



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Net Zero, Energy and Transport Committee

**Tuesday 31 October 2023**

**Session 6**



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**Tuesday 31 October 2023**

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**NET ZERO, ENERGY AND TRANSPORT COMMITTEE**

**30<sup>th</sup> Meeting 2023, Session 6**

**CONVENER**

\*Edward Mountain (Highlands and Islands) (Con)

**DEPUTY CONVENER**

Ben Macpherson (Edinburgh Northern and Leith) (SNP)

**COMMITTEE MEMBERS**

\*Jackie Dunbar (Aberdeen Donside) (SNP)

\*Monica Lennon (Central Scotland) (Lab)

\*Douglas Lumsden (North East Scotland) (Con)

\*Mark Ruskell (Mid Scotland and Fife) (Green)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Sarah Boyack (Lothian) (Lab)

Al Denholm (Scottish National Investment Bank)

Jim Fairlie (Perthshire South and Kinross-shire) (SNP) (Committee substitute)

Peter Farrer (Scottish Water)

Lucy Geoghegan (Scottish Government)

Màiri McAllan (Cabinet Secretary for Transport, Net Zero and Just Transition)

Alex Plant (Scottish Water)

Dame Susan Rice (Scottish Water)

Jimmy Williamson (Scottish National Investment Bank)

**CLERK TO THE COMMITTEE**

Peter McGrath

**LOCATION**

The Mary Fairfax Somerville Room (CR2)



## Scottish Parliament

### Net Zero, Energy and Transport Committee

*Tuesday 31 October 2023*

*[The Convener opened the meeting at 09:17]*

### Decision on Taking Business in Private

**The Convener (Edward Mountain):** Good morning, everyone, and welcome to the 30th meeting in 2023 of the Net Zero, Energy and Transport Committee. We have received apologies from the deputy convener, Ben Macpherson, and I welcome to the meeting Jim Fairlie, who is attending online as his substitute.

I should say that Ash Regan has resigned from the committee. Her notice was received yesterday, and she resigned with immediate effect. I thank Ash for the work that she put in while she was a member of the committee. We are sorry to see her go.

Agenda item 1 is a decision whether to take items 6, 7 and 8 in private. Under item 6, we will consider the evidence that we will hear under item 4; under item 7, we will consider the evidence that we will hear under item 5; and under item 8, we will consider proposals for a people's panel in relation to section 91 of the Climate Change (Scotland) Act 2009, which is about public engagement by the Scottish Government. Do members agree to take those items in private?

**Members** *indicated agreement.*

## Subordinate Legislation

### Greenhouse Gas Emissions Trading Scheme (Amendment) (No 2) Order 2023 [Draft]

09:18

**The Convener:** Agenda item 2 is consideration of a draft statutory instrument. I am pleased to welcome the Cabinet Secretary for Transport, Net Zero and Just Transition, Màiri McAllan, and from the Scottish Government, Mariana Cover, senior policy adviser, United Kingdom emissions trading scheme; and Lucy Geoghegan, head of unit, net zero economy and carbon markets. Thank you for joining us today.

As the instrument has been laid under the affirmative procedure, it cannot come into force unless the Parliament approves it. Following this evidence session, the committee will be invited under the next agenda item to consider a motion recommending that the instrument be approved. I remind everyone that officials can speak under this agenda item but not in the debate to follow.

I invite the cabinet secretary to make a brief opening statement.

**The Cabinet Secretary for Transport, Net Zero and Just Transition (Màiri McAllan):** Good morning. Given how complicated the topic can be, I will take the opportunity to make an opening statement, so that I can set things out as simply as I can.

I am pleased to be able to give evidence on the draft affirmative instrument to amend the Greenhouse Gas Emissions Trading Scheme Order 2020. In July, the emissions trading scheme authority, which is formed of the Scottish, UK, Welsh and Northern Irish Governments, published a joint Government response to last year's consultation. The response contains substantial changes to strengthen the ETS and to better align it with our net zero objectives. We have already brought into law some of the minor decisions that arose from that Government response, via a negative statutory instrument earlier this year. We are now implementing additional—mostly minor—amendments through this affirmative instrument.

The thrust of today's amendments is to amend the free allocation policies to ensure the correct functioning of the ETS. The committee will remember that free allocations are the allowances that are given for free to operators who are at risk of carbon leakage—that is, the risk of industries moving offshore to jurisdictions with less rigorous carbon policies. Specifically, the instrument would cap the amount of free allocation for the aviation sector. That is being done to amend a current

anomaly in the system, whereby data used to allocate free allocations to aircraft operators is inconsistent with current activity levels, resulting in some operators receiving an overallocation of free allowance and creating a competitive distortion.

Today's provisions, therefore, provide that free allocations will not exceed 100 per cent of the air operator's verified emissions, and they will be in place until the withdrawal of the aviation free allowance in 2026, which is a separate commitment from the joint response and is, I stress, not being legislated for presently, although I will be happy to keep the committee updated on it.

Two other minor issues are covered in today's instrument. First, it will introduce an amendment to allow installations with carbon capture and storage to receive free allocations. Again, the issue has arisen as a result of inconsistencies in the legislation whereby it is currently not possible to do that—and, clearly, we see that as lowering the incentive to install carbon capture and storage. As that was never the policy intent, we are changing it.

Secondly—and finally—the instrument contains three technical amendments to the free allocation rules for electricity generation, to more accurately reflect operator activity and to incentivise electricity produced by means of high-efficiency co-generation.

I also want to make a brief point about parliamentary processes. The Senedd and the UK Parliament are running a similar scrutiny process on the matters in today's order. The Northern Ireland Assembly will do so as soon as it can, but in the meantime the order will apply only to Great Britain. We aim to bring forward in due course the remaining changes to the ETS that are set out in the response, such as expanding the scope of the ETS and phasing out free allocation for aviation.

As I wrote to the committee on 7 July, one of the most significant changes—that of aligning the cap with a net zero trajectory—is currently being taken through the UK Parliament. I would have preferred it to have been taken through the Scottish Parliament in the first instance, but it is a pragmatic, albeit not ideal, response to the fact that there is no sitting Northern Ireland Assembly. As soon as there is one, we will lay the affirmative measures for that provision, and the committee will have the opportunity then to scrutinise it.

That is quite enough by way of opening remarks. My colleagues and I are very happy to take questions.

**The Convener:** Thank you, cabinet secretary.

I have a question on aeroplane oversubscription. Was there a huge discrepancy in that respect? Was it being abused considerably?

**Màiri McAllan:** First, I am not sure that I would use the word “abused”. It was basically an accounting issue whereby the free allocation was offered on the basis of out-of-date activity data. It will differ between operators; some will be far below 100 per cent of their verified emissions, and others will be slightly over. I do not know whether Lucy Geoghegan wants to add anything to that, but the general response would be that the situation differs between operators and that it was a case not of abuse but of the data being out of date and needing to be realigned.

**The Convener:** So it was just a paper exercise. Are you saying that there was no trading as a result or that there was no financial benefit from somebody having an overallocation?

**Lucy Geoghegan (Scottish Government):** No. There would have been an overallocation, and they would have financially benefited from that. However, the cabinet secretary is right that the allocation was based on 2010 activity data. In transitioning from the European Union ETS into the UK ETS, we transitioned the benchmark data, but it did not match the existing activity levels of aircraft operators across the UK. In essence, then, we needed to fix that anomaly.

**The Convener:** You have piqued my interest—I am now interested in knowing what the scale of that was. You will probably not be able to give me that information now, and it would be wrong of me to ask the question, but I am sure that you could write to the committee and say what the level was. It would be interesting for us to get a handle on that.

**Màiri McAllan:** We can certainly look into that, convener. As part of our impact assessments for some of those changes—and more so for some of the wider changes—we have looked at Scotland-specific commercial entities. It is sometimes a little difficult to discuss the commercial details, particularly as there are so few such entities in Scotland, but we have some of that data, and we will happily write to you with what we can.

**Douglas Lumsden (North East Scotland) (Con):** Cabinet secretary, you mentioned that the free allocation for aviation will be phased out over the coming years. What impact will that have on the aviation industry?

**Màiri McAllan:** That is a good question, and we have been looking very closely at the issue. The intention is to phase it out, because it is now the view that aviation is not at risk of carbon leakage. That is a change in view that each of the authority members have come to agreement on.

That said, although we agree on the need to phase it out, I have, like you, been asking the question about impact assessments. One of the things that I have put very starkly to my authority partners is the issue of Highlands and Islands connections. However, we are still developing our approach to the phase-out date, which is not until 2026, and assessing the impact.

As you will see in the response, I have won a concession under which the impact on connections to the Highlands and Islands will be considered and any mitigations that are required will be developed. That is still to be done, but as I have said, it is still a few years hence, and I will very much continue to assess the impact on operators and on people who need to get back and forth to remoter parts of the UK.

**The Convener:** As there appear to be no further questions, we move to agenda item 3, which is formal consideration of motion S6M-10535. I invite the cabinet secretary to speak to and move the motion.

*Motion moved,*

That the Net Zero, Energy and Transport Committee recommends that the Greenhouse Gas Emissions Trading Scheme (Amendment) (No 2) Order 2023 [draft] be approved.—[*Màiri McAllan*]

**The Convener:** Members do not seem to have any comments or questions, cabinet secretary, so I must formally ask whether you want to sum up. However, I am not sure that there is much that you can say.

**Màiri McAllan:** No, there is not, except to ask for the committee's support. Thank you.

*Motion agreed to.*

**The Convener:** The committee will report on the outcome of the instrument in due course. Are members happy to delegate authority to me, as convener, to finalise the report for publication?

**Members indicated agreement.**

**The Convener:** We look forward to getting the additional information that the cabinet secretary has kindly offered to give us.

Cabinet secretary, I thank you and your officials for attending, and I briefly suspend the meeting to allow for a changeover of witnesses.

09:29

*Meeting suspended.*

09:31

*On resuming—*

## **Scottish Water Annual Report and Accounts 2022-23**

**The Convener:** Our next item of business is an evidence session with Scottish Water and Business Stream, which is a subsidiary of Scottish Water. This is a chance for the committee to check in with Scottish Water on its important role. We will consider its most recent annual report and look ahead to its main priorities and challenges.

Before I go any further, I welcome Sarah Boyack, who is attending the meeting and who will get to ask questions at the end, once committee members have had a chance to ask a few questions.

As a matter of information, I remind people that I, along with every other person in Scotland—or the majority of people in Scotland, although not everyone—am a client of Scottish Water in the sense that I get water, but I am also a client of Business Stream, in that I get water from it for my farm. I say that just so that there is no dubiety about that.

I am pleased to welcome Dame Susan Rice, the chair of Scottish Water; Alex Plant, the chief executive of Scottish Water; Peter Farrer, the chief operating officer of Scottish Water; and Johanna Dow, the chief executive of Business Stream. Thank you for joining us.

Before we move to questions, I believe, Dame Susan, that you wish to make an opening statement. That is very formal—do you mind if I call you Susan?

**Dame Susan Rice (Scottish Water):** I was going to ask you to do that, please.

**The Convener:** I think that you want to make a brief opening statement.

**Dame Susan Rice:** I do.

I thank you, convener, and the committee for inviting us to give evidence. I will say a few words at a high level, just to set the scene.

Looking at the highlights from our latest annual report, which went to March 2023, I am pleased to say that Scottish Water performed well across its key indicators, including water quality, environmental performance and customer service. We also made good progress on our net zero route map. We delivered £886 million of capital investment last year. That is our highest level ever, and I think that we all feel very positive about that. That was possible only with the hard work of all the teams across the organisation and our

supply chain partners, who are integral to our success.

