waste (officers and Members).  
Kent Enviropower, Allington - Energy from Waste (officers).  
AmeyCespa, Waterbeach - Mechanical Biological Treatment (officers and Members).  
Cory, London Riverside – Energy from Waste (officers and Members).

**B1. Introduction**

B1.1 The following is a brief account of residual waste treatment processes currently operating or being proposed for residual waste treatment.

**B2. Energy From Waste / Incineration - Thermal Treatment in the Presence of Oxygen**

B2.1 Energy from Waste facilities, also referred to as incinerators, burn waste at above 850 °C under controlled conditions, to reduce its volume and hazardous properties, and to generate electricity and/or heat. Standard Energy From Waste plants require no pre-treatment.

B2.2 Energy From Waste plants, similar to the other thermal process detailed below, have strict process control measures requiring the clean up of air emissions. The residues include bottom ash from which scrap metals for recycling can be extracted and the ash itself is widely used as an aggregate in construction. Material captured from cleaning the flue gases, Air Pollution Control residues (also referred to as fly ash), can be recycled in some industrial processes or disposed of. Air Pollution Control residue is considered hazardous because it contains lime and is therefore alkaline.

B2.3 Most modern Energy From Waste plants, including the proposed Willows facility, use the moving grate furnace technology that slowly propels waste through the furnace by a mechanically moved grate. Other technologies used are rotating kilns (which revolve to ensure an efficient burn as at North East Lincolnshire's facility) and fluidized beds (which uses air to separate the waste to get an efficient burn as at Kent's facility). Energy from Waste, and in particular the moving grate technology, has an extensive and successful track record in the UK, Europe and worldwide.

**B3. Gasification - Thermal Treatment in the Presence of Oxygen at High Temperature**

B3.1 Gasification involves heating waste to temperatures of around 1000 °C to 1200 °C in the presence of oxygen and some water. This produces a gas which can be burnt to generate electricity or heat as with Energy From Waste or can be captured and used as a fuel.

B3.2 As with Energy From Waste plants, Gasification plants have strict process control measures requiring the clean up of air emissions which generates Air Pollution Control residues and produce a solid residue which may require disposal or may be suitable for reprocessing as a construction aggregate.

B3.3 There is some proven track record of successfully operating gasification plants processing mixed waste on a commercial scale in Europe but little in the UK. One of the final four bidders for the Residual Waste Treatment contract proposed using gasification.

**B4. Pyrolysis - Thermal Treatment in the Absence of Oxygen at Lower Temperature**

## Appendix B: Residual Waste Treatment Processes

- B4.1 Pyrolysis involves breaking down waste through heating it to temperatures of around 500 °C in the absence of oxygen to produce a gas which can be burnt to generate electricity or generate heat as with Energy from Waste or can be captured and used as a fuel.
- B4.2 The process would normally require pre sorting of residual waste prior to processing to remove most of the non organic material. There is no commercial large scale pyrolysis facility treating residual waste in the UK.
- B5. **Plasma Gasification - Thermal Treatment in the Presence of Oxygen at Very High Temperature**
- B5.1 Plasma gasification involves the use of a plasma torch to generate very high temperatures of between 2,000 °C and 14,000 °C to break down the waste. Like standard gasification, it produces a syngas and a char like residue.
- B5.2 There are few operational facilities around the world, generally operating at a relatively small scale on niche waste streams, although an American company 'Air Products' is currently developing a large scale facility on Teeside. There is insufficient track record of the process successfully processing residual waste at a full commercial scale (i.e. comparable to the Willows in size) which causes problems when seeking to fund such facilities.
- B6. **Mechanical and Biological Treatment Processes**
- B6.1 Mechanical Biological Treatment is a generic term for a wide variety of processes that involve a combination of mechanical and/or biological processes to recover some recyclable material and produce a fuel or generate a more stable output for landfill.
- B6.2 Some of the components that may be selected as part of a process are listed below:
- (1) Mechanical Treatment - the use of automated and / or manual sorting equipment to separate out materials such as metals, plastics, glass and cardboard for recycling.
  - (2) Biodrying - drawing air through waste to dry it and/or accelerate decomposition.
  - (3) Anaerobic Digestion - breaking down biodegradable material in controlled conditions in the absence of oxygen to produce a methane rich biogas which can be burnt to generate electricity and a stabilized output, referred to as compost like output.
  - (4) In Vessel Composting - the aerobic decomposition of waste within an enclosed container where moisture, temperature and odour can be regulated.
  - (5) Refuse Derived Fuel/Solid Recovered Fuel - the preparation of waste as a fuel using shredding, sorting and drying.
- B6.3 Three examples are given below:
- (1) Mechanical Treatment and Refuse Derived Fuel /Solid Recovered Fuel – Shanks for East London Waste Authority uses drying and shredding processes to create fuel and recover recyclables.
  - (2) Mechanical Treatment & Biodrying/ In Vessel Composting - AmeyCespa for

## Appendix B: Residual Waste Treatment Processes

Cambridgeshire use mechanical separation to extract recyclables. The rest of the waste undergoes a biodrying and aerobic composting process. A 'compost like output' is produced which is disposed of in landfill.

- (3) Mechanical, Anaerobic Digestion, In Vessel Composting - the Contract A proposal by News involved mechanical separation of recyclables, anaerobic digestion, wet separation to separate out plastics and minerals and further aerobic composting before residues were disposed of in landfill. It was abandoned in 2009 as it was prohibitively expensive.

### **B7. Creating a Fuel - Refuse Derived Fuel or Solid Recovered Fuel**

- B7.1 The use of processed dried waste as a fuel has become more widespread in recent years as part of solutions based on Mechanical Biological Treatment or in treating residual material from recycling facilities. More rudimentary processes are also available whereby residual waste undergoes a very simple process to extract some recyclable material before being bale wrapped for onward transfer. FCC Environment uses such a process at its transfer station in Costessey and a recent proposal from Rebelgroup appeared to use similar processes and was linked to export of waste to the Netherlands.

### **B.8 Autoclaving - Steam Processing**

- B8.1 Autoclaving heats pre treated and shredded waste to 160 °C using pressurised steam. Some recyclable materials are extracted, some material is rejected for disposal and much emerges as a 'flock' like material. It has no track record of sustained successful operation in the UK. A commercial scale facility in Rotherham operated for a short period but failed to market its 'flock' which was instead stockpiled at landfill sites. The company was placed into administration in 2012 and ceased operations shortly after.



**NOTE TO ALL MEMBERS OF NORFOLK COUNTY COUNCIL**  
**COMPARISON OF THE FINANCIAL OUTCOMES**  
**OF THE EXISTING AND ALTERNATIVE WASTE DISPOSAL PROPOSALS**

**Report by the Interim Head of Finance**

**1 Background**

- 1.1 Cabinet on 7 March 2011 approved the award of a contract to Cory Wheelabrator for the treatment of waste for residual municipal solid waste and the County Council signed the contract on 7 February 2012.
- 1.2 The previous Head of Finance, on 31 May 2013, circulated advice to all Councillors on the wider financial implications for the Council of termination of the Energy from Waste Contract. This was based on two scenarios: termination for failure to secure planning permission and council termination. This advice was provided in advance of consideration of the Residual Waste Contract by Cabinet Scrutiny Committee on 4 June 2013.
- 1.3 As reported to Cabinet Scrutiny Committee on 4 June 2013, the County Council has been in discussions with the contractor regarding a Revised Project Plan. This note updates the position on termination for failure to secure planning permission (rejection of the Revised Project Plan) and takes into account the Government's withdrawal of the Waste PFI grant and the latest information on terminating the foreign exchange and interest rates contracts that were put in place to mitigate the risk of changes in foreign exchange and interest rates. It also compares the existing scheme to the alternative out of UK incineration proposal.

**2 Purpose**

- 2.1 To set out the financial and legal outcomes from cancelling the Existing UK based incineration scheme, with the Alternative 'out of UK' incineration scheme. This report should be read in conjunction with the accompanying report on the financial and statutory implications of the treatment of waste contract.

**3 Comparison of steps in the process**

- 3.1 The Illustration below sets out the areas of difference between the two schemes. The more 'cost' steps there are in a scheme, the higher is the risk of more costs. The less 'income' steps there are, again, there is a higher risk of more cost.
- 3.2 It helps explain why we end up with different financial results, in terms of cost and income. The final column explains the background to each difference. There is only one step in all the processes that is common to both schemes.

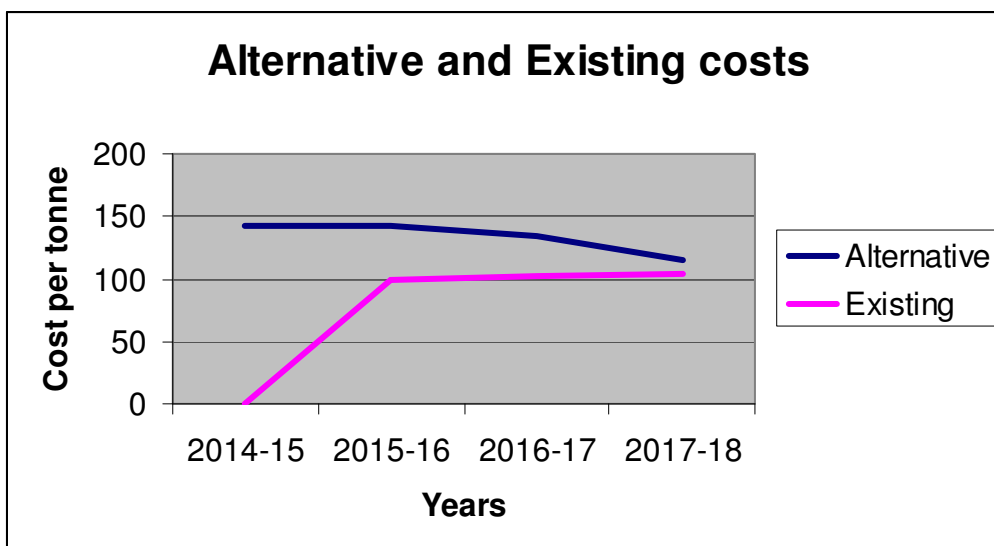
### Illustration 1 - of the areas of difference between the two schemes

Steps in the process	Existing contracted scheme	Alternative scheme	Alternative Difference	Explanation
1 cost step	N/a	Procurement	Additional cost	An alternative scheme would have to be procured
2 cost step	N/a	Pre-sorting	Additional cost	Prior to transport by sea, various types of waste would be removed (eg metals, cardboard, wood) and what remains, shrink wrapped. This step does <b>not</b> apply to a UK based operation.
3 cost step	N/a	Sea Transport	Additional cost	An addition step that only applies to the Alternative
4 cost step	Local Transport	Local Transport	Additional cost	In the Existing scheme some waste would be delivered directly to the facility by collection vehicles this is not possible in the alternative.
5 cost step	Incineration	Incineration		<b>Same process in both cases.</b>
6 income step	Additional income from electricity or heat	N/a	Income lost	Additional income from electricity or the heat generated is earned in the country in which it takes place.
7 cost step	N/a	Termination payment	Additional cost	Replacing the UK based scheme results in a £25.9m cancellation payment that would not occur if it proceeded.
8 cost step	Known financial risk	Unknown financial risk	Additional cost	Alternative scheme has no contract (it's an estimate), and is only for 3 years. Existing scheme has been negotiated and is for 25 years.
9 outcome	Council owns asset at end of contract	N/a	No asset	The facility in the existing scheme would revert to ownership by the County Council at the end of the contract.

