

NEW TECHNOLOGIES DEMONSTRATOR PROGRAMME - SUCCESSION STRATEGY
WDA/69/08

Recommendation

That:

1. Members agree to the succession strategy outlined in Option 3 of the report, namely to seek to negotiate the lease of the Huyton New Technology Demonstrator Programme (NTDP) building and equipment to Orchid Environmental Ltd.
2. Members agree to delegate authority to the Director in consultation with the Treasurer and, following legal advice, to complete the negotiation of lease terms and conditions with Orchid.
3. Members agree to further the review of the options available to the Authority in 2010/11.

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Report of the Director

1. Purpose of the Report

- 1.1 To seek Members agreement to a Succession Strategy for the New Technology Demonstrator Programme (NTDP) Plant at Huyton.

2. Background

- 2.1 The NTDP plant at Huyton, operated by Orchid Environmental Limited, is part of the national DEFRA Programme, designed to bring new UK technologies forward to assist in the development of new markets and to help improve the potential for commercialisation of those technologies.
- 2.2 The MWDA has taken a key role in the project, funding the acquisition of the site and building in which the process is housed. This was considered a relatively low-risk contribution, as the physical asset would retain value at the end of the project.
- 2.3 NWDA part-funded the development, to provide the economic benefits of a North West company. The funding breakdown for the project is as follows:-

	<u>£M</u>
MWDA	8.3
DEFRA	5.65
NWDA	<u>2.1</u>
	<u>£16.05</u>

- 2.4 The contract between MWDA and Orchid is to process up to 50,000 tonnes of municipal solid waste, producing a refuse-derived fuel (RdF) of bio-degradable waste, thereby diverting around 30,000 tonnes from landfill, with the associated avoided costs of landfill, as well as to stimulate local markets for RdF use and contribute to Recycling

performance via the sorting of recyclates from the waste prior to fuel production.

- 2.5 The NTDP Demonstrator period comes to an end in March 2009. The Orchid process was on course to complete the required number of 'running hours' prior to a fire at the plant on 24th October 2008. The plant is currently out of action until at least January 2009.

3. Succession Planning Options

- 3.1 There is a need to plan for the optimum succession strategy for the demonstrator project. In particular, for the Authority, there is the need to consider a number of key factors:-

- Return on Investment
- Technical performance (track record) and technical risks going forward.
- Need
- Cost
- Interface with main waste contract procurement programme and procurement rules.

3.2 Return on Investment:

The Authority has c. £10m capital invested in the facility, largely the physical assets i.e. land and building, assuming the NWDA repayment is made in full. It is important that, subject to need, the investment is either effectively utilised or recovered.

3.3 Technical Performance:

The NTDP is a demonstrator project and as such is not yet able to claim a fully 'proven' track record of consistent performance over many years. That said, the plant had reached the performance efficiency requirements for a period immediately prior to the fire on the 24th October 2008 and had satisfied the fuel end users supply quality standards for the Refuse derived Fuel (RdF) or Solid Recovered Fuel (SRF). Clearly, in considering whether the Authority would want to facilitate continued use of the facility for the treatment of the Authority's waste, the risks associated with relying on the technical performance of the plant are very important.

3.4 Need:

The Authority has to consider, not only whether it wishes or needs to use the plant, i.e. whether it is likely to exceed its landfill allowance in each year and by how much, but also the cost of alternative options, especially the option of trading landfill permits, which are available at a market price as part of the UK Government's Landfill Allowance Trading Scheme (LATS) for those Waste Disposal Authorities who remain heavily reliant on landfill and may exceed their landfill allowance.

Consideration also needs to be given to the desirability of keeping open the possibility of using the Orchid facility in the future. The plant continues to form the technology provider role to one of the RRC participants and preferred bidder will not be known until 2010.

The Authority may wish to discuss with the preferred bidder when selected, the prevailing economic market conditions, e.g. LATS trading prices, recycle market prices and the desirability of instigating an Interim procurement exercise to compare treatment costs with LATS permit prices at the time.

3.5 Cost:

As the cost of any option falls to the Authority and is ultimately levied to the constituent District Councils (and ultimately then, the Council taxpayer), the cost of pursuing particular options is critical in reaching decisions. In particular for any option, the comparison has to be made with the cost of tradable landfill permits which represent a very low-risk strategy for the Authority in that there is a much higher degree of certainty that the Authority's Landfill Allowance obligation has been met.

3.6 Interface with Procurement:

The RRC contract is not programmed to be let until 2010, with major new facilities not planned to be 'on-line' until around 2013/14 at the earliest.

The use of the plant for an 'interim' period, has been the subject of an Interim Contract Procurement exercise, the outcome of which was reported to Members in February 2008 (WDA08/08).

The Authority would, under the European Procurement Rules, and its own Procedural Rules, have to run a second competitive interim procurement exercise, if it considered that it could process the waste at a lesser cost than trading LATS permits in the future.