Business Stream, our retail business, delivered strong results in a competitive market and through what continue to be challenging economic times for many business customers. In Business Stream, we focused on supporting customers and promoting water efficiency measures, which is good for the environment and for customer costs. I was delighted that Business Stream was awarded a gold rating from the global sustainability assessor EcoVadis to recognise its achievements on the journey to net zero—it is very unusual to receive gold the first time you enter.

Looking to the future, our key challenges are undoubtedly how we adapt to climate change and maintain and replace our ageing physical assets. Those challenges are real and growing. They are complex and they are costly. During the winter, we dealt with massive swings in temperatures that caused significant water main damage and bursts across the country. In the early summer, we had an exceptionally long hot and dry spell, and we had to manage drought situations. Very recently, extensive flooding affected many customers across Scotland.

We are also seeing increased customer and societal expectations in the areas of improved environmental standards and net zero, and a greater demand for uninterrupted services, regardless of climate change pressures. To meet those challenges, we know that we need to transform and develop new ways of doing things. Some of that will involve capital investment to build resilience, and some of it will involve developing nature-based solutions, particularly around managing surface water, in partnership with others.

Water is a precious resource that needs to be carefully looked after by everyone. As a board, we focus on risks and how to manage them, and we continually try to understand and oversee mitigation of the escalating long-term risks that we face across our daily activities.

There are no easy solutions to the challenges, and we cannot avoid the difficult conversations about how they will need to be paid for. I know that, if we try to kick the can down the road, future generations will end up facing the consequences in poorer service levels and big hikes in bills. That simply would not be fair, and it is not our way. Our commitment is to constantly consider what can and should be done to help Scotland to flourish now and in the future.

We look forward to your questions.

**The Convener:** Thank you very much.

My first question, which is a very easy one, is for Alex Plant. What do you see as the key challenges that Scottish Water faces, and what are your priorities now that you are in the role?

**Alex Plant (Scottish Water):** It is a great honour to be with the committee this morning.

Some of this touches on the opening comments that Susan Rice has just made. The single biggest challenge that Scottish Water and, indeed, water companies across the globe face is the impacts of our changing climate. The kinds of approaches that we used to be able to deploy will increasingly not be fit for purpose for the more aggressive climate that we are seeing—the more frequent severe weather events—and the impact on assets that we operate, lots of which are old. That issue is not unique to Scottish Water, but we see it in our assessments of the forward pressures on those assets and the state of those assets. How we ensure that we are investing appropriately to maintain and replace those assets in ways that can cope with those different weather conditions is probably the single biggest issue, and that is where I have been putting a lot of my focus in the opening few months of my time in the role.

**The Convener:** Okay. Thank you.

I have looked at your previous year's annual report and accounts. You will not be surprised that pages 116 to 118 caught my eye. That gives you a chance, but you will be able to answer this question off the top of your head. Your predecessor was paid a quarter of a million pounds. Are you on the same rate that he was on?

**Alex Plant:** Issues relating to my remuneration are ones that Susan Rice is probably best placed to cover, given that the discussions about that took place before—

**The Convener:** I will certainly ask her to cover the next bit. I think that I am asking you a straightforward question. Is the salary the same?

**Alex Plant:** The salary that I was appointed on was higher than my predecessor's.

**The Convener:** Can you tell me how much that was, please?

**Alex Plant:** I am afraid that I cannot remember the exact numbers. I cannot remember how much higher it was than Douglas Millican's.

**The Convener:** His basic salary was £245,000.

**Alex Plant:** Yes. My basic salary is higher than that, and it is a matter of public record that that is—

**The Convener:** You must know what it is.

**Alex Plant:** I am trying to remember the exact number. It is £295,000.

**The Convener:** How much?

**Alex Plant:** £295,000.

**The Convener:** Susan, there is a wonderful phrase in the annual report and accounts, which for simple people such as me seems to be gobbledygook. It is “annual out-performance incentive plan”. For most people, that is a bonus. What bonus do you expect Alex to be on if Douglas was paid £80,000 in bonus last year?

**Dame Susan Rice:** I do not have those numbers. I do not know whether you have the formula for the bonus, but it has not really changed.

**Alex Plant:** I can add to that. The bonus arrangements are the same as they were in Douglas Millican’s time. They relate to the performance of the company. The bonus is up to a maximum amount, depending on the performance of the organisation during the year. That bonus payment position applies to me and to the executive directors.

**The Convener:** What is the maximum amount that you can get?

**Alex Plant:** From memory, 40 per cent is the maximum.

**The Convener:** Of your salary?

**Alex Plant:** Yes.

**The Convener:** Wow. That could be a lot of money. It costs over £1 million to employ the three executive members and the non-executive directors. In the big scheme of things, that is quite a lot of money. My maths is not that good but, if your bonus is 40 per cent of your salary, it could take you up to £430,000.

**Alex Plant:** If the full bonus were paid, that is the level that would accrue from that percentage.

**The Convener:** The pension benefits are on top of that. Those could be another bit, so it could be up to £450,000.

**Alex Plant:** Yes. All those figures are matters of public record.

**The Convener:** Yes, I know. I am just laying that out because we see questions about investment in the industry and about the salaries of people who work for you. You might be getting £450,000 and Peter Farrer might be getting a little bit less at roughly £350,000. That is a huge amount of money, and I am just laying that out so that the public are aware of it.

**Alex Plant:** Yes.

**Dame Susan Rice:** The executive salaries are matters for the board remuneration committee, so I will reply with my board hat on.

You are looking at the numbers through one lens, convener, which is the lens of numbers. Let me give a bit of context because it is helpful for people to understand. Our chief executive’s salary is less than that of any comparable water company chief executive in the UK, so Alex Plant did not benefit by making the move and jumping in. You need to understand that. That gives you a context for the pool that we chose from. We ran a very wide search and looked at a lot of individuals.

The pay reflects the essential nature of water and waste water services to the daily lives of everybody in Scotland, as well as the relationship to public health and some relationship to economic prosperity. The role is a key one with a lot of responsibility. Scottish Water is the fourth-biggest water and waste water utility in the UK, and we have to attract suitable leadership. We cannot simply say, “Here’s someone who’s volunteering. Let’s put them in the role.” You cannot run an organisation as important as Scottish Water without having someone who has the personal leadership qualities and the knowledge and experience to bring to bear.

The reward packages for all the executive roles in Scottish Water are substantially below reasonable market expectations. They have been benchmarked. We do that regularly, and we are conscious that we are not playing at the same market levels that the other companies are. It is important to know that our concern was to find a high-calibre new chief executive in Alex Plant, who was willing to come to us and the package that we offered.

**The Convener:** I take all those points on board. My only comment is that there is no other water company in the UK that is owned directly and underwritten by the Scottish Government and the people of Scotland. They are the owners, whereas other companies have different ownership structures.

**Mark Ruskell (Mid Scotland and Fife) (Green):** I am interested to know whether Scottish Water sets a maximum ratio between the highest-paid and the lowest-paid workers and what that is.

**Alex Plant:** We consider that issue. In the annual report and accounts, there is a comparison between the highest-paid person, which is me in the case of Scottish Water, and others. I would have to check the exact numbers, but the aim is to keep that in check so that it does not get beyond the ratios that you are talking about. We consider that partly for the reason that the convener mentioned. We recognise that, as a publicly owned entity, different approaches need to apply in our circumstances than would be true for a private company.

**Mark Ruskell:** Okay. I would like to move on, convener.

**The Convener:** Before we move on, I simply say that it will be up to the Scottish Government to answer that. As far as I am aware, its expectation for the public sector pay strategy is

“to deliver a 10 per cent reduction in the remuneration packages for all new Chief Executive appointments.”

I do not want to dwell too much on that—I want to bring in Mark Ruskell to ask some questions. However, if you really feel that it is important, Susan, I will let you in.

09:45

**Dame Susan Rice:** I really do, because there is an implication that we operated outside Government policy, and I want to affirm publicly that we operated within Government policy. I have a quote from a Scottish Government spokesperson, which sets out what the policy has been since 2010. It says that the 10 per cent reduction applies unless certain circumstances prevail.

We were in the situation of having circumstances prevail, and we were within the Scottish Government policy in that regard. It is really important to state that, so that there is no misunderstanding.

**The Convener:** I will just say, “Funny, that.”

Mark Ruskell has the next question.

**Mark Ruskell:** I come back to the comments about extreme weather and the impact on Scottish Water’s infrastructure. I am interested to know exactly what the impact has been. Given what we have seen in recent months, with intensifying extreme weather, have you identified any changing patterns?

Has storm Babet thrown up any thinking around whether particular regions of Scotland are more vulnerable than others and need to be prioritised for investment? What are we learning as a result of the extreme weather events that we are seeing? How is that affecting your investment strategy, and how is it putting pressure on the assets that you have?

**Alex Plant:** I will ask Peter Farrer to pick up on that. The one comment that I will make is that, in addition to the very recent impacts from extreme flood events that have caused extreme distress to residents in parts of north-east of Scotland in particular, we also had very severe dry-weather conditions earlier in the summer, which led to drought in parts of the country.

Before I ask Peter to come in on the specifics, it is important to note that both “too much” and “too

little” are becoming more frequent, which is driving our underpinning approaches and strategies.

**Peter Farrer (Scottish Water):** Notwithstanding the fact that, as Alex Plant said, weather events are changing significantly, we have many thousands of assets that require investment so that we can maintain them at the standards that we expect. We have in place an emergency planning process that is robust and very well tested, and allows us to manage events as well as possible. We have a full operational team that manages such events, and we learn from every single one.

We have just been through storm Babet, as Mark Ruskell mentioned. We do a lot proactively, including putting emergency generation out to our big assets to ensure that power outages do not impact on them. I am pleased to say that, through the robust planning that we do once we have been notified in advance of a storm, we had neither significant water quality issues nor major water supply disruptions throughout storm Babet.

Our biggest impact was a flooded waste water treatment works at Brechin, which was completely submerged. However, I am pleased to say that we immediately cleaned up all the mess and that, within six days, the treatment works was back up and running and delivering full environmental compliance.

One of the best previous examples involved storms Arwen, Malik and Corrie in 2021. We learned a lot from that experience, which was the most widespread power outage that I have experienced in 39 years in the industry: 1.5 million Scottish Water customers who were supplied by our assets lost power, but we managed to maintain supply all the way through the event because we had a emergency generation strategy and went out and turned the generators on beforehand, as we did with storm Babet. Throughout the event, that protected 1.5 million customers, who experienced no impact from it.

A small number of customers experienced outages for a couple of days; those were down to power losses at small water-pumping stations out in the network. We have learned from that and changed our emergency generation strategy. We have procured more generators, and we have gone round all the small pumping stations that do not have fixed generators on them and adapted them with electrical connections, so that we can easily plug in an emergency generator. That was one of the main things that we did.

We had an issue with not being able to communicate with our people, because the phone lines went down after a very short period. We have therefore purchased a number of satellite phones to allow us to deal with such situations.

We have started medium and long-term investment planning for generation across our whole asset stock. We could be talking about £200 million-worth to £300 million-worth of investment. That is going through the process.

One of the key things—

**Mark Ruskell:** I am sorry to interrupt. It is good to get the detail on that, but I am thinking about what Alex Plant said about the other extreme, which is drought situations. It is clear that you are describing resilience and how plant is operating. What about drought and the bigger challenges around reservoir water levels and everything else?

**Peter Farrer:** One of the best examples was 2021, which was the worst year that I have experienced for different weather events throughout the year. We had a freeze period at the start of the year, a very hot early summer, storms later in the summer and then storm Arwen and wind issues in the winter. We experienced extreme drought in the late autumn and reservoir levels dropped to levels that we had never seen before.