3.3 The Alternative scheme is untested and incomplete. As such it represents a high risk strategy compared to the Existing scheme.

## 4 Financial outcomes

4.1 A comparison of the financial outcomes is drawn from contract award prices (Existing) and the Rebelgroup proposal (Alternative). The cost for the Existing scheme is lower in all years 2014-18. The Alternative scheme incurs the cost of termination and re-procurement in 2014-17. It also requires a new contract in 2017-18. The prudent 'new contract' assumption is to take the higher end range of the CIWM research. The following graph shows the results, which are detailed, in a table, at Annex A:



## 5 Impact of cancellation of the Existing scheme and the law

- 5.1 Since the previous financial advice of 31 May 2013, attached at [Annex B](#), the Chancellor of Exchequer announced the spending round on 26 June 2013. As reported to Cabinet on 5 August and 2 September 2013, this has increased the level of financial savings that local authorities will need to make. The withdrawal of the Waste PFI grant by the Government further increases the amount of savings this Council will need to identify, and intensifies the requirement for increased prudence compared to the assumptions that underpinned the May advice.
- 5.2 The budget cost of cancellation of the Existing scheme amounts to at least £28.9m ([Annex C](#)) over the period 2013-17, of which, the one-off termination costs, amount £25.9m in 2013-14 (This is less than the £33m previously estimated due to a reduction in the foreign exchange and interest rate contracts termination cost.) These one-off termination costs have to be paid after 35 days of a decision to terminate<sup>1</sup>, that is December 19 (given an October 31 termination).
- 5.3 There is no budget for the one-off termination costs in 2013-14, which are greater than the Council's reserves. The Council's judgement at that time was that the likelihood of a termination for a 'planning failure' reason was very remote.
- 5.4 If the Council's expenditure exceeds its resources, as would be the case in 2013-14, there is the prospect of 'bankruptcy' for the Council and at that point the law takes over (a separate note on the law accompanies this note). The provisions of the Local Government Finance Act 1988 and the Local Government Act 2003 would force the Council to:
- not proceed with the cancellation until,
  - it has resolved how to pay the costs within 21 days of the issue of a S114 notice.

<sup>1</sup> After serving a termination notice, the contract ceases 15 business days later. Sums are payable 20 business days after the contract ceases. The total elapsed time is therefore 35 business days.

5.5 The Council would have to consider such measures, to fund the payment, as:

- A spending freeze, affecting contractors, both locally and nationally.
- Emergency cuts to services, affecting residents.
- The depletion of reserves, down to the agreed minimum of £16m, requiring a plan to re-instate the funds over a short period of time.

**Peter Timmins**

Interim Head of Finance

October 2013

F: 131007 V8 22/10

## Annex A

### Comparison of the financial outcomes

#### Base costs plus cancellation plus reprourement

1 Year	Existing		Alternative		
	2 Cost per tonne Contract £	3 As [2] less Income £	4 Local Fee per tonne £		
2014-15	Landfill	Landfill	133-143	(75-85)+50+8	Base+ Cancel+Reproc
2015-16	105-110	95-100	133-143	(75-85)+50+8	Base+ Cancel+Reproc
2016-17	107-112	97-102	125-135	(75-85)+50	Base+ Cancel
2017-18	109-114	99-104	68-115	(New contract CIWM 7/2013 inflated by 2% pa	

#### Existing - basis of cost range

Costs based on contract award prices before delay. The higher figures allow for a possible increase in costs of 5%, due to the delay

#### Alternative - basis of cost range

'A price in the range of £75-85 per tonne, which compares to the UK landfill tax alone of £80, plus gate fees of around £15 in 2014 and rising by £8 per annum thereafter through the period of the required contingency plan'.

Note this wording could be taken to mean either:

- (a) the gate fee is only £75-85 per tonne and not indexed, ie would be flat, or
  - (b) the gate fee would rise over a contingency period from £75 to £85 per tonne,
- or
- (c) the gate fee is £75-85 per tonne, plus a treatment gate fee, plus an £8 per annum indexation. By 2017-18 the cost per tonne would be £114-124 on this assumption.

The Alternative cost, quoted in the table above, is based on interpretation (a), the lowest outcome for the Alternative scheme.

The cost of termination and re-procurement have to be added to the Alternative scheme, which is a three year contract to take advantage of short-term oversupply of capacity.

## **Annex B**

### **Residual Waste Treatment Contract – Financial and Funding Implications of Contract Termination**

**Briefing Note from the Head of Finance      May 31, 2013**

#### **SUMMARY**

This briefing note should be read together with the Cabinet Scrutiny Report that accompanies the papers for the Cabinet Scrutiny Committee scheduled for Tuesday 4 June 2013.

It sets out the wider financial implications for the County Council of termination of the Energy from Waste Contract for two scenarios, set out in the Scrutiny Report as follows:

- Termination for Failure to Secure Planning Permission (estimated termination cost of some £33m); and
- Council Termination – Decision to Walk Away from the Contract – (Indicative costs for Cornwall County Council estimated at £80m to £90m)

It is not possible to state the actual cost of termination at this stage because those costs depend on a range of factors and in the case of voluntary termination in particular, would be subject to complex legal arguments. However for relevant comparison or illustrative purposes, I have used the higher indicative cost for Cornwall County Council - £90m.

Summary financial assessment is that:

- The costs of a decision to voluntarily terminate the contract would be exceptional and of a scale likely to place at risk the sound financial standing of the Council and the effective delivery of its services across Norfolk. The Authority would be required to identify £millions of additional in-year savings on top of those currently being delivered in 2013/14 and those forecast for the next three years (a further £144m of savings over the period 2014-2017).
- The contract requires the Authority to pay agreed costs in a lump sum and within 20 or 40 days of the termination date (depending on the cause of termination). Since the Authority cannot have an unbalanced Budget, (it is illegal), in making a decision to terminate, the Council must identify at the same time, how that cost will be met. (Where the money is coming from).
- The Council cannot borrow to meet the cost since termination represents a revenue cost. The Government can, in exceptional circumstances approve borrowing for revenue purposes; however in the event the costs arose from a voluntary decision by the Council, such an approval is highly unlikely. (Repayment costs of borrowing are currently close to £100,000 per £1m borrowed).
- The Authority could, in extremis and in the short term free up some £40m of reserves which would help meet a part of the expected costs of voluntary

termination, but these would need replenishing over a period of up to three years. This means that the Council would need to add another £12m a year to the forecast savings requirement for each of the next three years.

- Using the higher indicative cost for voluntary termination calculated for Cornwall County Council, the temporary use of £40m from reserves would still leave another £49m to find in year. This would need to come from service savings across Norfolk in 2013/14. Such savings would come on top of those already being developed for the next three years (£144m) and those being delivered in the current year.

In summary, the scale of service savings required to meet the cost of voluntary termination and replenish reserves, coming on top of £144m currently being planned for the next three years, would present the Council with a very significant challenge indeed and require significant additional service savings across Norfolk and across all services. It would weaken the currently sound financial standing of the Council and have a further adverse impact on all the Council's services across Norfolk.

In addition, voluntary termination would represent a material change to the PFI grant conditions agreed with DEFRA and could lead to the withdrawal of the £169m grant from DEFRA. This would be financially disadvantageous to the Norfolk taxpayers.

In making a decision on this matter, Members need to have regard to their responsibility for achieving value for money for Norfolk taxpayers

## **1. Purpose of Note**

1.1 This briefing note, which should be read together with the Cabinet Scrutiny Report, sets out the wider financial implications for the County Council of termination of the Energy from Waste Contract for two scenarios set out in the Scrutiny Report as follows:

- Termination for Failure to Secure Planning Permission (estimated termination cost of some £33m) – Section 3 of the Cabinet Scrutiny Report and covered in the published contract at Clause 69 'Termination on Force Majeure.' The financial implications are found in Schedule 17, Part 5. It should be noted that in respect of this termination, whilst the cost would be paid to the contractor, the contractor would be obliged to pay most of this to other parties.
- Council Termination – Decision to Walk Away from the Contract – as set out in clauses 73 and 74 of the published contract. (indicative costs for Cornwall County Council estimated at £80m to £90m) – Section 5 of the Cabinet Scrutiny Report.

## **2. Cost of Termination**

- 2.1 The actual cost of voluntary termination can only be determined once a decision is made to terminate the contract. This is because some of the costs are variable e.g., the foreign exchange and interest rate swaps and the sub contractor breakage costs would need to be negotiated with the contractor. The matter would be subject to complex legal arguments, so to protect the Authority's position in the event of such circumstances, the Cabinet Scrutiny Report refers to a report prepared for Cornwall County Council in respect of a voluntary termination. That report identifies a sum of between £80m and £90m. This is a relevant and useful indication of cost. This note assumes and uses the indicative sum of £90m to assess the Council's funding options to meet such a cost.
- 2.2 It is important to note that the contract signed, was with the County Council as a body corporate. This means that although it was signed by the previous Administration, it remains binding and is not affected or altered by the changes that have followed in the wake of the recent county council elections.
- 2.3 There has been some speculation that an exit from the contract could be secured for some £2m to £3m. This is not the case. In the event of either of the two termination scenarios considered in this note, the costs will be far in excess of such speculated sums as set out here, and in the Scrutiny report.

## **3. Financial Implications of Termination**

- 3.1 If the County Council decides to cancel the contract, the main areas of financial implication are:
- a) The County Council will have created an obligation to pay the contractor voluntary termination costs. The main contractual provisions relating to the various termination events are set out in the Cabinet Scrutiny Report. More detail is provided in section 4 below.
  - b) Defra is released from its obligations under the Waste Infrastructure Credit letter and can withdraw the Waste Infrastructure Credits i.e. the £169m grant is at risk. The Grant, which is payable over 25 years, contributes some £6.7m per annum towards the cost of Norfolk's waste disposal. The grant forms a significant element of the currently forecast annual saving from the project of £8m (excluding income from e.g. sales of heat). That £8m annual saving has been factored into the Council's forward financial planning from 2016/17 and would potentially be lost. The loss of Government Grant to local taxpayers would have to be made up from service savings.
  - c) An alternative approach to treating the County's residual waste would need to be identified, procured and financed by the County Council. Whilst this would be a task for the medium term, the authority has already invested considerably in procuring the arrangement with Cory Wheelabrator. This investment would be lost.
  - d) The financial implications of meeting agreed termination payments to the contractor are so sizeable that they put at risk the financial standing



of the Council which is, at the present time, very sound. This additional risk would come at a time when the County Council is in the final stages of successfully implementing a three year financial strategy that will have delivered £140m of savings required for the years 2011 -14. The authority is now faced with the task of addressing a further three year funding gap which is currently estimated to require savings of another £144m. In the event that Members decide to terminate the contract, the savings requirement will increase by many £millions as set out above.