Any contractor working for the Authority is treated in the same way under the EU rules and would have to run a competitive procurement.

3.7 LATS Trading Position

The Authority is not likely to require further landfill allowance permits until 2011/12, given the trades already made and the ability to bank or borrow permits against our forecast waste tonnages. On this basis, and taking the Orchid bid price from the Interim Contract Procurement conducted by the Authority, there is no financial or legislative driver to contract with Orchid beyond the demonstrator period.

The Authority's need for additional landfill allowance (permits) beyond 2010/11, assuming the RRC facilities do not come on stream until 2013/14, would be in the order of 115,000 to 170,000 tonnes, and assuming a trading price of £20 per tonne for the LATS permits, this gives the Authority a potential LATS financial exposure of between £2.3M to £3.4M.

3.8 Options

The principle options available to the Authority are to:-

1. Invite the RRC Contractor to operate the facility.
2. Run a second Interim Contract Procurement exercise.
3. Lease the building and plant to Orchid to operate as a commercial facility.
4. Sell the assets and purchase the necessary LATS permits to meet the Authority's landfill allowance.
5. Form a Special Purpose Vehicle Company to utilise the assets.

4. Risk Benefit Assessment

- 4.1 Table 1 below lays out the risks and benefits of the principle options and the overall 'rating' of the option compared to others.

OPTION	BENEFITS	RISKS	COMMENT	OVERALL RISK/BENEFIT ASSESSMENT
1. RRC CONTRACTOR OPERATES UNDER LICENCE	Allows continued use of asset within procured contract.	<p>Insufficient 'running time' actual data to draw firm conclusions on ability to sustain required levels of performance</p> <p>Limited interest from RRC bidders</p> <p>RRC contract award not until 2010 leaving facility inactive for at least 12 months</p> <p>Unable to make price comparison. Whilst LATS/landfill price reasonably certain, final RRC contract price is as yet unknown</p> <p>MWDA retains risks/liability for site, building, plant and equipment. Limited transfer of operating risks to RRC Contractor.</p>	Only one of four RRC bidders still interested	VERY POOR OPTION

<p>2. RUN SECOND INTERIM CONTRACT PROCUREMENT</p>	<p>Would 'flush out' whether plant could be operated under separate contract for less than WMRC contract price or LATS/Landfill price</p>	<p>Insufficient 'running time' actual data to draw firm conclusions on ability to sustain required levels of performance</p> <p>Would require 50,000 tonnes to be split off from WMRC contract which would result in different contract price banding and increased cost of WMRC contract</p> <p>Would require time and resources to run second interim contract procurement</p> <p>MWDA retains liability for site and building. May sell/lease plant and equipment to Orchid, but unknown price as yet</p>	<p>Result of first interim contract procurement known. Not competitive on price compared to LATS/landfill but may be in future</p>	<p>POOR OPTION</p>
<p>3. LEASE ASSETS TO ORCHID TO OPERATE AS COMMERCIAL PLANT AND PURCHASE LANDFILL PERMITS</p>	<p>Potentially recovers investment by MWDA and NWDA over time</p> <p>Retains site and building in MWDA ownership</p>	<p>Precludes use of the facility for processing MSW (and thereby diverting BMW from landfill), for the period of any lease, except if operated on commercial terms as sub-contractor to WMRC or RRC contractor</p> <p>No immediate recovery of investment</p>	<p>DEFRA do not require recovery of their investment</p> <p>Requires negotiated 'clawback' of NWDA funding through royalty payments from Orchid when commercially active</p>	<p>VERY GOOD OPTION</p>

	<p>Allows Orchid to commercialise and potentially expand</p> <p>Potential for future Reserved Capacity to form condition of lease</p>	<p>Term of lease to Orchid would preclude use for other purposes</p> <p>MWDA retains some ownership risks/liabilities</p>	<p>WMRC contractor may want to utilise as temporary Waste Transfer Station if need to redevelop Huyton Waste Transfer Station site next door</p> <p>High degree of certainty in respect of meeting LATS obligation at 'known' cost.</p>	
4. SELL ASSETS AND PURCHASE LANDFILL PERMITS	<p>Offers 'clean break' and fully transfers technical performance, and breakdown risks/liabilities</p> <p>Potentially recovers investments immediately</p>	<p>Precludes use of the facility for processing MSW (and thereby diverting BMW from landfill), except if operated on commercial terms as sub-contractor to WMRC or RRC contractor</p> <p>Does not retain asset for future use</p>	<p>Requires negotiated 'clawback' of NWDA funding through royalty payments from Orchid when commercially active</p> <p>Offer to sell to Orchid for best consideration in first instance as they have an obvious interest and hold the</p>	GOOD OPTION