There is a reservoir in Lanarkshire called Daer reservoir, and its level dropped to the lowest that we have recorded in 160 years. There was still water available, but it started to pull manganese out of the silts at the bottom of the reservoir. The treatment works were not able to deal with that, because we have never experienced manganese at that works before. On the back of that, we are having to consider big investment at Daer in order that we can deal with manganese and such events in the future. That is an example of what we have to deal with.

**Mark Ruskell:** It is good to get a flavour of those challenges. Is your blue-green infrastructure for managing surface water or pluvial and fluvial flooding events? Will your blue-green infrastructure be able to manage events such as storm Babet? Will you need to change your thinking on that?

**Alex Plant:** On blue-green infrastructure and how we best adapt to the future climate, we recognise that we will need to have a lot more nature-based solutions in place, so that we work with the grain of what is happening.

To be fair, there will probably be some grey as well as blue-green solutions, because we will still need engineering solutions to address what we have to deal with, alongside better approaches on blue-green infrastructure. Getting that kind of approach right allows alleviation of a problem at source.

In relation to the extreme rain events that we have just had, the environment that now receives such extreme rain is different to that of 150 years

ago, because so many more surfaces are hard paved, so there is very quick run-off into storm drains and overloading of sewage systems, which leads to the kind of situation that happened in Brechin.

When you get blue-green infrastructure right, you create more means by which surface water can be managed in the environment before it hits the sewage and storm-water systems, and you can store water more effectively on the land when you do those kinds of things. There are examples of that very close to here in work that we do in partnership with the City of Edinburgh Council and the Scottish Government at Craighleith, where we are looking at how to remodel the area so that in extreme events we can hold more water in the landscape.

**Mark Ruskell:** We are very aware of that approach; the question is whether what you have planned will be enough in the future. If you think that there will be even more extreme weather events, do you need to scale that up? Will that be adequate?

**Alex Plant:** We will need to scale up, is the short answer.

**Mark Ruskell:** My last question is on the legislative framework. Is there a need for any change in the legislation to enable you to adapt to the impacts of climate change?

**Alex Plant:** The policy proposals that have been discussed with the Scottish Government and consulted on are partly about recognising the different future climate. There are helpful things in the proposed changes that would ease the situation. In the past, the mindset has been that we, as Scottish Water, will deal with such issues and try to find a way in which our engineering assets can cope with the issues. The reality is that the scale of the climate challenges that we are facing means that we need lots of bodies to work together effectively to try to mitigate the impacts and adapt. Some of what is in the legislation is very much about looking at surface water differently and the different contributions that are made. To go back to the point about drought, it is also about all sectors looking at water resources collectively, so that we understand the likely future demands for water resources and where we have supply to meet that demand.

The changes that are foreseen in the policy proposals will give us more tools as a nation, if you like, rather than just as Scottish Water, to address the issues that we are seeing more frequently.

**Mark Ruskell:** Thank you.

**Monica Lennon (Central Scotland) (Lab):** Thank you, and good morning to the panel. This

question is for Alex Plant. I would be interested to hear more about your experience of the water industry in England and to understand what lessons can be learned by drawing on your experience. We have heard that you worked for Anglian Water, which is probably one of the worst polluters in England, on record. I have in front of me examples of the Environment Agency calling for water company bosses to be jailed for serious offences against the environment. Incidents of “ecocide” have been described. Drawing on that experience in that context, what hope can you give us for the situation in Scotland?

**Alex Plant:** That is quite a wide question. One of the key lessons that I learned from my time working in England is that some of the issues that we have seen and some of those that you have described almost go back to the point about how we need to make sure that we keep ahead of the investment curve so that we can maintain environmental and drinking water quality standards in the face of more complex climate challenges and, indeed, increased customer expectations, which I welcome. It is good that people expect higher quality in the environment.

For whatever reason, England has seen insufficient investment for quite a number of years, and the consequences of that have come through in the quality of service. If you look at the plans that the English water companies are now putting forward to their economic regulator, you will see that a very large increase in bills is proposed. On average, the increase will be around 29 per cent in real terms, to try to catch up with some of that lost time in investment to deal with the issues.

The first lesson is, therefore, that we should not let ourselves get to that position. Scotland has the opportunity to not put itself there, but we need to make sure that we keep investment steady so that we do not end up needing cliff-edge increases in bills, which is what we are seeing in England, and so that we do not see the diminution of water quality standards that has meant that customers in England have somewhat lost faith in their system of water provision, which is very sad. We need to make sure that we focus as hard as we can on delivering the service quality that Peter Farrer was talking about, and that the investment programme keeps pace with the changing demands of the climate.

**Monica Lennon:** Thank you for that response. The situation in England is, or has been, pretty bleak, but I am sure that we do not want to gloss over some of the media coverage that we had in Scotland at the weekend. Some really hard-hitting statements were made and Scottish Water has contested some of the analysis, but let us just look at people’s perception and what they are saying.

10:00

Surfers Against Sewage has accused Scottish Water of “appalling behaviour”. Campaigners and politicians—I will not name them all here—fear that the lack of spill monitoring could mean that dry spilling is a bigger issue than the data indicates. Scottish Water is accused of illegally discharging hundreds of times during dry weather, and soiling beauty spots, much-loved beaches and so on with human waste. We have seen the media coverage and heard the reaction from politicians, communities and key campaigners. As chief executive officer, what is your assessment of that?

**Alex Plant:** First, as you said, we dispute the methodology that sits behind some of the reports that you just described. Indeed, from our initial look at some of the material, we have seen that in more than 80 per cent of the instances that are claimed storm tanks are discharged from. Storm tanks operate only in extreme weather: they are for storm events. Something is therefore not correct in what is being put forward by some of those—

**Monica Lennon:** We can come back to the methodology, which is in dispute, but, for clarity, do you dispute the impact on communities and the environment? Are people exaggerating the impact?

**Alex Plant:** We are never sanguine about negative environmental impacts from what we do as a waste water provider. Whenever there is an issue, we seek to improve the position. I am absolutely not saying that it is all right for such things to happen, when they happen. However, as I said, I dispute the findings that were set out in the media at the weekend. They are not correct.

We, in Scotland, start from a much better position than the rest of the UK. We have among the best environmental water quality in Europe: 87 per cent of our water bodies are at good, or better, ecological status. We want to go further, so part of our £500 million investment in improving urban waterways will take us higher—to around 92 per cent.

To my mind, the issue that should be of most concern to us, as a society, is the quality of the water in the environment. Our waste water operations have an impact on the quality of water in the environment, so we should be looking at that. We are doing so, and we should not rest on our laurels. We should carry on improving it.

However, other elements contribute to the assessment of water quality. We should be looking at the issue in the round and trying to understand, catchment by catchment, what could be done to further improve our good position when it comes to river water quality. That requires thinking about

catchments as organic ecosystems, which is what we are doing.

**Monica Lennon:** Some of the complaints that we hear are about examples of human waste being overflowed into rivers and on to beaches, even when the system is not under abnormal stress. We have heard about some of the good performance and benchmarking compared with other parts of Britain, but for people in Scotland right now, is there an acceptable level of human waste that could be overflowed in that way? What is an acceptable level to Scottish Water?

**Alex Plant:** I ask Peter Farrer to pick that up.

**Peter Farrer:** I will take a couple of minutes to explain a couple of things. Everybody will have seen headlines saying things such as “Water Company Pumps Raw Sewage Into Watercourse, Causing Pollution”. Those have been standard headlines. There are a few things to clarify.

First, we never, ever pump overflows into watercourses. That sounds like a wilful act. We do not pump. Storm overflows are a necessary part of a combined sewerage system. They act like a relief valve so that, when it rains, the rainwater exits the system. That works in exactly the same way as an overflow from a water tank in the attic works to prevent your house from flooding. Storm overflows do exactly the same thing: they overflow rainwater to prevent people’s houses from flooding. That is the first point.

Secondly, the overflows are not raw sewage; they are 91 per cent rainwater.

Thirdly—to follow on from the points that Alex Plant made—the majority of the overflows do not cause pollution. The proof of that is that 87 per cent of Scotland’s rivers and water bodies have got good, or better, status.

**Monica Lennon:** That was helpful. Before I forget the number, you mentioned that overflows are 91 per cent rainwater, but I am not sure what the total volume is. Can you tell us the volume of human waste that is overflowed?

**Peter Farrer:** We cannot, because only a small number of our overflows are monitored. That is why—as Alex Plant said—as part of the urban waters route map we are spending £500 million on that, and why we have committed to putting 1,000 monitors into our assets by December 2024.

Let me be clear. The monitors tell us only how much overflow is going into the river, and it is 91 per cent rainwater. The fact that we have such good water quality in Scotland is an indication that those overflows generally do not cause pollution; it is dry spills that can cause pollution. We contested the report that came out at the weekend because we do not agree with the information in it.

**Monica Lennon:** Do you accept that we do not really know the full extent of the problem because of the lack of overflow monitors? That is why people have been calling for more electronic monitoring. You gave a figure, but perhaps you could update the committee on what progress has been made on the commitment to install 1,000 new overflow monitors.

**Peter Farrer:** We have taken quite a while—about a year—to prioritise areas and locations, because we have to ensure that we put the monitors in the areas that are most important. We have taken time to do that. We have installed 60 monitors so far, but we have a firm plan to have 1,000 in place by December 2024, and we are confident that we will do that.

**Monica Lennon:** You mentioned misleading media reporting and headlines. Is Scottish Water planning to take any legal action in that regard?

**Alex Plant:** We are not planning to take legal action, at this stage. We would always prefer to resolve such things by pointing out what we think are errors in the calculations, and by working with the bodies involved. In the end, we agree with the things that groups such as Surfers Against Sewage want. We want to have the best possible water quality environment in Scotland, so we would start by pointing out errors and by trying to work with organisations, so that we can have a better public debate on the issue.

We want to ensure that we are focusing investment in areas where it will be most helpful. We are talking about the monitors; we did a huge programme with SEPA to target the areas that are of greatest concern and we have done a lot of hydraulic modelling to understand where there could be environmental harm so that we can target the available money to the right places. We want to continue to do that.

**Mark Ruskell:** On what you said about targeting the most important areas for monitoring, I presume that those are designated bathing areas. I accept that, and acknowledge that there is investment going into that, but many people now use bodies of fresh water—rivers and lochs—for wild swimming, so they need information about whether those bathing places are safe to go into.

I have constituents who went for a wild swim in the River Tay, and everybody in that party—I think there were around 10 people—became ill a couple of days afterwards. It is very hard for them to pinpoint exactly what the cause was, but it was probably related to bacterial infection that they believe came from a combined sewer overflow incident in Stanley, in Perthshire. Their call to me and others has been for us to give them the information about that.

We realise that investment in the assets is needed to ensure that we do not get pollution but, at the very least, people need to know whether there has been an incident and whether they are putting their lives at risk by going into the water. That means that the issue is bigger than just our bathing waters, because there are lots of lochs and rivers where people go for a dip.

**Alex Plant:** That is right. When we roll out the monitors, we also think carefully about how we can ensure that we give information that is meaningful and helpful to the public to address the issues that you talked about.

**Mark Ruskell:** Is 1,000 monitors enough?

**Alex Plant:** Let us see. We are at the early stages of rolling out—we have deployed about 60 monitors so far. We are confident that we will get the 1,000 installed ahead of the time that we targeted, which is the end of next year, I think.