#### **4. Payment and Funding of Termination Costs**

##### **(i) Payment to the Contractor for Termination**

- 4.1 In the event of termination because of failure to secure planning permission, the agreed termination costs are payable within 20 days of the termination date and the contract requires them to be paid as a lump sum.
- 4.2 In the event of a voluntary termination, (the council decides to 'walk away from the contract) the contract requires that the agreed termination costs are payable in full within 40 days of the termination date. The contract also requires them to be paid as a lump sum.
- 4.3 This means that if the County Council decided to voluntarily terminate the contract in 2013 it would have to meet in full the agreed cost within the 2013/14 accounts.
- 4.4 In both circumstances, the Authority has to comply with statutory accounting requirements. This means that at the same time it took a decision to voluntarily terminate the contract, it would have to create a financial provision in the Council's accounts for the full costs of doing so. It must also show where the money was coming from to meet those costs in order to keep the Council's Budget in balance.
- 4.5 In law, the Council is not allowed to have an unbalanced budget so it cannot show termination costs without, at the same time, showing where the money was coming from to meet those costs. The Council therefore needs to consider how it will fund any termination costs.
- 4.6 As Head of Finance, powers conferred by Section 114 of the Local Government Finance Act 1988 requires me to ensure that the Council sets and maintains a balanced Budget. In the event that the Council incurred expenditure that created an unbalanced Budget I would be required to issue a report to the Full Council under section 114 of that Act. The Council would be prevented from incurring that expenditure until it had considered that report. This would have to be within 21 days of the issue of the report.

##### **(ii) Funding the Termination Costs - Options**

###### **Borrowing**

- 4.7 The voluntary termination cost has to be accounted for as revenue expenditure and, therefore, it is not possible to treat the cost as capital in

nature and finance it from borrowing since the expenditure does not create an asset.

- 4.8 If a Council finds itself for whatever reason in extreme financial difficulty, it is possible to apply to the Department of Communities and Local Government for a 'capitalisation direction.' This is an approval to borrow for revenue purposes. An application carries no guarantee of success if one were made to meet voluntary termination costs and due to the Government's approval criteria it is, in my view, unlikely to be successful.

### **Council Tax**

- 4.9 For exemplification purposes only, on the assumption that a decision is made in 2013, then it is not possible to finance the cost by an increase in council tax in 2013/14. The County Council is not legally allowed to change the level of council tax for a financial year once it has been set in February. For information, a 1% increase in council tax would generate some £3m additional revenue. Council tax increases are subject to referendum should they exceed a level prescribed by the Secretary of State which for 2013/14 was 2%.

### **Reserves**

- 4.10 At 31 March 2013, the Council holds in its own right, some £112m of cash backed provisions and reserves. It holds a further £49m for schools provisions and reserves which are earmarked for schools purposes only and could not be used to meet voluntary termination costs.
- 4.11 Of the County Council's £112m, £21m is set aside to meet known liabilities and is needed to comply with statutory accounting requirements regarding the Council's future financial obligations. If the Council were to use these to meet termination costs, that use would draw adverse comment from the External Auditor.
- 4.12 The remaining £91m is made up of 'earmarked County Council reserves'. This is not 'cash for a rainy day' but represents amounts set aside to meet specific future liabilities such as the Highways Maintenance Reserve. The Council's Policy on Provisions and Reserves is set out in the Budget Report to Cabinet in January each year and as part of the budget approval process, the Head of Finance is required to comment on their level to reflect the risks they are intended to cover. For information, the County Council holds below average levels of reserves compared with other shire counties, but their level is considered by the Head of Finance to be 'adequate and appropriate'.
- 4.13 Whilst reserves are kept under ongoing review, a recent thorough review of reserves and provisions has been undertaken by the Head of Finance to consider whether any could be made available in the short term to meet termination costs. That review has identified that in extremis and in the short term, a sum of some £40m could potentially be made available. However, because all of the Council's reserves are held for specific purposes, a replenishment plan would need to be put in place for most of the reserves should any be used to meet termination costs. That replenishment would add to future financial pressures.

- 4.14 Finally, the Council holds an un-earmarked reserve, 'General Balances.' The minimum level of General Balances was increased as part of the 2013/14 budget to a sum of £16m. The increase reflected additional financial risk for the Council around e.g., changes to government funding for local councils and changes to council tax and other benefits. At 31 March 2013, the actual level of available General Balance is some £20.8m after excluding known commitments in 2013/14. This is £4.8m in excess of the minimum level.
- 4.15 More generally, the use of reserves to meet termination costs will weaken the financial standing of the Council and its flexibility to respond to future financial challenges. In addition, the use of reserves is highly unlikely to meet the full cost of termination due to:
- the estimated amount (based on experience elsewhere) of the voluntary termination cost;
  - the Council's existing commitments and financial risks that need to be managed and which are covered by reserves.

## **5. In Year Service Reductions across all services and across the County as a whole**

- 5.1 A decision to voluntarily terminate the contract in 2013 will therefore require the Council to find an amount, after using reserves, from current service budgets in 2013/14.
- 5.2 Since those budgets are set and delivery underway, the later in the year this is, the harder it will be to achieve the level of required saving.
- 5.3 However, as noted above, the Council would also have to put in place a plan to replace any reserves that had been used. This is likely to need a two to three year implementation period. The authority would need to add these costs to the forecast savings requirement for the same period which currently stands at £144m.
- 5.4 Members would need to decide what services to cut in year to achieve the necessary savings. Although in the main they would represent one off reductions, they would come on top of the ongoing savings required to meet the estimated future funding gap 2014-17 of £144m.
- 5.5 It is probable that in order to deliver the required in year savings to meet termination costs, the Council will also incur other costs such as the redundancy costs of staff and potentially, termination costs on other existing contracts.

## **6. Summary**

- 6.1 In order to meet the legal requirement for a balanced budget, if a decision to terminate the contract is made, Council approval is also required at the same time to meet the cost of termination. This could be met from a combination of reserves and service reductions. However, the cost of voluntary termination is likely to be of such a scale as to have very significant adverse impact on both day to day services and the current sound financial standing of the Council.

- 6.2 The Council is currently seeking savings of £68m in 2014/15 and some £144m over the period 2014-17.
- 6.3 Assuming Council agreed to free up some £40m of reserves to meet an element of the voluntary termination cost, service savings across Norfolk of some £49m (indicative figure only) in 2013/14 would also be required on top of the savings already in plan. Those savings would need to be identified and delivered in a very short space of time (in year).
- 6.4 As also noted in this briefing, the Council would need to replenish its reserves at a cost of another £12m per annum. This could only be found from further service savings across Norfolk.
- 6.5 In summary, the financial assessment is that the scale of service savings required to meet the cost of termination and replenish reserves, coming on top of £144m currently being planned for the next three years, would represent a very considerable challenge, require very significant reductions in services across the whole of Norfolk and weaken the currently sound financial standing of the Council.
- 6.6 In addition, voluntary termination would represent a material change to the PFI grant conditions agreed with DEFRA and could lead to the withdrawal of the £169m grant from DEFRA. This would be financially disadvantageous to Norfolk taxpayers.
- 6.7 In making a decision on this matter, Members need to have regard to their responsibility for achieving value for money for Norfolk taxpayers

**Paul Brittain**  
Head of Finance  
31 May 2013

## Annex C

### Budget cost of cancellation of the Existing scheme

	2013-14	2014-15	2015-16	2016-17	Total
Termination	25.90				25.90
Re-procurement		1.50	1.50		3.00
Higher cost of alternative scheme	not available	not available	not available	not available	not available
	<u>25.90</u>	<u>1.5</u>	<u>1.5</u>	<u>0</u>	<u><b>28.9</b></u>

**NOTE TO ALL MEMBERS OF NORFOLK COUNTY COUNCIL**

**FINANCIAL AND STATUTORY IMPLICATIONS**

**OF THE TREATMENT OF WASTE CONTRACT**

**Report by the Interim Head of Finance**

**1. Purpose of Note**

1.1 To provide advice, so that any decision is soundly based in terms of finance and the statutory provisions. To this end, the paper is structured around the following three issues:

1. The law, with regard to the legality of expenditure.
2. The financial context in which such a decision would be situated.
3. The consequent advice of the Council's Chief Finance Officer, also known as the S151 officer.

**2. The law, with regard to the legality of expenditure**

2.1 Under Section 28 of the Local Government Act 2003, local authorities are required to monitor their budgets during the financial year, and must take remedial action if this is necessary because of potential overspendings and/or potential shortfalls in income. There is not an option to delay a decision.

2.2 Under Section 114 of the Local Government Finance Act 1988, the Chief Finance Officer shall make a report if it appears to him that:

- i. the authority has taken, or is about to take a course of action which, if pursued to its conclusion, would be unlawful and likely to cause a loss or deficiency (114/2b).
- ii. the expenditure of the authority incurred in a financial year is likely to exceed the resources (114/3).

2.3 The Local Government Act 2003 (Section 27) requires each local authority's Chief Finance Officer to report to the authority if it appears likely that the authority's reserves will fall below the prescribed minimum level, and to explain why this is likely to happen, and what action should be taken.

2.4 In summary, the Council has to ensure its spending is within Council's agreed budget and that its reserves are not likely to fall below the minimum level, both immediately and in the longer term.

### 3. The financial context

- 3.1 The reserves that are available for unforeseen events stands at £20.811m. However, the prescribed minimum level is £16m. Termination would take the Council's reserves below the prescribed minimal level which would trigger the events set out at para 2.2 above.
- 3.2 In the medium term, 2014-17, the Council has to identify £189m of savings. To date, it has identified £140m, subject to consultation. It has still to identify £49m. The addition of a further £28.9m of savings over the planning period significantly increases the size of the gap, for which no compensatory savings have been identified. Such a decision would require the identification of those savings, to show that course of action is lawful and affordable.
- 3.3 There is one further matter that has to be considered. The LGA advice is that the period of Government funding reductions is likely to continue until 2020. The level of savings in later years may be understated. The recent experience is that the level of savings required from local government has increased from previously announced planning figures. Also, local authorities are finding it increasingly difficult to successfully deliver their saving plans.
- 3.4 Significantly increasing the level of future savings, from £189m to at least £217.9m is, in the current financial context, financially ill-advised.

### 4. The consequent advice the Council's Chief Finance Officer

- 4.1 If the County Council rejects the Revised Project Plan, it will trigger the costs of £28.9m. These costs are in excess of its ability to fund them in 2013-14, and most likely over the planning period 2014-17.
- 4.2 It is a financial step too far, such that it would trigger a Section 114 notice.
- 4.3 The S114 process, **starts** with the sending of 'the report' (S114/4), which has to go to:
- The Council's external auditor;
  - Every Councillor;
  - The Chief Executive/General Manager
- In preparing the report, the CFO should (if practicable) consult with the CE and the Monitoring Officer (S114/3A)
- 4.4 **Second step.** A Council meeting is required, which should take place within 21 days from the issuing of the report. (S115/3)
- 4.5 **Third step.** The Council shall decide if it agrees or disagrees with the report, and what action to take (if any) (S115/2).

4.6 **In the meanwhile**, the Council's scope for action is constrained in the period "report issue and meeting resolution", as follows:

- If the grounds for the report is 'future loss' (S114/2b) the proposal cannot be pursued (S115/5).
- If the grounds for the report is an 'in-year loss' (S114/3) the Council cannot enter into any new expenditure agreements (S115/6).