	Allows Orchid to commercialise and potentially expand		<p>technology licence for the equipment</p> <p>Waste Transfer Station if need to redevelop Huyton Waste Transfer Station site next door</p> <p>High degree of certainty in respect of meeting LATS obligation at 'known' cost.</p>	
5. FORM SPECIAL PURPOSE VEHICLE TO OPERATE PLANT	<p>Allows use of the facility for processing MSW (and thereby diverting BMW from landfill)</p> <p>Potentially recovers investment by MWDA and NWDA over time</p> <p>Retains site and building in MWDA ownership</p>	<p>Unknown appetite of WMRC contractor to form SPV</p> <p>MWDA may include site and building as investment in SPV. May sell or lease plant and equipment to SPV or Orchid, but unknown price as yet.</p> <p>MWDA retain some risks/liabilities as landowner unless sold into SPV</p> <p>Unknown SPV funding/cost burden</p>	<p>Requires formation of SPV between MWDA/WMRC contractor and Orchid</p> <p>Negotiation on legal contract, structure, risk profiles and funding of SPV required</p>	POOR OPTION

	Allows Orchid to commercialise and potentially expand			
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5. Outcome of Risk/Benefit Assessment

- 5.1 The Authority does not need the Orchid facility to meet its immediate LATS allowance obligations. However, beyond 2010/11 the Authority has a potential LATS exposure of some £3.4M. It is recommended that the Authority do not contract with Orchid to process Municipal Solid Waste, but lease the facility to Orchid for the short-term and review the position in 2010/11 in light of the prevailing procurement position, LATS price and market conditions at the time.
- 5.2 The lack of a proven long-term track record for the Orchid facility means that any option which involves processing the Authority's waste, leaves the Authority with high risks and the Authority cannot utilise the facility for its WMRC contractor when selected, without a further Interim Contract Procurement.

6. Preferred Option:

- 6.1 Because of these two critical issues, the best performing option is to lease the building, plant and equipment to Orchid. The future LATS and economic conditions are very uncertain at this time. The Authority would retain ownership of the land and building, preserving its flexibility should it wish to utilise either the Orchid technology or the site in the future and, in the meantime, would grant Orchid a short-term lease to occupy the site.
- 6.2 This would mean that the facility would be operated by Orchid as a commercial (or 'Merchant') facility which was not involved in processing waste through this Authority's contracts. This would transfer the operating performance risk to Orchid.
- 6.3 The purpose of seeking to negotiate a short-term lease, of say 5 years, with a 3 year break clause, is so that the Authority can review its position in 2010/11 and decide whether it wishes to run a second Interim Contract Procurement exercise (or trade permits) for future years. Reviewing matters at that time would enable the Authority to take stock of the LATS trading price and availability of permits compared to alternative processing capacity available (including Orchid) in the market place at that time, as well as the stage reached in the RRC contract procurement.
- 6.4 If it is acceptable that retention of the site (and the sunk investment in it) is desirable to the Authority, given the potential need to compare interim

contract prices with LATS prices for 2011/12 onwards, a short-term lease would obviate any long-term risk exposure to the Authority.

- 6.5 This option would also give Orchid the opportunity to complete many more hours of operations and prove the consistent performance of the process over several years, in addition to the potential to expand the throughput of the process (but at Orchid's own commercial risk).
- 6.6 It is recommended that a condition of the lease be negotiated to reserve 50% of the capacity to the MWDA at the current consented capacity 50,000 tonnes/year, i.e. 25,000 tonnes/year, with a further 15% reserve capacity to be made against any future expansion of the consented capacity, to enable the Authority or its contractor to take advantage of the facility in the future if necessary beyond 2010/11.
- 6.7 The lease option would also allow flexibility for the Resources From Waste Alliance bid to utilise the facility in the event of their selection as preferred bidder in the RRC contract. Whichever RRC Contractor is ultimately selected as preferred bidder, they may wish to consider running their own procurement and, if Orchid were successful, contracting with Orchid, if, through the RRC Contracts and procurement process, the Orchid gate fee was lower than total landfill costs at that time (and the operational risks were not prohibitive).

7. HR Implications

- 7.1 None

8. Environmental Implications

- 8.1 Would result in fewer tonnes of Biodegradable Municipal Waste being diverted from landfill in the short term.

9. Financial Implications

- 9.1 The terms and conditions of the lease arrangements to be at prevailing market rates.
- 9.2 As part of the lease negotiation, the new lease payment from Orchid will need to be greater than any annual loan interest and repayment costs borne by the Authority.

10. Conclusion

- 10.1 The Authority is recommended to agree to lease the asset to Orchid Environmental Ltd as outlined in Option 3 of the report. Delegated powers to complete the negotiation of the lease arrangements to be granted to the Director, in consultation with the Treasurer and Solicitor to the Authority, following legal advice.
- 10.2 In the event that satisfactory lease terms and conditions cannot be achieved, a further report will be presented for Members consideration.

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The background documents to this report are open to inspection in accordance with Section 100D of The Local Government Act 1972 - Nil.