It is worth saying that, for designated bathing waters in Scotland, 98 per cent pass the environmental standards. We have a system that we can build on to get to an even better position for people who want to wild swim. It will not be appropriate to wild swim everywhere, but the designated bathing water status approach is a mechanism by which we can ensure that we give the best possible information to the public. That is what we will be doing.

Do you want to come in on that, Peter?

**Peter Farrer:** I clarify that the event monitors that we are putting in will simply indicate how much water has gone into the water course; they will not tell us what the quality of that water is. SEPA determines the quality of water bodies—it provides the 87 per cent quality figure that we talk about. The quality of the receiving water bodies is very good in Scotland but, to determine every single water body's quality and get that out to the public would be a massive exercise.

**Mark Ruskell:** That would require joined-up working between you and SEPA.

**Peter Farrer:** Absolutely. We already do that with bathing water—SEPA reports the bathing water results. If we have a significant issue with an asset during storms, for example, we work with SEPA, and it will put a notification out to the public on bathing waters to tell them that it is potentially unsafe to swim.

There are only 90 designated bathing waters in Scotland, and there are a lot of other places that people go to wild swim these days.

**The Convener:** That is helpful.

Peter, I am slightly confused by the figures that you used. You gave percentages but then said that there are no accurate figures, so I am not sure

how you come up with figures of 91 per cent and 9 per cent.

When there are storms, there will be problems, but there is more water and therefore the pollution is more diffuse and can move out quickly. I am not saying that that is acceptable, and I am sure that you are not saying that it is acceptable. As I see it, however, the critical issue is when water is very low and therefore a smaller amount of pollution becomes more extreme.

When there is low water, such as we had in June this year, especially around the Highlands, at my home and in places such as Loch Ewe, small pollution incidents could be much more problematic. Are you happy that Scottish Water is on top of that?

**Alex Plant:** I will ask Peter Farrer to pick up on that particular question, but your general point is really good. The sort of events that you describe are much more environmentally harmful than when a combined sewer overflow is operating as it should do. In that situation, the combined sewer overflow provides a release valve and primarily rain water and storm water are discharged. The more intense environmental impacts are from exactly the kind of situation that you describe. They are often caused by blockages to sewers and so on. I will let Peter Farrer pick up on that point, but it is an important distinction with regard to where the environmental harm sits. That is where we should be deploying our efforts and investment.

**Peter Farrer:** You are absolutely right, convener. The biggest risk of pollution is when there is no rainfall and water levels are running low. As part of our transformation plan, we are implementing a project called intelligent waste water networks, which involves putting in another 1,200 monitors. Those are not event monitors that tell us how much goes into a river; they are monitors throughout the network that tell us when levels are starting to build up in the sewers. When we have blockages—we have 36,000 blockages a year, the majority of which are caused by wet wipes—the sewers rise and we get overflows, which can have a significant impact in dry weather.

Through our transformation programme, we are putting in smart networks, which will allow my operational team in our control centre to see events that are building up, so that we can get out there and clear blockages before they actually cause pollution.

**The Convener:** Will those 1,200 monitors also be in place by the end of 2024?

**Peter Farrer:** Yes, they will be in place in 2024.

**The Convener:** Gosh. A huge number of monitors will be installed by the end of next year.

Alex Plant, do you want to come in?

10:15

**Alex Plant:** I have a quick point that relates to the issue that Peter Farrer was just talking about. As he said, a lot of blockages are caused by wet wipes. The intelligent monitoring of our network means that we can get in ahead of the problem but progress on banning wet wipes that contain plastic would be massively helpful in reducing the effects of extreme weather events. We have been working with the Scottish and UK Governments to try to move that forward. I know that that has been an area of focus for the committee, but anything that the committee can do to keep pushing for that to happen as soon as possible would be very welcome.

**The Convener:** The committee recognises that Scottish Water has taken the lead on tackling the problem of wet wipes and that it is pushing hard on the issue. However, the problem is also all the other things that people put down the drain, which I will not mention but can include cooking waste and toilet waste. I suggest that we also need to get on top of those other things, but that is a point well made.

**Jackie Dunbar (Aberdeen Donside) (SNP):** I would like some clarification. When you talk about wet wipes, do you mean all wipes, including flushable wipes? It is quite important to get that message out, because some folk get confused.

**Alex Plant:** The wet wipes that contain plastics cause the blockages. Those are the wipes that we are seeking to get banned.

**Jackie Dunbar:** You are not referring to flushable wipes. I know that you would prefer that no wipes are flushed at all.

**Alex Plant:** “Flushable” is a very unhelpful label—

**Jackie Dunbar:** That is why I am asking you the question.

**Alex Plant:** Peter Farrer might want to talk about that, but I understand why the question is being asked.

**Peter Farrer:** Some manufacturers decided to say that wipes are flushable because they biodegrade over a period of time, but that takes years and blockages happen within a matter of weeks of the wipes going down into the sewer. Therefore, being flushable, particularly if they contain plastic, is of no benefit from our perspective, because those wipes will still cause blockages.

**Jackie Dunbar:** It is helpful to get that message out, because some folk are trying to do their bit, but they do not realise that they are not helping.

**Alex Plant:** Yes, exactly, which is why the label of “flushable” is unhelpful, as Peter Farrer described.

**Jackie Dunbar:** Thank you. If I may move on—

**The Convener:** Yes, absolutely, move on. [Laughter.]

**Jackie Dunbar:** I will move on from sewage and pollution to questions about your net zero projects. In your annual report, you mention the challenges that you are facing in negotiating access to land for peatland restoration work. Can you expand on what barriers you are facing to gain that access and say what is being done to improve relationships with tenant farmers and landowners to deliver your net zero projects?

**Alex Plant:** You are right that the issue that we have had in achieving the level of peatland restoration across the hectareage that we wanted has been down to the ability to negotiate access with tenant farmers. As a result of that, we reviewed how we were engaging with tenant farmers and third party landowners to try to understand their views and priorities earlier. That can help us to get to a better position to deliver some of the peatland opportunities that we think exist. Therefore, we realised that earlier engagement could get us to a win-win outcome, so that everybody’s interests are met and we can deliver some of those opportunities. We did that review over the course of this year.

**Jackie Dunbar:** How successful have you been? Are you beginning to see any benefits from that?

**Alex Plant:** It is early to say whether we have got there. The learning from the land in question will be applicable when we look at that issue across the piece. I am confident that those ways of working will yield better outcomes but, at the moment, I cannot say, “And, with one bound, we have delivered all the things we wanted on peatland”, because it is an on-going issue.

We also had deliveries on woodland planting, which was the same sort of question. Some of our schemes have been slower than we wanted. However, again, we have taken the learning and tried to work with all the relevant parties. Although those woodland schemes have been slightly delayed, I am confident that they will be delivered during 2023-24. We wanted to do them during 2022-23.

There is an awful lot of willingness to understand what we are trying to do, but in some of the earlier schemes, we just did not get those

conversations going early enough in the process to allow the plans to come to fruition sooner.

**Jackie Dunbar:** How are the economic global pressures that everybody is facing, such as inflation, supply chain issues and operating costs, affecting your ability to deliver on your net zero projects? Are they having a huge impact?

**Alex Plant:** Yes, they are. As you rightly say, all those factors are affecting people, households and businesses across the economy and we are seeing the same pressures from cost inflation.

We have been seeking to keep making progress on our net zero plans, even with less funding than was expected at the beginning of the regulatory period that we are in, and the update that we released earlier this year demonstrates that we are on track to meet our net zero commitments. However, that is not easy and it is challenging to deliver the operational investment that we must deliver while trying to meet our net zero commitments. At the moment, we are on track.

**Jackie Dunbar:** I was going to ask if you are on track, but you have already answered that.

**The Convener:** You mentioned tenant farmers and woodland. I have not taken part in any questions but I am a tenant farmer and I have woodlands. I say that so that there is no dubiety in the committee about my having correctly declared my interests, which are, of course, recorded in the parliamentary register.

Jim Fairlie wants to come in.

**Jim Fairlie (Perthshire South and Kinross-shire) (SNP):** Alex Plant, you raised the issue of tenant farmers and permission. Can you be a bit more specific about exactly what the issues were? Had the landowners agreed to do something without consulting the tenant farmers? What was the issue with permissions?

**Alex Plant:** [*Inaudible.*]

**Jim Fairlie:** I cannot hear you.

**Alex Plant:** I am sorry.

**The Convener:** Do not touch the button. That will be done for you. That could cause confusion.

**Alex Plant:** Can you hear me now Jim?

**Jim Fairlie:** I can hear you.

**Alex Plant:** My apologies.

I was not directly involved in the issue that we were dealing with, which was about peatland. It is my understanding that the issue was one of negotiating access with a tenant farmer and that things were not as clear as they could have been at tenant farmer level. I am hesitant to go further

as I do not know the intimate details of the particular case.

**Jim Fairlie:** I presume that someone had agreed to allow you access to land to do some sort of peatland restoration without taking into account the person who was actually working the land.

**Alex Plant:** That might have been the case. As I said, I do not have enough detail about the individual case to be able to give you a confident answer. I would be very happy to write to you after the meeting so that I can go back and get a bit more detail that will help me to understand the case and answer your question.

**Jim Fairlie:** That would be appreciated; thank you.

**The Convener:** Alex Plant, if you can write to the committee with your answer to that question so that we are all aware of it, we will ensure that Jim Fairlie gets a copy.

I have some questions about the Circular Economy (Scotland) Bill, but I will leave them until last because other members have lots of questions and I have asked quite a few.

Douglas Lumsden has some questions.

**Douglas Lumsden:** I am looking at the issue of charges to customers. Last year, there could have been an 11 per cent increase, but the increase was only 5 per cent—well, I say “only”. You spoke earlier about increases being lower in other parts of the country and I think that you talked about lost time and suggested that there might be a bigger increase later.

If last year’s increase was smaller than you were hoping, does that store up problems that might have to be addressed? Might bills have to increase sooner than they would have otherwise?

**Alex Plant:** That question is central to how we keep on top of the issues that we are talking about. Although it was before my time, it is my understanding that the board’s decision recognised the particularly acute circumstances that households were facing, first because of Covid and then because of the cost of living crisis. So, rather than raising bills by the level that was expected in the 2021 strategic review of charges, the board decided to hold that back.

That has significant consequences. It means that we have about £500 million less than we expected to have in the investment pot to deliver, across a six-year period, all the necessary things that we have been talking about today. We recognise that shortfall and the need to manage it as best we can, but, as a result of that choice, we will not be able to deliver all the things that we

thought we would deliver when we were at the start of the strategic review period in 2021.

I am not saying that that was the wrong choice. I completely understand the challenge of recognising the particularly difficult circumstances for households while also trying to ensure that we are delivering investment. However, there is a point about the problem becoming bigger each time, if you keep deferring investment. You are always trying to balance the needs of the current generation against the needs of the future generation and trying to plot a course that reaches the best possible balance.

**Douglas Lumsden:** With inflation still high, do you anticipate large increases this year? Obviously, water bills go out at the same time as council tax bills, which are going to be frozen. Do you anticipate that the water charges will be frozen or is that just unrealistic?

**Alex Plant:** We are at the beginning of a process where we work through what the right answer is on annual charges, which is ultimately a decision for the board to take. However, our starting point is to say that, having made the choices that we made in previous years, we recognise that continuing not to recover the investment trajectory that we think we need will have significant impacts on service quality for customers and communities across Scotland. I do not want to foreshadow the discussions that will take place before we come to a conclusion on charges by the end of the year, but my starting point would certainly be to be wary of further deferring the necessary investment.

**Douglas Lumsden:** Just for clarity, you might have a figure in mind, but does that need agreement from Scottish Government? How does that work?