In this case, both conditions apply, so the proposal cannot be implemented immediately and the Council would have to institute a spending freeze on new proposals during the 21 days.

## **SUMMARY**

The S114 process is not instantaneous. It is designed to help the Council avoid an unlawful act. There is the risk that during the S114 notice period, termination would occur. The unaffordable costs would be incurred and emergency action to fund those costs would have to be implemented, as set out in the accompanying paper at 5.5.

**Peter Timmins**

Interim Head of Finance

October 2013 F:131014 V5



**FINANCIAL REPORT**  
**COMPARING THE 'WILLOWS' INCINERATOR WITH AN**  
**ALTERNATIVE PROPOSAL OFFERED BY REBEL GROUP**

**Dr CHRIS EDWARDS,**  
**SENIOR FELLOW, UNIVERSITY OF EAST ANGLIA**

**For**  
**Cllr RICHARD (TOBY) COKE, NORFOLK COUNTY COUNCIL**

**27<sup>th</sup> September 2013**

This report is provided for the use of Councillor Coke (Leader of the UKIP Group) at Norfolk County Council. Dr Edwards is not a member of UKIP and not affiliated with the Party in any way.

## Introduction

This report investigates whether Norfolk County Council would save money by replacing the 'Willows' incinerator contract with an alternative such as the Rebel Group proposal for exporting Refuse Derived Fuel to Amsterdam.

The report does not imply there is only one option available to the Council. There may well be other viable alternatives or combination of options. Implementing the proposal analysed in this report would give Norfolk County Council ample time to arrive at a sustainable long-term solution for Norfolk's waste. (Councillor Richard Toby Coke)

## Excess capacity in incineration in northern Europe and the implications for the proposed incinerator at King's Lynn.

Chris Edwards, September 2013<sup>1</sup>

### Main points

1. Rebelgroup has made an offer (acting as agents to Afval Energie Bedrijf or AEB, a company operating an incinerator in Amsterdam) to take black bin waste from the Norfolk County Council's (NCC) waste transfer stations for between £75 and £85 per tonne. This price is between £24 and £34 per tonne below the price of £109 per tonne payable in 2015 to Cory-Wheelabrator (CW) by the NCC for the proposed incinerator at King's Lynn.
2. As a result of the growing over-capacity in incineration, it is likely that the offer from AEB will be replicated over the next decade by other incineration plants not just in the Netherlands but also in Germany and even the UK. The contract price of £109 per tonne payable to CW by the NCC is highly likely to turn out to be a very bad deal.
3. But here I take the Rebelgroup price as a marker and ask the question; what does this mean for the NCC and Norfolk? It is clear that the NCC would save £123 million from taking up the offer from AEB (of £80 per tonne) compared to the cost of incineration at King's Lynn (of £109 per tonne). This saving is based on a tonnage from NCC of 170,000 tonnes per year over 25 operating years from 2017 to 2041 and is in 2015 prices.
4. Does this mean that the NCC should cancel the contract with CW and switch to AEB? The answer is 'probably not - at least not in narrow financial terms' since if the contract with CW were to be cancelled, the NCC would lose the Waste Infrastructure Grant (WIG, formerly called the Private Finance Initiative credit) payable by the UK government to the NCC in respect of the King's Lynn incinerator.
5. The WIG amounts to £169 million payable over 25 years. What is this worth in real terms (2015 prices)? Assuming the first payment is received by the NCC in 2014 and assuming an average rate of inflation of 2.7% per year<sup>2</sup>, the WIG would be worth £128 million in 2015 prices. For the way in which this £128 million is arrived at, see Appendix 1. £128 million is £5 million more than the saving from the switch to AEB so there is a clear monetary incentive for the NCC to stay with the CW contract.
6. But the monetary incentive is even larger than £5 million when two further factors are considered. One is a loss to NCC from its share of electricity income

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<sup>1</sup>. Chris Edwards is a Senior Fellow at the University of East Anglia. This is the seventh revision of an original draft. Any comments on this paper should be sent to [c.edwards4@btinternet.com](mailto:c.edwards4@btinternet.com)

<sup>2</sup>. 2.7% per year was the average growth in the consumer price index (CPI) over the ten years from January 2003 to January 2013. For the details of the value of the WIG, see Appendix 2 of this paper

produced by the King’s Lynn incinerator. This would amount to a maximum of £15 million over 25 years. To see how this is calculated, go to Appendix 2. The second factor is the cost which may be incurred by the NCC as a result of cancelling the contract with CW. Current estimates of these compensation costs range from £20 million to £90 million. At the moment the process through which the contract was arrived at by the NCC is being investigated by Jonathan Acton Davis, QC and it may be that the NCC can make a claim for negligence against the companies advising NCC on the incinerator contract. However unless the cancellation costs were more than offset by any claims for negligence, it is clear that the NCC has little monetary incentive to cancel the contract and switch.

**7. Therefore, if we view the incinerator from the narrow financial viewpoint of the NCC, there is a clear monetary incentive (amounting to between £40 million and £110 million over 25 years) for the NCC to go ahead with the contract with CW.**

8. Of course as far as Norfolk is concerned, there will be pollution costs associated with the King’s Lynn incinerator. There are two types of pollution cost. One is the emissions of greenhouse gases in the form of carbon dioxide. These are costs which are not borne solely or even mostly by the people of Norfolk. However the second type of pollution costs are those in the form of particulates, dioxins and related chemicals. These are discussed in some detail in a memorandum submitted in 2007 to the UK Parliament’s Environment, Food and Rural Affairs Committee by Professor Dearden (see Dearden 2007). These represent a form of pollution which would affect the lives of many of the people of West Norfolk which is of course a factor why so many of them voted against the incinerator - see Appendix 3.

9. What would these environmental costs (from chemicals) amount to? This issue is discussed in Appendix 4, but to cut a long story short, we do not know for certain. Using a peer-reviewed study in the Netherlands, the estimated cost of the pollution likely to exclusively affect the people of West Norfolk is £6.6 million per year. Over 25 years, this amounts to £165 million.

10. Bringing the figures together, we have a picture as summarised in Box 1.

**Box 1 The gains and losses to Norfolk from cancelling the contract with CW (£ million in 2015 prices)**

The gain to the NCC from the Rebelgroup offer	123
The loss from the withdrawal of the WIG	-128
The loss from the share of electricity revenue	-15
The loss from the compensation costs of cancelling the contract	-20 to -90
<b>The loss to the NCC from switching</b>	<b>-40 to -110</b>
<b>The environmental gain to the people of West Norfolk from cancelling the CW contract</b>	<b>165</b>

11. The loss to the NCC from switching from CW to the AEB (Rebelgroup) offer is between £40 million and £110 million. But this needs to be considered in the context of a cost of pollution exclusively affecting the people of West Norfolk which is estimated as £165 million over 25 years. Furthermore, without the WIG (the Waste Infrastructure Grant), the NCC itself would save between £18 and £88 million.

12. Clearly there is a strong case for the withdrawal of the WIG by the UK government, since the situation would seem to contravene number 12 of the government's Criteria for Securing Waste PFI Credits which states that "*the project continues to deliver value for money in relation to the biodegradable municipal waste being managed through it*" (DEFRA, August 2007). The King's Lynn site does not provide value for money and it is probable, therefore, that the government has a case for withdrawing the WIG.

13. The problem of the WIG is that it is giving a wrong price signal to the waste disposal market. It is not the only wrong price but it adds to the problems posed by the even larger tax on biodegradable waste going to landfill, as Box 2 explains.

#### **Box 2 The wasteful price signals in the UK's waste disposal industry.**

A quick look at a few figures on incinerators and landfill reveals the way in which what is profitable to a county council like Norfolk is hopelessly uneconomic from the viewpoint of the UK economy.

Let's start with the WIG, the grant for the incinerator from the UK government to Norfolk County Council. This represents a subsidy to the incinerator of £30 per tonne (in 2015 prices). This is in addition to the tax on biodegradable MSW going to landfill which in this tax year (2013/14) is £72 per tonne. Since there is no tax on incineration in the UK, and since the landfill tax is due to rise to £80 per tonne in the next tax year (2014-15), the subsidy to incineration in 2014-15 sums to £110 per tonne once the value of the WIG is included.

This is a massive subsidy for incineration compared to landfill and makes little or no sense, since the average gate fees for incineration in the UK are four to five times the average gate fees for landfill. Average gate fees for landfill in the UK are £21 per tonne whereas average gate fees for incineration in the UK are between £68 and £111 per tonne depending on the annual capacity. These gate fees are for 2012/13 and taken from WRAP, 2013.

Therefore the difference between the gate fees for landfill and gate fees for incineration is between £47 and £90 per tonne. The average excess is £69 per tonne. But from this we need to subtract the value of energy produced by incinerators. Here we use the figures from the proposed incinerator at King's Lynn. As shown in Appendix 2, the energy produced from this incinerator is likely to be worth about £7.65 million per year. This is equivalent to just under about £29 per tonne of waste incinerated for the 268,000 tonnes of annual capacity.

Deducting this, gives us an additional cost of incineration compared with landfill of about £40 per tonne. If we apply this excess cost to the incinerator at King's Lynn with its capacity of 268,000 tonnes per year, we get an excess cost of £10.7 million per year or £268 million over the 25 operating years.

Furthermore given that the environmental costs (pollution from carbon emissions and particulates) of incinerators are at least equal to those from landfill (see Dijkgraaf and Vollebergh 2004, 240 and Defra June 2011, 14), the £268 million figure may be an underestimate. As a report by the OECD on 2007 put it; *“estimates in both countries [UK and the Netherlands] indicate that the environmental harm caused by a modern landfill and a modern incineration plant are of a similar magnitude, while the costs of building and operating an incinerator are much higher than the similar costs for a landfill”* (OECD 2007). The same OECD report went on to say that *“some reconsideration of the current preference being given to incineration could be useful”*

As a result, due to the absurd pricing system for waste disposal in the UK, a relatively small incinerator (such as that proposed for King's Lynn) raises the cost of waste disposal to the UK economy by just under £11 million per year. Imagine what the excess cost of incineration is if applied to *all* the incinerators in the UK.

14. It is this distorted pricing system for waste disposal that creates a situation where what is good for the incinerator industry and may even be financially attractive for County Councils is bad for the UK economy.

15. It is the enormous subsidy for incineration which has generated a rapid growth of incinerator capacity in the UK - a 'Dash for Ash' as a report in the Independent newspaper of December 28, 2010 put it. A report by Eunomia in 2012 has forecast an overcapacity of waste treatment of just under 7 million tonnes in the UK when the facilities that have planning consent come into operation (see GAIA, 2013,10). The same trend has occurred in other North European countries. The GAIA report states that there is already excess incineration capacity in Germany, the Netherlands, Sweden and Denmark (GAIA 2013 10-12, see also Letsrecycle, November 2009).

16. The sharp competition extends also to Scandinavia. In 2010 there was competition between Norway and Sweden for waste for incinerators. In October 2010, Norway abolished its tax on waste incineration in response to Norwegian incinerators running short of waste with the waste being exported to Sweden. In response, on the same day, Sweden abolished its tax on waste incineration.

17. The GAIA report points out two outcomes of this overcapacity, namely ....

(a) the raising of recycling rates is discouraged, as is the prevention of waste even though both prevention and recycling are higher than incineration in the waste hierarchy (GAIA 2013, 3)

(b) the shipping of waste between countries is encouraged, even though this contradicts the principle of proximity set out in the EU's Waste Framework Directive (GAIA 2013, 2)

18. If the NCC goes ahead with the proposed incinerator at King's Lynn, both of these outcomes are likely to apply. The Council will slow down in its efforts at recycling in order to meet the contract tonnage of 170,000 tonnes per year and the King's Lynn plant (being on the western edge of Norfolk) will violate the proximity principle.

19. But a further likely outcome of the excess capacity is (as stated at the beginning of this report) is a fall in the price per tonne for incineration. In 2009, in the eastern half of Germany incineration charges were reported to be as low as £40 per tonne while the lowest prices in the south of Germany were £65 per tonne. These prices compare with the £109 per tonne to be paid in 2015 at King's Lynn. It is likely that the result of the growing excess capacity in incineration will be that the charges for incineration will continue to fall and the NCC's contract with CW will turn out to be increasingly over-priced.

20. This means that the WIG payable to the NCC will more and more starkly violate the value for money principle. Therefore the UK government should withdraw the WIG. If this were done, the NCC would find it financially as well as environmentally worthwhile to cancel the contract with CW.

## Main report

### 1. The purpose of this report

Rebelgroup has made an offer to take black bin waste from waste transfer stations in Norfolk for between £75 and £85 per tonne. This offer relates to a minimum annual tonnage of around 40,000 and for a contract of at least three years. The waste would be exported from Norfolk to Amsterdam.

The purpose of this short report is to set out the cost savings (if any) from Norfolk County Council taking up such an offer.

### 2. Details of the offer from Amsterdam

The offer has been set out in a letter from Phil Pacey of Rebelgroup to Richard (Toby) Coke, a Norfolk County Councillor and leader of the UKIP group in the Council. The two-page letter which was received by Toby Coke in June 2013 sets out more details of the offer. Rebelgroup are advisers to Afval Energie Bedrijf (Waste and Energy Company) or AEB for short.

AEB is a company wholly owned by the Amsterdam public authorities and operates an incinerator in Amsterdam with an annual capacity of 1.4 million tonnes. More details of AEB (in English) can be found on its website at [www.amsterdam.nl/aeb/english](http://www.amsterdam.nl/aeb/english).

Phil Pacey's letter states that "*a formal commercial offer would only be possible should the council invite it through an open tender procedure*". However AEB's incinerator in Amsterdam has an annual capacity of 1.4 million tonnes and the letter states that AEB has sufficient surplus capacity to handle the full annual tonnage from Norfolk.

The waste would be shredded and baled at one or more waste transfer stations in Norfolk in preparation for export. The resulting Refuse Derived Fuel (RDF) would be compliant with the requirements of the necessary export licence. The RDF would be exported from a strategic seaport such as Great Yarmouth and/or Kings Lynn to Amsterdam in ships of around 3,000 tons.

### 3. The implications for the NCC

Box 3 below compares the year-by-year costs of the contract with Cory-Wheelabrator with the costs of a contract with AEB. The assumptions are set out in the box.



### Box 3 Cost comparison - Cory-Wheelabrator versus AEB

#### Assumptions

1. The costs are compared over 25 years from 2015 as year 1 through to 2041 as year 27
2. The incinerator at Kings Lynn is constructed over 3 years (2014 to 2016 inclusive) and starts operating at the beginning of 2017 (year 3)
3. The charge by Cory-Wheelabrator for incineration at Kings Lynn is £108.9 per tonne in 2015 rising in line with inflation
4. The charge by AEB is £80 per tonne in 2015, rising in line with inflation
5. The metric tonnage incinerated in each year from 2017 to 2041 is 170,000 (the annual tonnage contracted with Cory-Wheelabrator). In the *Final Business Case* for the incinerator, Norfolk County Council assumes that its residual municipal solid waste (MSW) will remain at about 214,000 tonnes from 2011 onwards

#### Costs

The total costs of incineration (in 2015 prices) over the 25 operating years from 2017 to 2041 inclusive (for 170,000 tonnes) are;

	£m
Kings Lynn (Cory-Wheelabrator)	463
Amsterdam (AEB)	340

We can see that the saving from the AEB offer would be £123 million over the 25 operating years. These costs are in 2015 prices so that for Cory-Wheelabrator, they amount to 170,000 (tonnage) \* 25 (operating years) \* £108.9 (the charge per tonne) giving a total of £462.8 million. For the Amsterdam cost, we simply substitute £80 for £108.9.

Therefore the gain to the NCC from the switch would be £123 million. However the economic calculation is not as simple as this. If the contract with CW is cancelled by the NCC, the NCC would lose in three other ways. First it would lose the WIG. Second it would lose its share of electricity production from the incinerator at King's Lynn. Third, it would have to pay compensation to CW for cancelling the contract.

The losses from these three were set out in Box 1 where it was shown that the loss to the NCC from cancelling the contract with CW would be between £40 million and £110 million. The real value (in 2015 prices) of the WIG to the NCC is £128 million so a withdrawal of the WIG by the UK government would produce a very different picture.

Some of the recent history of the incinerator is given in Appendix 3 of this paper. In brief, the most important point to note is the change in political control in May 2013. Before May 2013 the Conservative Party held more than 60% of the seats on the Council. Now it holds less than 50% and the administration comprises a Labour/Liberal Democrat coalition with a Labour leader.

Given this political change, the termination of the contract with CW has become a real possibility. Clearly the over-capacity in incineration in northern Europe (including the UK) is producing a situation in which incineration prices are likely to fall and the NCC's deal with CW will increasingly look like a very bad deal.

This means that the WIG will be given to support a contract which provides poor value for money thereby violating one of the principles supposedly behind the WIG

Without the Waste Infrastructure Grant, the County Council would save between £18 million and £88 million from cancelling the contract and switching to the AEB. In addition the environmental costs suffered directly and exclusively by the people of West Norfolk and estimated here to be £165 million would be avoided. Given this, it is perhaps not surprising that the people of West Norfolk voted so overwhelmingly against the proposed incinerator at King's Lynn.

## Appendix 1 The Waste Infrastructure Grant in 2015 prices

The following table shows the value of the Waste Infrastructure Grant payable by the UK Government to the NCC in 2015 prices, assuming a rate of inflation of 2.7 per cent per year. The latter was the average rise in the Consumer Price Index (CPI) between January 2003 and January 2013.

year	year	Waste infrastructure grant-----		
		£m	Price index (2015=100)	£m in 2015 prices
2014	1	6.76	97.4	6.94
2015	2	6.76	100.0	6.76
2016	3	6.76	102.7	6.58
2017	4	6.76	105.5	6.41
2018	5	6.76	108.3	6.24
2019	6	6.76	111.2	6.08
2020	7	6.76	114.2	5.92
2021	8	6.76	117.3	5.76
2022	9	6.76	120.5	5.61
2023	10	6.76	123.8	5.46
2024	11	6.76	127.1	5.32
2025	12	6.76	130.5	5.18
2026	13	6.76	134.1	5.04
2027	14	6.76	137.7	4.91
2028	15	6.76	141.4	4.78
2029	16	6.76	145.2	4.66
2030	17	6.76	149.1	4.53
2031	18	6.76	153.2	4.41
2032	19	6.76	157.3	4.30
2033	20	6.76	161.5	4.18
2034	21	6.76	165.9	4.07
2035	22	6.76	170.4	3.97
2036	23	6.76	175.0	3.86
2037	24	6.76	179.7	3.76
2038	25	6.76	184.6	3.66
<b>Total (2014-2038)</b>		<b>169</b>		<b>128.4</b>

We can see that the value of the WIG in 2015 prices is £128 million.

## Appendix 2 NCC's revenue from the electricity produced by an incinerator at King's Lynn

Page 76 of a briefing paper by the NCC Cabinet dated March 7 2011 indicates that the NCC's share of electricity would be 50% of that produced from non-guaranteed waste. The rest would belong to CW. How much then is the non-guaranteed waste?

Clearly the 170,000 tonnes to be supplied by the NCC to CW is guaranteed waste. How much of the remaining 98,000 tonnes is guaranteed waste?

The original bid from Amey-Cespa for the Norfolk contract included a guaranteed 55,000 tonnes per year of third party waste from Cambridgeshire. It is highly probable that CW will have secured such a guarantee so it is reasonable to assume that CW would get at least this amount of third-party waste guaranteed.

Therefore the guaranteed waste is 55,000 tonnes plus the 170,000 tonnes from the NCC giving a total of 225,000 tonnes. Subtracting this from the total annual capacity of 268,000 tonnes gives a **maximum tonnage of non-guaranteed waste** of 43,000 tonnes. In fact it is likely to be less than this, but here we stick with this figure of 43,000 tonnes.

On this basis, NCC's share of electricity output from the incinerator would be 50% of 43,000 tonnes equals 21,500 tonnes which is 8% of the total of 268,000 tonnes.

Now we need to see what the value of the incinerator's electricity production is likely to be.

CW papers talk about 4 weeks of shutdown per year. The permit application to the Environment Agency refers to a capacity of 21.1 MW. If we use these figures, the electricity produced by the incinerator if it operated at 100% efficiency for the 48 weeks is estimated as follows;

$21.1 \text{ MW capacity} * 48 * 7 * 24 = 170,000 \text{ MWh a year.}$

This assumes that the incinerator is working in 'electricity only' mode and not in 'the CHP' mode. Working in CHP mode reduces the electricity going to the grid (to about 62% of the 'electricity only' mode), but the drop in revenue from electricity production would be offset by income from Renewable Obligation Certificates (ROCs). However we can ignore this complication, since Palm Paper is going ahead with its own CHP scheme so it seems that the incinerator will operate in 'electricity only' mode. **This means that the incinerator will not be eligible for ROCs.**

So we return to the 'electricity only' mode. What is a reasonable efficiency to assume?

Colleagues of mine who are engineers say that it is reasonable to assume an efficiency of 90%. This means that the electricity produced would be  $170,000 \text{ MWh per year} * 90\% = 153,000 \text{ MWh per year}$ . This compares with a figure of 155,000 MWh a year derived from a paper by Dijkgraaf and Vollebergh written in 2004. In their paper, the output of electricity was assumed to be 580 kWh of electricity per

tonne of waste (page 238). For the King's Lynn capacity of 268,000 tonnes, this implies an electricity production of 155,000 MWh per year, very close to our estimate of 153,000 MWh per year.

Now we need to estimate the value of this production? The average wholesale price of electricity over the past two years (2011 to 2013) has been about £50 per MWh (see Business Electricity Prices website accessed in September 2013). This compares with a price assumed in appendix K of the Revised Outline Business Case (ROBC) of £35 per MWh (see page 178 of the ROBC). Here I assume a price of £50 per MWh which gives a value for a volume of 153,000 MWh per year of about £7.65 million per year.

As we have seen, the NCC would get 8% of this and 8% of £7.65 million per year is £0.6 million per year or £15 million over 25 years. This is the **maximum** value of electricity likely to be received by the NCC.