**Alex Plant:** No, it is a decision of the board. We have a formal process whereby that is then worked through with our economic regulator, the Water Industry Commission for Scotland, but it is a board decision. Does Susan Rice wish to add anything on that?

**Dame Susan Rice:** You have basically said it, but for the regulatory review period, which is currently seven years, the overall amount, to put it in simple terms, that can be charged is set out by the economic regulator. It has a very responsible role in that. It is then our job to decide each year how much we should raise the charges. We took an exceptional decision last year and the year before to go in below what we were allocated by way of the raise, and we, including me personally, had a lot of conversations with the previous and current cabinet secretaries, so that they understood fully the implications of holding back. However, at some point you say, "This is in the

best interests of the people of Scotland, given the other pressures that are around."

We cannot do that any more. As Alex said, we do not have a number but we do not expect huge increases. They might be more than we have seen in the past couple of years. When any of those increases are translated to daily living, we are often talking about the cost of a cup of coffee a week. I cannot give you a number, but it is not something that should make the population fall over.

**Douglas Lumsden:** Do you anticipate trying to borrow more from the Scottish Government for the large capital project that you obviously have? It is often said that you are sitting on cash reserves. I do not know how much they are, but could they be used?

**Alex Plant:** Cash reserves today are about £260 million, which is lower than the figure in the report because they were managed down this year. It is important just to step back and explain why we hold those cash balances. It is partly because Scottish Water is a very large business with lots of investment needs and the management of payments and receipts is somewhat volatile, as it would be for any large business of our scale. The cash reserve of about £260 million represents something like nine weeks of trading. That is the kind of buffer that it gives us. As Scottish Water is a public corporation, we do not have access to capital markets in the way that a private company would, to use that as a buffer, so cash becomes a more important buffer for us.

The board regularly reviews its risk appetite on the level of cash balances that it should hold. At the moment, that is around £200 million as a minimum, so the £259 million that I think we are at feels like a reasonable level. Essentially, there is little to play for in that level without getting to a point at which the company's financial robustness would be at risk.

**Douglas Lumsden:** So, when there is a call for you to use more of your cash reserves, you would defend vigorously the position that you have taken.

**Alex Plant:** The position that we are in now is a prudent one to hold at that sort of level. As chief executive, I would be uncomfortable if we were looking at anything much lower than that £200 million level, which starts to become more difficult.

**Douglas Lumsden:** We have heard that, during the coming months, you will be balancing the increase of costs to consumers and your capital plan, and I guess that increases in staff pay will also be taken into consideration. All of those issues will come into the mix before you decide on the increase and your capital spend going forward.

10:30

**Alex Plant:** That is right; all those things are interrelated.

The other thing that is worth saying is that about 80 per cent of our expenditure—historically and currently—is funded from customer charges, and about 20 per cent of it is funded from the Scottish Government debt that we hold. That is an 80-20 split on debt versus income, if you like.

**The Convener:** Jim Fairlie wanted to come in on that, and then I have a brief question.

**Jim Fairlie:** My question is directed to Alex Plant, and it is to do with the fact that I am new to the committee and I am filling in as a substitute member. I was sent a quote from the minutes of the 21 September 2022 meeting of the investment planning and prioritisation group, which Alex Plant sits on. David Satti, the director of strategy and governance of the Water Industry Commission for Scotland, stated that £799 million was invested in 2021-22, but there was no indication as to what had been delivered and whether that amount had been spent efficiently. Is Mr Satti's comment fair? If it is fair, what have you done to improve that situation?

**Alex Plant:** Thank you for that, Jim. I am new to the committee, too, so we are in the same boat from that point of view.

The meeting in September of last year was before my time in office, but I do sit on that group, and I have had conversations with colleagues at the Water Industry Commission for Scotland around their wanting to understand at a more granular level precisely what the investment plan has been delivering. Since Mr Satti's comment last year, we have been trying to work through that, so that we give a much clearer sense of the delivery. There was a global figure of £799 million at that point, and we are delivering more than that this year. We are basically saying, "Here is the investment programme, here is what is being delivered, and here are the outcomes." That is the issue that the regulator wanted a clearer line of sight to, and I believe that we have made progress on that in the year since that comment was made.

**Jim Fairlie:** Okay. Can I ask one more question, convener?

**The Convener:** It is hard to say no, Jim, because you have been very quiet so far.

**Jim Fairlie:** My question is probably not high level enough for this conversation, but I will ask it anyway, on the basis of what you have just said about overall investment and the value of that investment.

I have a constituency issue right now involving the water that runs from the Glenfarg reservoir

down to Glenrothes over a 17-mile distance. There are various leaks in that piping system. What is being proposed at the moment, and I am not sure whether it has actually been started or is still in the space—[Inaudible.]—ground stage—

**The Convener:** Jim, I am sorry for being difficult, but I am trying to keep the questions away from constituency issues. I respectfully suggest that Alex Plant and Peter Farrer come back to you directly on that. Maybe Peter could make a brief comment on it. I know that the matter is really important, but I am quite strong on the need for this committee to look beyond the constituency. I will let Peter come back to you on that and then I will allow you to come back in briefly after you have thought about his response.

**Peter Farrer:** I am not sure which specific matter Jim Fairlie was going to go into, but I give him a commitment that I will take it offline with him and make sure that we answer all his questions.

**The Convener:** Jim, I know that you will find that unsatisfactory, but you have an offer to take the matter offline straight after this committee meeting or as soon as possible. I would like to keep the discussion at a slightly higher level.

I have another question before we leave that area completely. Obviously, not putting up the charges for Scottish Water has implications for how people are remunerated.

Looking at the accounts, it seems that you had more employees at the end of the accounting period. I had not seen that the salaries had gone up significantly to replicate that. It is very difficult to see in the accounts how much of the salary increase on the previous year was due to extra employees or to pay. Is there a conflict between what you can pay your staff and what you can get in from the income that you raise from the public?

**Alex Plant:** I go back to my earlier point about the way that we are financed as an organisation and that 80-20 split. That covers all our outgoings, whether our capital programme, salary bill, energy bill or whatever else it may be. There is obviously a relationship between those things. Part of the reason why the number of full-time employees has gone up is the scale of the capital programme. Although we work with our supply chain on some of the employee consequences that sit within it, in our kind of business we also need more people to cope with that much-increased level of activity. It is the biggest investment programme that we have ever had and we need people to help us deliver it. That is partly where that increase comes from.

Of course, there will also be an element that links to last year's annual pay increase. The two things are both there.

**The Convener:** There is a conflict in what you get in, what you can put your charges up by, and what you can pay your staff.

**Alex Plant:** That is one of the outgoings. They are, of course, interrelated.

**The Convener:** I turn to the next questions. Douglas, have you finished all your questions?

**Douglas Lumsden:** Yes, I have.

**The Convener:** Okay. Monica, I think that you have some questions. I will then go to Sarah Boyack.

**Monica Lennon:** Yes, we are back to me, convener.

Alex, you mentioned pay. Can you give us an update on the current status of pay negotiations with the trade unions?

**Alex Plant:** I will ask Peter Farrer to lead on that, because he leads our negotiating forum with the trade unions and has been in regular discussions over recent weeks—with some frequency, as you might imagine.

**Monica Lennon:** Before Peter Farrer answers, I remind the committee of my entry in the register of members' interests, in that I am a member of the GMB and Unite.

**Peter Farrer:** First of all, I want to say how disappointed I am that we have not managed to reach agreement with our three unions, which are Unison, Unite and the GMB. We have put a proposal to the unions that would give all our Scottish Water employees a generous pay award by any public sector standard and a reasonable process for reshaping an outdated pay and rewards system. We went through a process with the Advisory, Conciliation and Arbitration Service over the two Mondays before this one but, unfortunately, that did not lead to an agreement either.

On Friday, we received notification from the three unions of industrial action that would commence on Friday 10 November. There are three elements to that: a full four-day strike from 10 to 13 November, no out-of-hours standby or contractual overtime for every weekend thereafter until January, and no voluntary overtime continuously until January.

As the committee can imagine, we are working to deal with that and have had a team in place. We have used our very successful Covid management plans, which have been put in place as a good starting point. Our main priority throughout will be to ensure that public health is maintained and that the environment is protected.

**Monica Lennon:** That is very disappointing to hear. Strike action that results in loss of take-home

pay for workers is always a last resort. That is a pretty desperate place to be, with the cost of living crisis.

It is worth going over some of the things that the unions have said in the past couple of weeks. Some of the comments predate the ACAS meeting, but let us get them on the record.

Unison said that there has been no meaningful engagement with Scottish Water bosses—which I guess is the people in front of us just now—that there has been a withholding of information from trade unions, and that

“there is a feeling amongst members that Scottish Water bosses are behaving like Victorian Mill owners”.

Those are serious statements.

The GMB says that Scottish Water is acting like a “rogue employer”. It also said:

“It has been astonishing to watch and a masterclass in how to demolish good and productive industrial relations.”

I could continue with more quotations. All that is pretty damning, is it not?

**Peter Farrer:** With respect, Monica, this is not the forum where we will negotiate a deal with the unions. We have—

**Monica Lennon:** I am not a union negotiator. Given what we have heard about your annual report and your performance—

**Peter Farrer:** I know. I know.

**The Convener:** [*Inaudible.*]

**Monica Lennon:** —and the impact on customers, it is all entirely relevant, with respect.

**The Convener:** Monica and Peter, this is really difficult. I know how seriously you take this, Monica, and I am sure that Scottish Water take it extremely seriously. I do not want anything to be misquoted or for anyone to be misled, which could cause the negotiations to fail.

Monica, you have very much made your points and your comments, and I encourage Peter or Alex to come back on those. I am not asking you to set out a pay statement or to put a pay deal on the table, but the committee is making the point to you that it is very concerned about this issue, and Monica has eloquently made that point. The committee is looking for an undertaking from Scottish Water that it has heard what we have said and to say what it is going to do about it.

**Alex Plant:** Let me come back on that, because what you are doing is setting out some things that have been said, including in the press, by our unions. I do not think that those representations are fair, but they come from a position of deep concern on the part of the unions, and unions exist to do the best deal that they can for the people

who they represent. They are an important part of our negotiating forum, and they are critical to how we have worked in the past and will want to work in the future. I do not want to get into a “He said, she said” thing, because that is not helpful. However, I understand whence that comes.

The point that I would make is that it feels to me that the issue at hand is the need to modernise a 21-year-old pay and grading system. Our colleagues in our unions and colleagues across Scottish Water recognise that that needs to be updated. In bringing in the new pay and grading system, Scottish Water sought to utilise the fact that, by linking it to the annual pay award, we could have greater flexibility than would normally apply in public sector pay policy. Normally, that would be a 3.5 per cent base, going up to 5 per cent if efficiencies could be demonstrated. By tying the two together, we felt that we could get an even better deal for our colleagues across Scottish Water. That is the deal of a minimum of 8 per cent that Peter Farrer described.

There were concerns about tying the two things together, and issues came through in feedback from colleagues, which we sought to recognise in order to go back with an improved offer through the ACAS negotiations. Unfortunately, those have not yet led to a conclusion, but the message that I want to give is that our door absolutely remains open at any time for continued discussions with our unions to reach a resolution and not then realise the very significant issues of take-home pay being lost by colleagues. Indeed, all our colleagues are facing the impacts of rising costs of living, which have been going on without the benefit of an annual pay award for many months. That is really difficult for people. It is in no one’s interest for the pay dispute not to be resolved. We are very keen to resolve it.

**The Convener:** Monica, do you want to come back on that?

**Monica Lennon:** On that final point, I agree that this situation is in no one’s interest. It is not in the public interest or the interest of your very hard-working staff, to whom we are all very thankful.