### **Appendix 3 The proposed incinerator at King's Lynn - the recent history**

Between 2009 and May 2013, Norfolk County Council was dominated by the Conservative Party and under the leadership of Derrick Murphy from October 2010, but in the elections of May 2013, the Conservative Party lost its overall majority.

The negotiations for a planned incinerator at King's Lynn have to be viewed within this political context. It was in March 2011 that Norfolk County Council's cabinet agreed to award a 25 year service contract to Cory Wheelabrator to build and operate an incinerator on an industrial site at Saddlebow near King's Lynn. Just under a year later (on January 18 2012), the Secretary of State for the Environment confirmed with a Promissory Note that a Waste Infrastructure Grant (previously known as a PFI credit) worth £169 million over 25 years had been allocated to Norfolk County Council to help contribute towards the cost of disposing of waste at the proposed incinerator.

About three weeks later (on February 7 2012), the County Council signed a contract with Cory-Wheelabrator. On the same day, a Waste Infrastructure Credit Letter was issued. **The contract was signed by the County Council before planning permission had been granted and in the face of massive opposition from the population of the Borough of King's Lynn and West Norfolk.** A referendum held across all West Norfolk resulted in 92% of the voters opposing the incinerator. The turnout exceeded 60% meaning that an absolute majority of the eligible electorate voted against the incinerator.

In June 2012 the County Council voted to grant planning permission for the 'Willows' application and in July 2012 the Environmental Agency granted an Environmental Permit to allow the proposed incinerator to operate. However, in August 2012, the Secretary of State for Communities wrote to the County Council to say that he had decided to call in the planning application for the incinerator. This Planning Inquiry was held between February 2013 and May 2013 with the Inspector's Final Report being expected by September 2013 and with a decision

expected from the Secretary of State for Communities on or before mid-January 2014

Up until 2 May 2013, the County Council was dominated by the Conservative Party. At the 2009 elections they won 60 of the 84 seats with 46% of the vote across the County. As a result of the May 2013 election, their share of the overall vote fell to 33% and they lost their overall majority. They now have 40 of the 84 seats. The administration now comprises a Labour/Liberal Democrat coalition with a Labour Leader of the County Council.

At the first post-election meeting of the Full Council on 13<sup>th</sup> May 2013 members requested that a report on the contractual penalties that would arise in the event of the County Council withdrawing from the incinerator contract be discussed at the next Cabinet Scrutiny Committee (CSC) meeting scheduled for June 2013.

The CSC meeting was held on June 4, 2013 and received a report on the contractual penalties but the meeting also heard concerns about the impartiality of advice from officers of the Council in respect of the consequences for the Council if the Council terminated the contract. On 10 June 2013, the Cabinet of the NCC following the recommendation of the CSC meeting agreed to commission a QC to report on the legal implications on each penalty scenario and a review of how the contract with CW was entered into. This report is now being carried out.

#### **Appendix 4 The cost of 'pollution' to the people of West Norfolk from an incinerator at King's Lynn**

Looking at Government sources such as the US Environmental Protection Agency (EPA) and the UK Health Protection Agency (HPA), there seems to be a lack of research on incinerator emissions, although they both generally consider 'well-managed' incinerators to pose little danger. However they also say that they cannot be certain. However there are peer-reviewed studies by respected scientists suggesting that even 'modern' incinerators have a negative impact on public health.

If it is problematic to assess the pollution impact, it is even more problematic to put a cost to it. The health impact of man-made particulate air pollution experienced in the UK in 2007 was estimated to cost between £8 billion and £20 billion per year but this is thought to be an underestimate since it only took account of mortality and excluded morbidity (Environmental Audit Committee, Report on *Air Quality*, 2009/10, 11). But using these figures gives a cost per head (for a UK population of 60 million) of between £130 and £350 per year, or an average of £240 per year.

If (and clearly this is a big IF) the incinerator at King's Lynn generated particulate air pollution equal to this UK average, then for a population of 50,000 in West Norfolk affected by the incinerator (the population of King's Lynn in 2007 was 42,800 and the population of West Norfolk in the same year was 143,500), this would amount to an average of  $£240 * 50,000 = £12.0$  million per year. This gives

an idea of the scale of the cost of particulate air pollution only; note that this figure of £12 million per year does not include the wider consequences of carbon emissions.

But this is a very crude estimate. A less crude estimate comes from a peer-reviewed study produced in the Netherlands in 2004 by Dijkgraaf and Vollebergh. They estimated that the cost of ‘pollution’ from an incinerator was 46 Euro per tonne of waste incinerated (page 240). They estimated that 38% of this consisted of emissions to air. Some of this 38% consists of acid rain emissions and nitrogen oxides, but here I take a conservative approach and include only the 62% as the environmental costs solely and directly affecting the people of West Norfolk. 62% of 46 Euro is 29 Euro.

The 29 Euro per tonne of waste incinerated relates to the year 2000. Using an exchange rate to the £ in 2000 of 1.65 (the Euro was much weaker in 2000 than it is now), this is equivalent to £17.6 per tonne of waste incinerated. Therefore, for the King’s Lynn annual capacity of 268,000 tonnes, the environmental cost in 2000 prices is £4.7 million a year. Between 2000 and 2015, the Consumer Price Index rose by 40%. Therefore in 2015 prices, the environmental cost of the ‘chemical’ pollution as given in the Dijkgraaf and Vollebergh study comes to £6.6 million per year. Over 25 years, this is equal to £165 million.

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# High Level Validation of Rebel Group Proposal to Norfolk County Council

Final Report to Councillor Richard (Toby) Coke

September 2013



## *Report for:*

Councillor Richard (Toby) Coke, Leader of the UKIP Group Norfolk County Council

### *Contact Details*

Eunomia Research & Consulting Ltd  
37 Queen Square  
Bristol  
BS1 4QS

United Kingdom

Tel: +44 (0)117 9172250

Fax: +44 (0)8717 142942

[www.eunomia.co.uk](http://www.eunomia.co.uk)

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## 1.0 Introduction, Scope and Context

Eunomia Research & Consulting Ltd ('Eunomia') has strong a track record of working with both UK and overseas operators in the residual waste management sector. We are currently providing advice to a range of organisations involved in the preparation, transportation, export and treatment of residual waste arising in the UK. As such, we have a good understanding of the UK market and are therefore well placed to also comment on the wider export market.

In January 2012, the Department of Environment, Food and Rural Affairs (Defra) formally agreed to help support Cory-Wheelabrator's proposal for the 'Willows' incinerator at King's Lynn using what are known as Waste Infrastructure Credits (formerly Private Finance Initiative - PFI - Credits) worth £6.7million per annum for 25 years. Norfolk County Council (NCC) subsequently signed a contract with Cory-Wheelabrator for the treatment of residual waste at the proposed Willow's incinerator in February 2012. The planning application for Willow's incinerator was subsequently 'called in' by the Secretary of State (SoS) and a public inquiry commenced on 26 February 2013 and continued until 17 May 2013. The Borough Council of King's Lynn and West Norfolk along with the King's Lynn Without Incineration (KLWIN) and many 3<sup>rd</sup> parties presented evidence as objectors to the scheme. The Secretary of State is expected to make a decision on the planning application by 14 January 2014.

A Cabinet paper from 2011 sets out the costs submitted by Cory Wheelabrator in their final tender to NCC.<sup>1</sup> The headline financial information presented indicates that the gate fee agreed between NCC and Cory-Wheelabrator is £108.90 (April 2015 price), rising (in line with RPIx) to an average gate fee over the 25 year period of the contract of £140.50.

NCC has recently been approached with an alternative proposal for treatment of residual waste from the Rebel Group (acting on behalf of Afval Energie Bedrijf - AEB).<sup>2</sup> This involves the production and export of solid recovered fuel (SRF) to The Netherlands for high-efficiency incineration. The goal of this short report on behalf of Richard (Toby) Coke, is to provide a high-level validation of the terms of the Rebel Group proposal and includes:

- Analysis of proposed contract gate fees (which include pre-treatment) in comparison to those seen in the wider UK export market;
- Analysis of the proposed contract duration and how this compares to current export contracts (or appetite for contracts from receiving organisations in The Netherlands) of which we are aware;

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<sup>1</sup> Leaked Cabinet Paper: Director of Environment, Transport, and Development Norfolk County Council (2011) *Cabinet Paper: Waste PFI Contract Award*, March 2011

<sup>2</sup> Rebel Group (2013) *Contingency Plans For The Disposal Of Norfolk's Municipal Waste and the Feasibility Of Exporting RDF To Amsterdam*, 30<sup>th</sup> June 2013

- Assessment of the likelihood of AEB or other overseas operators offering a contract without any guaranteed minimum tonnage (GMT), but with an exclusivity clause; and
- Analysis of whether the Rebel Group's proposal represents a realistic and potentially cheaper alternative to Cory-Wheelabrator's 'Willows' incinerator.

The Rebel Group proposal also references the potential for local employment and use of local port infrastructure, although consideration of such issues is outside the scope of our analysis. It can be surmised, however, that such possibilities exist and might be explored further by NCC should they consider the export market in more detail.

## 2.0 Summary of the Rebel Group Proposal

In its proposal, the Rebel Group rightly acknowledges that a formal commercial offer would only be possible from them should NCC invite bids via a formal tender procedure, in compliance with European Union (EU) procurement rules. Its proposal does, however, present the following high-level attributes of any offer they would make to NCC as part of any such procurement process:

- Annual tonnage would be flexible to increase or decrease, but with a guaranteed minimum tonnage (GMT) requirement of around 40 ktpa
- Receipt of waste by the contracting entity would be at a licensed waste transfer station within Norfolk;
- A gate fee of £75-85 / tonne, which would include the costs of:
  - Processing of residual waste into 'low-grade' SRF (shredding);
  - Preparation for shipping, which would include baling and wrapping of SRF; and
  - Transportation, which would include on-land transport to port, shipping, and any further transport in The Netherlands.
- A contract of at least 3 years' duration; and
- An alternative to landfill in Norfolk that could realistically be delivered within 12 months.

The most likely transportation arrangements for SRF would be the use of 'curtain-sider' trucks driven on and off a ferry, but the Rebel Group states that dedicated 'barges' carrying 3,000 tonnes per journey from Great Yarmouth direct into site in Amsterdam, would also be considered.

## 3.0 Analysis of Wider Export Market

### 3.1 Current Gate Fees

It should be noted that gate fees for SRF export are often quoted excluding either the costs of transport or those associated with fuel preparation (i.e. shredding, baling and wrapping, should these be required). In order to make comparisons with the Rebel Group proposal, therefore, it is important to ensure that the same elements are

included within any such assessment. As noted above, it should be emphasised that the cost proposed by the Rebel Group is fully inclusive.

During 2011, anecdotal evidence gathered by Eunomia suggested that more than one incinerator operator in The Netherlands was offering gate fees as low as €50/tonne (including transport) for low grade SRF from commercial wastes. The aim of this low rate was to fill spare capacity in the short-term. Our market intelligence suggests that the market has subsequently matured relatively quickly, such that commercial waste operators in the UK might currently expect to pay a gate fee of €60-68/tonne (£49-55) plus a transport cost of €15-20/tonne in the short term.

Commercial confidentiality means that there is little data published on gate fees for SRF export. Currently the only UK source is the recent study published by the Chartered Institution of Wastes Management (CIWM).<sup>3</sup> The data presented within the CIWM report is summarised in Table 1. This suggests that total costs are somewhere between €75 - €125/tonne (£63-106).

**Table 1: Export Costs Breakdown**

Costs Breakdown	Lower (€)	Upper (€)
Shredding	15	20
Baling and wrapping	5	10
On-land transport (up to 40 miles)	10	10
Administration and port costs	5	10
Sea transportation costs	0	15
Facility gate fee	40	60
<b>Total</b>	<b>75</b>	<b>125</b>

Source: Figures above are summarised from CIWM (2013) *Research into SRF and RDF Exports to Other EU Countries*, AMEC for CIWM, July 2013

Whilst the range presented in Table 1 is not particularly helpful (and we also believe the data relating to the lower end of this estimate is somewhat out of date) the central band of the range (i.e. €90-110/tonne or £80-100/tonne) is not dissimilar to our own understanding of the market, once shredding and baling costs (which we assume to be lower than presented by CIWM) are taken into consideration.

This suggests that the upper end of the offer presented by Rebel Group (£85) represents a reasonable representation of the full costs of SRF export in the current

<sup>3</sup> CIWM (2013) *Research into SRF and RDF Exports to Other EU Countries*, AMEC for CIWM, July 2013 <http://www.ciwm.co.uk/nmsruntime/saveasdialog.aspx?IID=13707&sID=22910>

market, albeit as discussed below, lower gate fees might be achievable depending upon the nature of contracts and spread of risk.

### 3.2 Future Gate Fees

It should be noted that the extent to which export gate fees might rise over time is not considered within the Rebel Group proposal. Our market intelligence suggests that these will be either index linked to either RPI or CPI (as is common practice with PFI contracts), or include an incremental increase of a set amount, which might broadly equate to CPI or RPI forecasts. In the long-term, therefore, NCC might expect gate fees to increase by 2-5% per annum.

The gate fees outlined in Section 3.1 assume, in terms of transportation, that curtain-siders are used to drive wrapped bales on and off a ferry to The Netherlands. Whilst the use of dedicated 'barges' may also be relevant, the use of curtain-siders and ferries is most likely, and it is therefore important to provide analysis of potential changes in related costs. The current depressed nature of global trade is such that there are two key factors which will influence such costs should the trade situation improve significantly:

1. At present, there is a lot of spare capacity on ferries and thus prices are somewhat lower than might be the long-term norm. As a result, in the coming years following (assumed) economic recovery, we could see these prices rebound, such that exports become less competitive with the domestic market; and
2. On the other hand, a certain amount of baled and wrapped SRF is currently 'back-hauled' to The Netherlands and Germany, following transport of finished goods to the UK. This suggests that any improvement in global trade could further reduce the costs of transport.

The balance of these two factors is such that even if there is a slight increase in the costs of SRF transport, the extent of this is unlikely to be significant.

### 3.3 Contract Duration

Our experience is that whilst, initially, overseas incineration facilities were entering into short term contracts of 1-3 years, the market has quickly matured. Whilst such short-term contracts are still being agreed, we are now seeing a desire for longer term contracts (potentially 10-15 years in some instances) as operators become more strategic in the way they aim to fill capacity gaps at large scale plant. As a result, some overseas operators are now focusing on the local authority market, as is the case in this instance with regard to the proposal from the Rebel Group (and AEB).

Longer-term contracts can be more attractive to operators, particularly where large tonnages are concerned. This is because a short-term contract for a large tonnage will result in a significant deficit in feedstock supply for the facility once the contract has expired. This can present significant risk to the operator, and therefore, most prefer a wider 'portfolio' approach. An additional factor is that a large proportion of incineration plant operating in The Netherlands, Denmark, Sweden and Germany have remaining operational lifespans of 10-20 years. Following any kind of procurement process run by NCC, therefore, we would expect the market to come

forward with offers of a longer contract term than the initial 3 years proposed by the Rebel Group.

### 3.4 Nature of the Contract

As stated above, the Rebel Group (and AEB) is offering the flexibility of waste to increase or decrease over the contract, but requires a guaranteed minimum tonnage (GMT) of 40 ktpa. Whilst a GMT will usually reduce the level of gate fees, many, overseas operators are willing to structure deals whereby they take 'exclusivity' on waste, rather than a GMT.<sup>4</sup> This kind of contract would require all residual waste generated by the local authority to be sent to the receiving facility, but allows the level of tonnage to rise and fall with no GMT.

Whilst such a contract may deliver a gate fee marginally higher than a contract with a GMT, the key benefits of such an approach is that it allows levels of recycling (and composting / anaerobic digestion) to increase over time, with no financial penalty to be paid by the local authority.

The gate fees quoted in Section 3.1 relate primarily to the commercial waste market. In the context of contract structures, therefore, the following should be noted in respect of differences which might apply to local authority contracts:

- If a GMT (or at least exclusivity) for a reasonable length of time is agreed, this can reduce gate fees compared with commercial waste contracts, which do not usually include meaningful penalties for non-supply of SRF; but
- On the other hand, contracts for export of SRF derived from commercial waste tend to have low levels of penalties for non-performance of the operator (for example, if a facility is not able to receive waste) in comparison with those associated with local authority contracts, which tend to place far greater risk on the operator. Consequently this can push up gate fees compared with those for commercial wastes.

The net effect of these two influences will depend upon the detail of contracts, each of which is likely to be different.

## 4.0 Key Messages

The key messages from our analysis can be summarised as follows:

1. The gate fee range of £75-85/tonne proposed by The Rebel Group falls within the range of gate fees Eunomia is currently seeing in the export market for SRF. Even at the higher end of this range, which we believe is more accurate, this is considerably less costly than the gate fee NCC has agreed with Cory-Wheelabrator;

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<sup>4</sup> This is possible as they have already financed their facilities, in contrast to most UK proposals



2. We would expect export gate fees to be indexed in a similar manner to the Cory-Wheelabrator-NCC contract, and whilst we may see a slight increase in transport costs during the next 5-10 years, this is unlikely to be significant;
3. Should NCC wish to export all of its residual waste (207,700 tonnes in 2011/12) as SRF, it would be likely to realise the lowest gate fee by agreeing a long-term (>10 year) contract, which would be most attractive to the market;<sup>5</sup>
4. It is likely that an SRF export contract granting exclusivity rather than a GMT would be possible, which would allow recycling rates to increase over time, which is likely to be in contrast to the Cory-Wheelabrator proposal. Equally, a contract could be concluded for a GMT much lower than in the Cory-Wheelabrator proposal, with virtually no risk of the GMT not being exceeded (even under the most optimistic assumptions regarding recycling and waste prevention); and
5. As acknowledged by the Rebel Group, NCC would only be able to agree a contract for export of SRF following a formal tender process in accordance with EU procurement rules. Despite this process it is still likely to represent a considerably cheaper alternative deliverable some years in advance of the 'Willows' planned service commencement date.<sup>6</sup> Indeed, we are confident that procurement of capacity at existing facilities can be undertaken in a streamlined manner, avoiding the excessive time, and client-side costs, of a typical PFI procurement.

To sum up, this brief analysis strongly suggests that taxpayers would be better off if Norfolk's residual waste was exported as SRF to existing facilities in The Netherlands (or potentially in other Member States) rather than it being sent to the proposed Willows incinerator.<sup>7</sup>

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<sup>5</sup> Albeit, if NCC was willing to take on the risk, it might realise the lowest overall priced by playing the spot market, agreeing 6-12 month contracts on an ongoing basis. Such an approach, however, would require significant ongoing management, and the risks presented are such that it is unlikely to be attractive

<sup>6</sup> Originally the Willows plant's planned service commencement date was April 2015. Currently, a revised date has not been agreed, albeit this would be unlikely to be before 2017

<sup>7</sup> It should be noted, however, that we do not have access to the contractual penalties which may be payable by NCC to Cory-Wheelabrator should NCC divert waste away from the proposed Willows plant. As a result, the analysis within this report does not take into consideration the impact of such penalties

## Residual Waste Treatment Contract – Revised Project Plan

Report by the Director of Environment, Transport and Development

### Summary

This paper is provided to facilitate a debate on the Revised Project Plan for the Residual Waste Treatment Contract. It explains:

- (a) The Plan essentially refreshes contract dates to address the delay to works caused by the Public Inquiry. The effect of the new dates is reflected in an updated price. The process, location and size of the facility remain unchanged, the contract conditions remain the same and the County Council's liabilities are not increased.
- (b) The contractor provided a draft Plan on 30 April 2013. This has been subject to negotiation to improve the price and ensure the County Council's liabilities did not increase in the final version of the Plan.
- (c) The original contract dates were for works to start in summer 2012 at the earliest with a provision for delay until summer 2013. If the project continues it is now not likely that works could start until spring 2014 at the earliest and possibly until late 2014. A service could start around 34 months later.
- (d) The effect of new dates is reflected in an updated price which is around 2.5% cheaper than if the project had gone ahead in June 2013. Compared to landfill costs, savings are expected to be at least £20 million over the contract period.
- (e) The Plan can be either accepted or rejected. 'No response' is deemed equivalent to rejection. The contract has been taken to mean this must be concluded by 29 October 2013.
- (f) Accepting the Plan is a continuation of the Cabinet decision in March 2011 for the contract award and preserves the status quo. It would mean that Communities Secretary would determine if the project goes ahead, is further delayed or does not get delivered through his independent review of the planning application.
- (g) If the Plan is accepted and the Secretary of State does not grant planning permission and the contractor does not challenge this, the County Council will have the right to terminate for failure to secure planning permission. This is if no allowance were made for further delay and the County Council did not expect to be able to secure permission within a reasonable period of around a year, i.e. by the new planning longstop date. In this scenario the County Council would have to make payments for termination for failure to secure planning.
- (h) If Cabinet, via a new decision, were to reject the Plan on grounds for termination for planning failure, this would trigger a payment to the contractor recently estimated as up to £25.9 million. This consists of contractor and bank costs capped at £20.3 million, a share of the Public Inquiry cost currently around £1.6 million and a cost most recently calculated at around £4 million relating to cancellation of arrangements to address the risk of foreign exchange and interest rates affecting the cost of the project. Such costs would be added to by those necessary to re-procure alternative facilities, the loss of a Government grant and the likelihood that alternatives could be more expensive e.g. exporting waste, transferring it to other treatment facilities or landfill.
- (i) Defra informed the County Council on 18 October 2013 that it was removing the £91 million grant, estimated to be worth around £169 million over the life of the contract, due to the delay experienced on the project. A decision on the planning application is expected from the Communities Secretary on or before 14/1/2014.

## 1. **Background**

1.1 A request for an Extraordinary Council Meeting was made by Councillors Toby Coke, Stan Hebborn, Andrew Boswell and John Dobson which outlined that:

*'The purpose of the meeting is for Members to receive the following reports:-*

- the independent QC's report and the financial expert's report commissioned by Cabinet;*
- a report from officers on contingency arrangements;*
- a report from the Head of Finance on implications for the County Council's budget position;*
- reports from Eunomia and from Dr Chris Edwards, both commissioned by Cllr Coke;*

*and:-*

- a) To consider whether to accept or reject the Revised Project Plan for the Energy from Waste contract and to recommend to Cabinet that they accept and act on the decision so made.*
- b) To approve the Minerals and Waste Site Allocation Plans.'*

This report is provided to help facilitate that debate at this meeting.