Therefore, my final question is: given that Scottish Water is a signatory to the Scottish Government’s fair work convention, will you reflect on what has been said here today and elsewhere and demonstrate that there is an effective voice in the workplace for all staff and trade union partners, who play a critical role?

**Alex Plant:** Yes, absolutely.

**The Convener:** Thank you. I am sorry, Monica, to have cut you short.

Sarah, would you like to come in?

**Sarah Boyack (Lothian) (Lab):** Yes, I would. Thank you, convener. I much appreciate being able to ask a question in an interesting session.

Earlier, there was a discussion about resilience and the impact of loss-of-power emergency generation investment, and there is also the renewable power generation programme. I wondered if you would talk a bit about those. There is obviously a benefit in the lowering of climate emissions, but is there also an opportunity for resilience and income generation?

Witnesses have talked about hydro, wind, solar and combined heat and power using organic waste. How does all of that fit into Scottish Water’s overall strategy? Are they income generators?

10:45

**Alex Plant:** That is a really good question. The different aspects have different elements to them, but increasing our energy resilience is part of what the net zero campaign is going to do. Reducing our energy needs is the first thing that can be done, and we have been doing well at that through considering different technologies that are less carbon hungry—particularly when we are delivering investment programmes.

As an example, we have just gone through a major refurbishment of our waste water treatment plant in Dalmarnock, and part of what we did there was to look at particular aspects of the waste water treatment; by shifting to a different technology, we reduced carbon emissions by about 80 per cent, and we reduced our energy consumption. We have also done things such as shift our fleet increasingly to EV rather than petrol vehicles, and we are doing many things that reduce demand at source, as well.

Sarah Boyack talked about solar power, hosted wind power and various other aspects. Those are starting to give us much more self-sufficiency for the energy demands that we still have, even with the reduction in demand.

There is income generation, too. We largely progressed those proposals and programmes through Scottish Water Horizons, which is our non-regulated subsidiary. That organisation has been doing quite a lot on renewable energy, including hydrogen.

We have one of the first pilots on utilising our resources into hydrogen production, which can then give us an income flow, and—going back to the earlier conversations—anything that comes in on that side can help us to offset the amount that we need to seek from customers to deliver resilience enhancements. That is quite an exciting area. There is quite a lot that we can do there, and I would like to do more.

We have an initial pilot on green hydrogen. The most exciting thing about it is the potential to use the final effluent from our treated waste water as an input into green hydrogen production. The key thing about that is co-location, because we need to partner with an energy company that is close enough to our waste water treatment works to make approaches of that kind economically viable.

**Sarah Boyack:** That was very interesting. My final question is about heat and power networks. You mentioned energy from waste. What about the potential for more community-oriented projects, given the infrastructure of water heat networks that Scottish Water has, and which are currently being developed by local authorities?

**Alex Plant:** We capture some heat from wastewater treatment processes, and that is linked into district heating. We have about three pilots around the country at the moment, which is not a large number, but they are interesting pilots that are giving us a sense of what can be done in that area.

A lot of that is based on the ability to partner effectively where the demand is. That applies for district heating, which could involve partnering with local authorities, housing providers or particular high-heat-demand installations such as swimming pools and so on.

We have three processes on capturing heat, but we could look to do more in that area.

**Mark Ruskell:** I am interested to understand how you engage with stakeholders. There are obviously customer forums, and there is the role of the economic regulator, but I am interested in what your relationship is with environmental organisations and campaigners, in particular.

We heard earlier that Surfers Against Sewage has been very critical in recent media coverage. Do you engage with those organisations? Do you meet with the likes of Feargal Sharkey and others who are campaigning in that area? Do you take on board their concerns?

**Alex Plant:** I have not met Feargal, but he was a hero of mine when I was growing up—I had pictures of him on my wall when I was 15—so I would be very pleased to meet him, or any of the environmental organisations that are arguing for improvements.

As I said, the outcome that we want is the same. We sometimes do not agree with the way in which the issue is presented by those groups, because sometimes it is not the most helpful way to help deliver the outcome that we are all seeking. Having moved up to this role in June, my sense is that the relations are generally pretty good. There is quite positive engagement between Scottish Water and environmental bodies, local community

groups and so on, on a range of issues. I am sure that we can always be better, but I do not detect a problematic relationship. There might be differences of view, of course, but the engagement is pretty good.

**The Convener:** I would love to be able to say that Feargal Sharkey was before my time, but everyone knows that that is not true.

Jackie Dunbar, did you want to say something?

**Jackie Dunbar:** Monica Lennon spoke about pay increases and about unions, and I would like to declare that I have a family member who works for Scottish Water. I have not taken part in anything, but in the interest of transparency, I thought that I would declare that to the committee.

**The Convener:** That brings us to the end of our session. Johanna Dow, you are obviously sitting there feeling that Business Stream is perfect, because you have not been asked any questions; I apologise for that.

Alex Plant, Peter Farrer and Susan Rice, there are a couple of questions that we wanted to ask on the Circular Economy (Scotland) Bill, which is currently going through the Parliament, but sadly we have run out of time, so I am going to ask the clerks to write to you all with those questions. I ask respectfully if you could answer them as quickly as possible, because we are considering the bill as we speak.

Thank you all very much. It has been an extremely interesting session. I briefly suspend the meeting to allow for a changeover of witnesses.

10:51

*Meeting suspended.*

10:59

*On resuming—*

## **Circular Economy (Scotland) Bill: Stage 1**

**The Convener:** Our next item of business is an evidence session with the Scottish National Investment Bank as part of our stage 1 scrutiny of the Circular Economy (Scotland) Bill.

I am pleased to welcome Al Denholm, who is the chief executive officer of the Scottish National Investment Bank, and Jimmy Williamson, who is the executive director of the investment team for the Scottish National Investment Bank. Thank you for joining us.

Before we move to questions, I believe that Al Denholm wishes to make a brief opening statement.

**Al Denholm (Scottish National Investment Bank):** Yes, thank you. Good morning to you, convener, and to the committee. I am pleased to have the opportunity to engage with the committee. This is my first meeting with the committee and I look forward to working with you all in future.

In terms of my background, I have worked in the investment industry for more than 35 years, initially with a subsidiary of the Royal Bank of Scotland before managing investment portfolios and investment management business units for a number of leading asset managers. That experience included Aviva Investors, Prudential, BlackRock, ING Investment Management, Insight Investment and Scottish Widows. I have also led environmental, social and governance investment teams since 2000, and their development has been something of a theme throughout my career.

I took up the post as chief executive of the Scottish National Investment Bank in May of this year. I am joined by my colleague, Jimmy Williamson, who will introduce himself.

**Jimmy Williamson (Scottish National Investment Bank):** Good morning. I am an executive director on the investment team. My background is in more than 30 years of investment in corporate banking, private equity and venture capital, as well as supporting private equity management buyouts in multiple sectors and consulting in the industrial and energy markets.

My day-to-day job at the Scottish National Investment Bank is leading one of the investment origination teams, which means originating, finding, sourcing, executing and structuring the investments that we make. I am also partly involved in managing those on an on-going basis.

**Al Denholm:** Thanks, Jimmy.

Since coming into the post, I have been pleased to see the progress that the bank has made since its launch in November 2020. We are coming up for our three-year anniversary very soon. I am hoping to work with the team to build on that progress. I see particular opportunities to further develop the bank's reputation as an impact investor and in working with institutional investors to mobilise their capital to meet the key economic and societal challenges and opportunities that we have in Scotland.

The bank has now concluded 29 investments, committing almost £460 million directly, with £750 million crowded in from third-party investors as well. That takes us to more than £1.2 billion of economic impact into the Scottish economy in those first three years.

We are pleased to be here to discuss the circular economy. That is an area in which we see an important role for the bank, and it is one of our key strategic initiatives or priorities. We are supportive of initiatives to support the circular economy including the introduction of the bill. I appreciate that the committee has been hearing detailed feedback on some of the proposals in the bill. As an investor, though, our interest is mostly at a higher level—how the bill might support the development of the circular economy business models to support and scale up circular businesses.

We are happy to share our perspectives and to provide an investor's point of view on the development of the circular economy and the various business models therein. We already have a number of investments in that area. A particularly strong example, which the committee may be aware of, is a natural fibre insulation manufacturer called IndiNature, which our £5 million investment has supported to open a manufacturing facility in Jedburgh. We are seeing other opportunities in the circular economy coming into our pipeline and we hope to conclude more investments in that area in due course.

I will conclude there. We look forward to our discussion.

**The Convener:** Thank you. You have quite a few questions coming your way. The first questions come from Monica Lennon.

**Monica Lennon:** Good morning, panel. I did not catch all the details, but you gave an example just a second ago. My first question is to ask how the Scottish National Investment Bank is currently supporting the transition to a circular economy in Scotland and how that links to your mission and investment principles—for example, to seek to invest where the private market is failing and to be a patient and ethical investor.

**Al Denholm:** I will give an overview of that, and then I will ask Jimmy Williamson to go into a bit more detail with some examples, if you do not mind.

When the bank was set up, one of the key objectives was to focus on the transition to net zero, and on the circular economy as a core part of that. Whether we use less or recycle, it all plays into that, and we think that it is a good and positive thing to do. We are aiming to do that strategically by setting a focus on the area as a key objective for the bank. Over time, we will publish our results and how we are doing in that area—for example, the amount of money that we invest in businesses; by how much waste has been reduced; and how those businesses contribute to the circular economy. It is a key initiative for us.

As I mentioned, we have been starting to make some investments in the area. We are clearly reliant to an extent on what I will call commercial opportunities coming our way. We are not a grant or project-financing body—we invest in and support businesses as they have a commercial opportunity to scale up. If a business is attractive, or if we can help it to look attractive from a commercial perspective, that offers a strong opportunity for third-party private capital to come in alongside us. Obviously, private capital has its own target returns and objectives; most of those private companies want to make a positive return on their capital, in the same way as we do as part of our mandate.

Jimmy Williamson can give some examples to bring that to life.

**Jimmy Williamson:** In 2023, for the first time, we added a new objective to the net zero mission aims in our impact report, which is to grow the circular economy by 2045. That raises the prominence of the circular economy in our core mandate, as part of our net zero mission investment objectives.

In practical terms, that means that we are bound by objectives, as well as at an institutional level, to report on the progress of the investments that we make in contributing to that end objective. We aggregate those key performance indicators that we establish for individual business investments.

In practical terms, that will involve the amount that is invested in circular economy businesses and the proportion of the bank's investments that contribute towards the circular economy. It could also involve KPIs at business level, where we have targets on the re-use of materials—for example, the recycling of products that have gone off. Those will be aggregated at institutional level, and we will report on the themes that underpin the trend towards a circular economy in our annual impact report.

The message is that it will become part of our core reporting framework.

**Monica Lennon:** To build on that, can you say a little more about the key opportunities to integrate circular economy principles across your missions of net zero, improving places and harnessing innovation? Will you look at circular economy principles when you are investing in housing, energy projects or technology, for example?

**Jimmy Williamson:** The consistent theme is that circular economy principles are very broad based. Although we position them within our net zero mission, they apply across all our mission areas, including the place mission as well as the innovation mission.

I will paint some examples of the type of business models that we expect to see and where we think that the opportunities lie. With well-thought-out legislation, and the regulation that comes from that and actually creates business models, those businesses will need to comply with that. There is obviously a cost to doing so, but equally there is a consequence of not doing so.

What we find in other markets where regulation is imposed is that business models establish themselves to help businesses to comply in service provision. That is one example of where we would expect to see interesting business models for investment opportunities.