1.2 In line with the County Council's constitution, where required, any decisions relating to the contract are a matter for Cabinet.

## 2. **Background: Project Status**

### 2.1.1 **Defra's Decision to Remove the £91 Million Grant**

Defra notified the County Council on 18 October 2013 that due to the delay experienced on the project it had decided to remove the grant it had allocated to Norfolk. It's rationale for this action is that Defra no longer felt under an obligation to provide the grant because planning permission had not been secured by 10 June 2013. The failure to do so arose only due to the call in of the planning process by the Government's Communities Secretary, and that is the breach that has been referred to.

In addition, Defra has reviewed waste results and targets and concluded it did not have to continue to support Norfolk's project to help it meet national targets to move waste from landfill. As such the Defra view is that in the current financial circumstances the decision to withdraw the grant was justified.

2.1.2 PFI contracts are essentially Public Private Partnership type contracts but supported by a Government grant. Therefore as a decision has been made to withdraw the grant the contract could now be described accurately as a Public Private Partnership contract, in the same way as projects in Cumbria, Hampshire, Kent, Oxfordshire and Sheffield.

Defra had confirmed its grant award to Norfolk in January 2012 prior to the award of the contract in February 2012. The grant confirmed was for £91 million - which would have been worth £169 million to Norfolk over the 25 year contract period.

2.1.3 Defra confirmed on 10 July 2013 that 'there is no other equivalent funding stream within Defra to support local authorities in the same way and to the same extent.'

## 2.2 **Planning Permission**

The Secretary of State put in place an independent Public Inquiry to help determine whether the contractor should be granted planning permission to build the facility. This Inquiry ended on 17 May 2013 and the Inspector submitted a report on 30 September 2013 to the Secretary of State to allow his decision to follow in winter 2013/2014. The advertised date for a decision is on or before 14 January 2014.

## 2.3 **Permit to Operate**

The Environment Agency approved a permit to operate the facility in August 2012 after a series of public consultations on the contractor's application in July 2011. This saw the views of all stakeholders taken in to account. This permit award means that in the view of the relevant regulator, the facility would operate safely and not pose a threat to human health or the environment.

## 2.4 **Contractor's Ongoing Financial Commitment**

The service was expected to start in 2015. Due to the protracted nature of the planning process this is not going to happen. The contractor has therefore had to put in place plans and make arrangements to accommodate this delay. This includes ensuring there is still access to the required level of funds for the project (the capital costs are around £150 million), extending arrangements put in place to mitigate the effects of foreign exchange and interest rate changes, and ensuring suitable arrangements exist for specialist sub-contractors.

The contractor is not receiving any payment from the County Council in meeting these additional costs. It is doing so in the knowledge that if there were to be a termination, in certain scenarios not all of these extra costs would be recovered. This could see a very substantial loss to the Contractor, the amount of which is increasing by hundreds of thousands of pounds each month.

## 3. **The Plan**

### 3.1 **The Willows Power and Recycling Centre**

The waste treatment process, location and size of the facility remain unchanged.

### 3.2 **Dates**

The Plan is essentially a refresh of contract dates to accommodate the delay caused by the Public Inquiry.

The original dates were for works to start in summer 2012 at the earliest, with a provision for delay until summer 2013. If the process continues it is now not likely that works could start until spring 2014. This is the earliest justifiable time by which unchallengeable planning permission could be expected to be in place, but possibly due to further delay until late 2014. A service would start around 34 months after

works started and the contract end date is still 2040.

### 3.3 **Price**

The effect of the new dates is reflected in an updated price that following negotiations is 2.5% cheaper than if the project had gone ahead a year earlier in June 2013.

With the removal of the grant, and taking in to account the effect of delay, in 2017/18 the savings compared to landfill, are currently expected to be around £174,000. The total amount of saving rises to around £20 million over the life of the contract to 2040. In extra value for money terms, when the potential for additional income from electricity sales is taken in to account, these savings could increase by some further £2 million each year.

Unfortunately we cannot refer to the precise figure, either as a cost per tonne or a total contract value, because this would breach the County Council's contractual obligations to treat this information as confidential. However, the price remains cheaper than landfill without the benefit of the Government grant.

If the Plan were accepted, the actual cost at the time of financial close could increase or decrease. If the parameters for such variation were outside those agreed by Cabinet in March 2011, or were deemed unacceptable for any reason, Cabinet would be required to make a new decision, and this could include rejection. It is also possible that the plan could fail in the implementation stage, for instance if funders withdrew from the project.

### 3.4 **Liabilities**

The County Council's capped liabilities relating to termination for planning failure have remained as they were, i.e. £20.3 million. This is despite the contractor having to meet additional costs caused by the delay that would not be picked up by the County Council on termination for failure to secure planning.

## 4. **Acceptance of the Plan**

- 4.1 Accepting the Plan is a continuation of the March 2011 Cabinet decision for the contract award. It would preserve the current contractual situation and mean that the independent review of the planning application by the Secretary of State would determine if the project goes ahead, is further delayed or does not get delivered.

If the liabilities had increased or the contract price had gone significantly higher then Cabinet would have been required to make a new decision to accept the Plan. The removal of the Government grant on 18 October 2013 has had the same effect and is leading to Cabinet considering the Plan.

## 5. **Non Acceptance of the Plan**

- 5.1 Rejection of the Plan leading to termination of the contract would require a new Cabinet decision, as it would incur significant costs to the County Council and it is not covered by the original March 2011 Cabinet decision relating to the contract

award.

## 5.2 **Contract Implications of Rejection**

If the Plan is rejected, or no response is provided by the County Council, then the contract can be terminated for failure to secure planning permission. This would expose the County Council to:

- (i) The prospect of meeting a share of the contractor's costs up to £20.3 million which is a figure approved by the Government and agreed in the contract.
- (ii) The prospect of meeting around 90% of the contractor's public inquiry costs which are currently estimated at around £1.6 million.
- (iii) The cost or income generated from cancelling arrangements put in place to mitigate the risk of changes in foreign exchange and interest rates. The amount would be dependent on the prevailing financial conditions at the time, and based on the recent markets in September 2013 this was calculated to generate a cost of some £4 million previously calculated as more than £11 million in May 2013, when market conditions were different. The costs would only be confirmed on cancellation.

These detailed breakage costs payable on planning failure were extensively scrutinised by Members in the Cabinet Scrutiny meetings of 23 November 2010 and on 19 April 2011 as part of that Committee's call in procedure. In addition they were presented in reports considered by Cabinet, and the Environment, Transport and Development Overview and Scrutiny Panel in detail in November 2010 and January and March 2011.

Information was also provided to Cabinet Scrutiny on 04 June 2013 and Full Council on 07 June 2013.

The positions were approved by Defra when the competitive dialogue process was closed. Defra only allows this when its commercial team is satisfied that all positions are in line with market positions for deals recently closed or in the final stages of closing and meet Treasury requirements.

These provisions have also been the subject of a fully independent review that is to be addressed by other reports to be provided to Councillors.

## 5.3 **How the scenario for Termination for Planning Failure is Addressed in the Contract**

This scenario for termination is covered in Schedule 26 'Planning' and is explained in the contract at Clause 69 'Termination on Force Majeure' and the financial implications are found in Schedule 17 (Compensation on Termination) Part 5 'Compensation on Termination for Force Majeure or Uninsurability'.

This part of Schedule 17, in section 1.7, shows that the County Council's cost for this is capped at £20.3 million plus or minus the costs or receipts arising under the arrangements put in place on 07 February 2012 to mitigate foreign exchange and interest rate changes.

#### 5.4 **Why Breakage Costs are Capped at £20.3 Million**

The capital cost for the facility is around £150 million. The arrangements to have money in place for all aspects of the project and to allow for delay to the project are made at the point of contract award. If there is a delay the cost of having those arrangements in place is a significant ongoing cost.

If the project is delivered, these costs are just a part of what the payments for the service each month relate to. If the project doesn't go ahead, these costs are met by the County Council on termination for planning failure.

This approach is required because waste infrastructure projects have been shown to carry very significant planning risk. This means that unless the public sector is prepared to pay the cost of cancellation of those arrangements if the project does not go ahead, the banks that generally fund these developments will not agree to fund them. Since most, if not all, companies do not have the ability to fund many waste deals corporately, they have a heavy reliance on bank funding for residual waste treatment projects.

Other costs that are relevant in calculating the breakage cost include some of the costs that the contractor has experienced, for instance development costs and costs relating to sub-contractors, in relation to progressing the contract, but not all of them.

The £20.3 million cap is payable on auditable and evidenced costs against specified heads relating to bank fees and bid development costs. This is plus or minus the cost or income from breaking arrangements in place to hedge long term risks around foreign exchange and interest rates

The figure for the cap was approved by Defra and Treasury when it approved the appointment of the Preferred Bidder and again prior to the award of contract. This approval is only given when Defra is convinced a position has been reached which represents the market position for deals of a similar nature.

#### 5.5 **Cost of Breaking Arrangements to Mitigate Foreign Exchange and Interest Rate Changes**

On 07 February 2012 the contractor put in place contracts to mitigate the risk of changes to the cost of elements of the project priced in Euro and Swiss Francs and the effects of changes in interest rates. This mitigation was required by the banks that fund the project to convince them that whatever happens in these markets the project remained viable within the approved amounts of debt provided.

To give an idea of how volatile this can be if not mitigated, changes in rates prior to the contract award, i.e. during 2010 and in to early 2011, moved the price within a range of around £40 million pounds, eventually delivering a cheaper price than was in the bid.

Due to the delay the contractor is having to extend the arrangements put in place to mitigate the risks of foreign exchange and interest rates until they are required.

If these arrangements are ended as a part of a termination it could generate a cost or an income to the County Council. However, due to the changes in the relevant foreign exchange and interest rates this sum is subject to daily fluctuations, for example in May 2013 it was calculated to generate a cost of more than £11 million which when recalculated in September 2013 had reduced to around £4 million.

## 5.6 Public Inquiry Cost

The public sector always carries planning risk in contracts of this kind. The County Council has to meet 90% of the contractor's cost for the Public Inquiry above a five figure sum, i.e. above a figure between £10,000 and £99,000. The precise sum is contained within the County Council's contractual confidentiality obligations.

The Public Inquiry process is now finished but the contractor's final costs for participating are not yet known. However they can reasonably be expected to be between £1.6 million and £2 million pounds. Under the terms of our agreement, the County Council must meet some 90% of that cost. This cost reflects the length of the Public Inquiry as determined by the Inspector.

## Background Papers

Cabinet: Waste PFI Contract Award, 07 March 2011.

<http://www.norfolk.gov.uk/view/cabinet070311item17pdf>

Cabinet Scrutiny: Residual Waste Treatment Contract, 04 June 2013.

<http://www.norfolk.gov.uk/download/cabscrut040613agendapdf>

### Officer Contact

If you have any questions about matters contained in this paper please get in touch with:

Name	Telephone Number	Email address
Joel Hull	01603 223374	joel.hull@norfolk.gov.uk
Mark Allen	01603 223222	mark.allen@norfolk.gov.uk



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