There are other features that we see. Scotland is instituting these bills, which puts us, relatively speaking, ahead of the curve in comparison with other countries. Some countries are arguably ahead of where we are, and we would take soundings from those countries to understand what best practice looks like. However, in our experience, such an approach creates business models. If we are ahead of the game internationally, it creates export market opportunities, so businesses that are developing circular economy models in Scotland can then start to export those models globally.

I have seen examples of that. In the chlorofluorocarbon and refrigeration-gas sector, for example, recycling and reuse of those harmful chemicals were contained within a smaller number of businesses that became experts in those fields. Those business models exported themselves around different international territories as regulation developed. We like supporting export-orientated business models, so we see opportunities there.

We also look carefully at areas in which Scotland has a particular competitive advantage or where we have industries in which we are strong. Whisky would be one good example; the wind sector would be another. Where we find circular

models that play to those indigenous industries, they rank higher on the bank's priority list of where to deploy investment.

That gives some context around the types of industries and our approach, but I think that you asked a question about housing. Could you remind me of it?

**Monica Lennon:** That was just an example. You mentioned wind, so do you want to expand on that? What do you think the opportunities might be there?

**Jimmy Williamson:** I would be happy to. Clearly, the market development being done by ScotWind is placing Scotland at the forefront of floating offshore wind.

We see circular economy opportunities in the wind sector in a couple of areas. There is a real issue in the wind industry with leading-edge erosion—I might get a bit technical—on the blades themselves. Historically, manufacturers and developers would just dispose of the blades and replace them with new ones. That is very expensive, and the new ones were not really costed. Business models are being developed that use different types of materials and techniques to predict the failure rate in those areas, so that performance can be improved. We also expect to see, over time, certain products being engineered to be able to be replaced; for example, inserts can be put into the blades. That is one example of where the business models are developing. Another example of that is in the area of turbines.

There are parallels in the aerospace and gas turbine industries, where very detailed and complex supply chains have been built up to address failure of parts in order to enhance the performance over time of the embedded infrastructure and equipment. The wind industry, because it is less mature, has not developed the same level of supply chain support. We see opportunities to help the embedded infrastructure that will go into Scotland to be less disposable, with a supply chain that helps to prolong the life of turbines, for example. Those are a couple of examples of where we see opportunities.

**Monica Lennon:** That is helpful. I have a final question, and I will stick with you, Jimmy. You mentioned KPIs. What metrics and KPIs do you use in assessing investments to support the transition to a circular economy? You just talked about supply chains. Do you look systematically across the supply chain of a project? Does that include looking at things such as the ethical extraction of virgin resources, embodied carbon, biodiversity impact and the circularity of resources? Are you confident that your investment criteria are robust enough to avoid any harm in those areas?

**Jimmy Williamson:** In terms of KPIs, you are correct. For every investment that we make, as well as developing objectives on the financial performance of that investment, we develop a suite of KPIs on the impact outcomes that we expect from those investments.

We very recently developed a broad and detailed set of KPIs that are pre-engineered and pre-loaded for individual sectors. We have our own pre-agreed set of circular economy KPIs. We have looked at the circular economy industry sector to see what good looks like and we have developed a range of KPIs that we will apply in that sector; we will then need to be proportionate and choose the right KPIs for individual businesses.

That work enables us, when we see a circular model that we consider investing in, to draw from a universe of pre-existing outputs and measures for those outputs that are appropriate and should deliver the desired end results.

We are in the early stages of developing that more systematic approach to KPIs. We expect to see the outputs of that in due course and will report on that in our annual impact report.

11:15

**The Convener:** I am interested in how you come up with the investment. With the current bank rate, some investors might look at a straightforward investment with a fairly moderate rate of return of about 8 to 10 per cent. With a riskier opportunity, that might go up to 17 per cent; it might go up even higher, depending on what investors are looking at for a rate of return.

You obviously will not be looking at that, which means that you could be investing in more risky businesses. You are not going to give me the standard rate of return that you would expect for your investment, but can you talk more about that so that I can understand how you are a facilitator to allow that without taking all the risk in the most risky projects?

**Al Denholm:** I will tackle that question from a strategic holistic perspective. A key point is that we were set up as a development bank to take some risks that the private sector might not take. We were also set up with a clear set of guidelines that include the fact that we cannot crowd out the private sector. Therefore, we cannot offer investment terms that are well below commercial rates, because that would impinge on state subsidy control rules, so we are very cognisant of the market rate.

Convener, you mentioned some numbers, which are the sorts of numbers that we might look at on individual deals, based on the risk profiles.

However, it very much comes down to the credit risk that we are taking and the commensurate interest rate that is charged on the debt or the equity valuation that we place on something.

We have that mandate to operate commercially but, with some investments, you will sometimes find that the private sector does not want to come in, even at higher commercial rates, because of the risk profile. That is the role of the development bank. In practice, that might mean that we take a longer-term view. For example, we might go in to create an opportunity and therefore crowd in other lenders or investors when the opportunity has developed a bit further and perhaps been de-risked a bit, because that then allows them to come in and get it through their credit committees, for example. That is how it works in practice. However, we absolutely do not intend, and nor are we allowed, to price below commercial rates.

**The Convener:** However, longer-term investments mean that you tie up your capital, which means that you cannot replicate the investment as and when it is needed. What I guess I am trying to ask you, in a very clumsy way, is whether you would ever be below what the bank base rate is plus about 4 per cent?

**AI Denholm:** It depends very much on the opportunity. We do not price on that basis; we price on a risk basis, based on the commercial rate at that point in time. As you know, interest rates have gone up recently, and, therefore, the prices that we would lend at have gone up commensurately.

**The Convener:** But you will never be below the bank base rate, will you?

**AI Denholm:** I just cannot imagine that, no. We could do something today and the bank base rate could change, so something that was written a few years ago—

**The Convener:** I understand that. Some people who came in two years ago when the rate was 1 per cent or thereby will have got a very good deal, especially if they went for a 30-year transaction. In hindsight, that probably does not look that good in today's market in order for the bank to have the capital to invest in other projects. How do you balance those aspects?

**AI Denholm:** Jimmy Williamson can talk about what we are seeing happening today but, on your point about recycling, one of the things that we are focused on is ensuring that we invest with a view to removing our capital at some point in future, whether that is an equity investment or debt investment, so that the capital is not tied up for ever, as you are indicating, because that is absolutely not our objective. Our objective is to provide some development capital to support the business in its growth stage. Over time, a third

party will come in, and the need for our capital will be removed. At that point, we can take that capital, either through income return, equity return or debt principal return and recycle it into other investments. That is the general model that we are talking about, so we are totally aligned with not tying up capital for ever.

**The Convener:** I understand. What is the average time that you would aim to invest in a project for?

**Jimmy Williamson:** The period depends; it is determined by the project and the market. In our mandate, we have been given flexibility to lend money to businesses on a fixed basis, but we can also lend on a floating-rate basis. As we are investing over a relatively longer period, we have to be responsible, as any commercial investor would be, and understand the counterparty risk.

If you are investing on a fixed basis—for example, by lending—locking in the rate will look quite expensive at the moment. We have the flexibility to offer floating-rate lending at this point in the cycle, which would be expected. The projects and businesses that we are looking at, which are considering a lending-type investment rather than an equity-type investment, are more likely to take a floating-rate exposure, because the assumption is that rates will come down over time.

That plays into the point that we have flexibility to adapt to what the client is looking for. Ultimately, the client is the decision maker; we do not impose a structure on it.

**Mark Ruskell:** My question is about the role of small and medium-sized enterprises, social enterprises and community businesses in the circular economy and whether they can be supported through financing. Over the years, that is where some great innovation has taken place in relation to the circular economy. Can you find mechanisms to support such business models?

**Jimmy Williamson:** I touched on the point that we see circular models across a wide range of business situations. We might look at pure-play projects where some form of off-product from another industry is being treated. By definition, that is a project, so it might involve a business that is just setting up or something that exists not as a business but as a special purpose vehicle.

We understand your point about SMEs. One of our more general concerns is about new regulation in industries. In general, larger enterprises are better placed to comply and have the financial and physical resources and the people to deal with that. Sometimes, SMEs are more challenged by that.

Regardless of whether there is a circular play, our approach is that we are set up to invest in

SMEs—arguably more so than in larger enterprises. Subsidy control rules encourage us to support SMEs; dealing with larger enterprises is more problematic and involves navigating more hurdles. In that context, our ability to help to finance SMEs is built around their investment thesis rather than addressing a cost issue.

**AI Denholm:** We see a couple of facets to our role. When a business is ready for investment and is ready to scale, as a development bank, we can help it to do that. That applies to a business that has a path to profitability—perhaps it has visible sales—and can scale. That is the here and now of what Jimmy Williamson and his origination team look at.

We also have a number of people in our team who focus on the market creation element that Mark Ruskell just referred to—that is how I am thinking of the question.

**Mark Ruskell:** Yes—the question was about commercialisation benefits.

**AI Denholm:** Those people are convening and sharing insights with key stakeholders and players in industry, whether that be in housing, the circular economy or natural capital. We engage in conversations, hold workshops or conferences and share insights about how such activities could, at some point in the future, attract commercial capital. That is how we see ourselves operating.

To give an example, yesterday, in a call with an agency, we talked about how we could work together to see whether it could bring capital into its space. We understand what commercial investors are looking for. As a development bank, we are the conduit; we are in the middle, so we can see whether, over time, we can join the dots. That will not happen overnight, but we are actively focused on that market creation—that is what we call it internally.

**Mark Ruskell:** That is useful to know.

You mentioned the restrictions for the bank on funding public bodies. Do you see that situation changing over time? I see it as an area of frustration. I was talking just yesterday to Fife College, which is going through a massive redevelopment of its campus, and there is a frustration that it is not able to invest in electric vehicle charging facilities or renewable energy in the way that it might do if it were set up as a different body.

There seems to be a lot of frustration in the public sector that there are investment opportunities right now, as infrastructure that is needed to tackle the climate emergency is being built, but the finance is not always there.

**AI Denholm:** We have many incoming inquiries, and one of our key criteria is that the project has to

be ready for the commercialisation phase. We are talking to a number of major entities—housing, universities or whatever—with which we could perhaps come in on projects as part of an overall business plan. As Jimmy Williamson said, however, one of the problems with a project is that it is a sunk cost and you can never release your capital back out of it. We can be a catalyst but, from our perspective, we would ultimately like to get a return.

We would, therefore, seek to talk to those entities and ask how we can help them to achieve their goals through our market insights, rather than having us necessarily invest directly, because I do not believe that it is in our mandate to do so.

**Mark Ruskell:** Finally, I turn to the opportunities around offshore wind, which you mentioned. There is potential with onshore wind too, and with a linkage between the onshore and offshore sectors. Given that we will be going through quite a dramatic phase of repowering onshore wind farms, do you see a circular economy opportunity to develop a supply chain and links to the offshore industries?

**AI Denholm:** We are supporting both onshore and offshore—we do not have a mindset of focusing specifically on one or the other. In response to your supply chain questions, we are also actively seeking to develop the supply chain in Scotland. We have found that the supply chain tends to be quite limited in Scotland; a number of studies have suggested that a lot of components are imported. It would be great if they could be manufactured here, and ScotWind provides an amazing opportunity for us to do exactly that.

For the consents that have been given, there was a requirement for people who bought the licences to commit to supply-chain spending in Scotland. We are actively trying to develop those supply chains—it is a priority. If we can do that, it will be a massive opportunity for Scotland.

To go back to Jimmy Williamson's point, once we create that expertise, we can then export it: the oil and gas sector created globally leading expertise and you can now go anywhere around the world and hear a Scottish voice on those kinds of projects. It would be nice if we could get there with wind as well.

**Mark Ruskell:** Is there something in particular about the way in which the ScotWind process has evolved that has helped in that regard? For example, the supply chain statements have been up front in the bids for ScotWind leases. Has that revealed or provided a bit more certainty about where the opportunities are? Has it helped to stimulate things?

**Al Denholm:** Jimmy Williamson is the day-to-day lead on that, so it is a very appropriate question for him.

**Jimmy Williamson:** From an investment perspective, it creates something that is deemed to be highly unusual, in the sense that there is a very significant long-term structural growth opportunity in offshore wind in Scotland. It has political support, broader community support and economic support. The projects take a number of years to develop and put in place, so that momentum creates a very stable environment—relatively speaking—in which to make investment decisions.

An important point concerns the frameworks that have been created around how ScotWind projects are developed. ScotWind is predominantly underpinned by floating wind technology, because the turbines and the locations are further offshore. That in itself is a new technology, and there is more technical risk.

11:30

There is a very interesting transition finance play around taking skill sets from the offshore oil and gas industry, in particular around the north-east—the engineering requirements for floating platforms are quite similar to what was used in the offshore oil and gas industry, so that helps.

To go back to Al Denholm's point, the UK's offshore wind capacity and capability—of which Scotland is an important part—is, outside China, number 1 in the world. It is the leader in the sector not only in deployed offshore wind infrastructure, but in terms of commitments to more capacity going in.

We have got to that position on an import-led model, with the original equipment manufacturers, the supply chain and so on. Interestingly, we are exporting our people—if we look at recruitment businesses for specialist skill sets in that sector, we see that those skills are being exported globally, because they are very flexible resources.

Just now, we are seeing what are turning out to be well-crafted, thoughtful policies and systems that are put in place to encourage an investment regime by which we can create in Scotland some of what would have been imported. That includes sustainable original equipment manufacturers as well as better, longer-lasting port infrastructure.

Ultimately, we want to get to a place where that infrastructure and those businesses that we create here are not in the UK and Scotland just for the growth phase—we hope that, in due course, they will start to serve export markets. In our view, that creates a much more sustainable investment-in-business community.

**Jackie Dunbar:** The Circular Economy (Scotland) Bill includes powers to set legal circular economy targets. Can you explain what you think that the impact will be on the investment environment as a result of having those targets in place? Do those targets drive investment?

**Al Denholm:** I will answer that broadly, rather than specifically in relation to the bill. One of the key points is that businesses—globally, not just Scottish businesses—like to have some certainty in a couple of areas. One is the direction of travel for every policy or for new industry targets, whatever those targets are—I am not here to suggest what they could be. As a general comment, however, I think that it is fair to say that businesses that are hoping to make commercial investments like to have some degree of certainty as to what the environment will be like when they make those investments. The circular economy is no different from any other industry—that is just a general statement—so I think that that will be helpful.

**Jimmy Williamson:** To add to the point that I made earlier about business models, if not complying with regulation has a consequence, that creates business models that will help businesses to comply in that way. That can involve separate businesses that are set up specifically for that purpose, or existing service providers that do something similar and then move into that space. There are business opportunities to help businesses to navigate the new legal framework.

**Jackie Dunbar:** Do you think that the SNIB has the mandate to pursue circular investment opportunities in and around the areas of reprocessing or reuse, which are geared more towards reducing consumption emissions and may not actually reduce our territorial emissions?

**Al Denholm:** I am trying to work through that question—I am sorry; it got quite complicated at the end. Would you mind repeating it?

**Jackie Dunbar:** Do you think that the bank has the mandate to pursue circular investment opportunities in and around the areas of reprocessing or reuse, which I feel is geared more towards reducing consumption emissions rather than our territorial emissions?

**Al Denholm:** In general terms, anything that we can do on reuse is positive. If that means having some form of processing to make that happen, it would seem to be, at first blush, something that we might look at. However, as I said earlier, it has to be something that fits with our overall mission and with both our KPIs and our commercial KPIs.

If I understood your question, an example is that investing in developing a port might lead to some carbon or to some concrete being poured, but it also creates the opportunity for offshore wind to be

developed. We have taken the view that it is better to do the former in order to achieve the latter, in that example.

**Jackie Dunbar:** Have you come across any tensions between reducing our carbon footprint and our domestic net zero targets?

**AI Denholm:** Are you aware of any, Jimmy?

**Jimmy Williamson:** There is societal endorsement that it is a good thing.

Most of the circular opportunities that we see now and that we are likely to see in future are industrial and commercial in their nature, rather than at the retail level, but there are retail and consumer opportunities. We were talking beforehand about a business called Bike Club. Kids grow up quickly and they do not use their bikes, so they become resources that are left behind, and it is expensive for the families concerned. Bike Club created a subscription model: families subscribe so that their kids have access to new and second-hand bikes and the total cost of the subscription over time is less than buying bikes would be. It could be argued that that may or may not result in more bicycle sales for manufacturers of bicycles. However, on a societal level and a business level, it is endorsed as a good thing.

The feedback that we get from businesses about circular models is generally not pushback. Businesses are not saying that circular models are bad or are going to reduce output or growth opportunities. We would struggle to think of any businesses where that is the case. Most accept this as progression.

**Jackie Dunbar:** They see that there are different opportunities.

**The Convener:** In your 2022 report, you mentioned “enablers”—people who will increase investment. Who or what are the enablers? Can you give us a bit more information on them?

**AI Denholm:** I am sorry, but I took up my role only a few months ago, so I do not remember the 2022 report. Could you give me some context?

**The Convener:** The report highlights the importance of “enablers” in facilitating the growth of impact investment. Who or what are those enablers?

**AI Denholm:** We have already touched on a couple of the themes. A couple of the enablers are policy certainty and working with agencies. We talked about creating clarity between the private sector and the public sector, which can enable us to do some market making. As a development bank, we can sometimes go in earlier than a commercial bank would, so I consider that as an enabler in helping to create a circular economy.

We have already touched on a number of examples of what I imagine that word means. I am sorry—I do not know the specific context that you are referring to—but that is what I imagine was meant by the word. We are also crowding in—

**The Convener:** Yes, I understand that. I am trying to work out whether other people are following your lead. Private investment banks are getting involved in forestry, for example, and I am trying to find out whether there are other such enablers.

**AI Denholm:** That is a really good question. One thing that I have noticed is that, over time, a number of large asset owners—we count ourselves as an asset owner, with the £2 billion commitment—have become very interested in committing to impact investments in a way that they were not 20 or 30 years ago, or even 10 years ago. Such investments were not on the radar of many chief executives or chief investment officers of large institutions, although, obviously, some of the impact funds and environmental, social and governance funds were market leading.

I have noticed that, in recent years, among large insurance companies, large pension schemes and other entities such as ourselves, the UK Investment Bank and the British Business Bank, there has been a massive shift—a change in mindset—to focusing on enabling investments in the areas that we are talking about. We all have similar impact theses in our mandates, although some are not as direct as ours. That part of our mandate is front and centre. Other organisations’ mandates might have commercial considerations as the first objective, with impact as a secondary objective, whereas we clearly consider impact and commercial issues equally.

There is a lot of interest in providing capital to support such projects over time. That is why, as we said earlier, providing certainty and clarity is important, as it will help with money being committed. If you sit on an investment committee, as I have done, at XYZ insurance company—I mentioned earlier that I have worked on investment committees for five or six companies, and I have been the chief investment officer of a number of them—you have boxes to tick and risk and governance processes to go through. All those companies are looking for clarity that their investment will be safe and will achieve good at the same time.

**The Convener:** Okay, I understand that. There are companies and banks out there that want to join you.

**AI Denholm:** Yes.

**The Convener:** You have clear principles and standards of practice in relation to how you invest. Who will ensure that everyone else follows those

standards and principles, and how will they do that? You would not want to be tied to an organisation that had fewer principles and lower standards of practice, would you?

**AI Denholm:** One of the key things is to bring the market along with you. If you are a leader, the key is to convince others to come along and share those views. I have been down in London for the past two weeks speaking to some large institutions—I do not want to name names—which are all on journeys and are developing. I have worked for a number of such institutions throughout my career, so I can see the journey that they have been on. It is a moving feast.

I think that the Scottish National Investment Bank is slightly further ahead on that journey. What we are doing by, for example, publishing our impact report is market leading. We are about to publish our carbon management plan, which we also think is market leading. By putting that out there, we will set standards that, we hope, others will aspire to in time.

It is a journey. Not everyone will copy us; organisations will all have their own views. However, if we seek to go on that journey and to learn at all points—we are a young organisation that is seeking to learn—we will seek to improve on all those elements. We are not brilliant and do not profess to being so, but we are seeking to become a market leader in all those areas.

**The Convener:** I am gently pushing you to see whether you are going to codify the principles and standards of practice, because, as an investor of money from the people of Scotland, you surely do not want to be involved in something that does not epitomise everything that you want to do as a bank. Will there be a code? Will you lay those things out, or will someone else lay them out for you to follow?

**AI Denholm:** In our impact reporting, we clearly set out the impact that we are making across all the missions and sectors, and the information is getting more and more granular over time. Compared with the position three years ago, there has been an evolution in that regard.

The bank's board has just signed off a set of targets for the impacts. We do not think that many private sector investors are publishing targets. A lot of them do backward-looking reporting, which is fine. It is good for that information to be in the public domain, but the setting of targets and mission levels is something that will set us apart. We continue to do that, but we are doing it in the context of our grand challenges and what we are seeking to achieve, so we are making sure that the targets are relevant to what we are seeking to achieve and that we are not taking a scatter-gun approach across all areas.

**The Convener:** Have those targets been published yet?

**AI Denholm:** Not yet. They have just been signed off by the board. They will be published in due course.

**The Convener:** Okay. From the committee's point of view, we would like to see those targets as soon as possible so that we can understand how they fit into the evidence that we have heard today.

**AI Denholm:** Sure—of course.

**The Convener:** That would be extremely useful.

Douglas Lumsden has some questions.

**Douglas Lumsden:** Will you update the committee on the £9 million investment that the bank made in Circularity Scotland? Do we expect any of that money to come back?

11:45

**AI Denholm:** As you mentioned, a few years ago, we invested in Circularity Scotland with a £9 million debt facility. In our latest annual report, we show that, at that time, we expected a write-off of £4.5 million. We also said in the annual report that we expect to recover about £1 million, but that will be very much dependent on the administrator process. Since that point, we have had no further insight into what the specific number will be, but we are aware that the administrator is going through a due process. From what we are hearing, that seems to be a reasonable estimate of recovery.

**Douglas Lumsden:** What happens to the other £3.5 million, if you expect—

**AI Denholm:** At the time of writing the annual report, which was in March, that was our view. As you know, things have developed since then, which have crystallised what was at the time an unrealised loss into a highly likely loss of a much higher magnitude, which is where we are now.

**Douglas Lumsden:** From that £9 million, you expect £8 million to be lost?

**AI Denholm:** Yes—it is around that number.

**Douglas Lumsden:** Okay. What lessons have been learned from that process of lending to Circularity Scotland? Was the internal market act not previously seen as a risk, and is it seen as a risk now? Has anything changed in the bank when you look at potential investments?

**AI Denholm:** I went through the due diligence process for CSL after I joined. Clearly, that process was happening just as I joined, so I wanted to get myself up to speed and, therefore, the answer that I give will be based on that. At the

time, I think that the investment involved the relevant due diligence, in terms of opportunity and risk analysis, that you would expect of any asset manager that I have looked at. The elements of risk were properly discussed.

One element that we saw at the time as being what we call a risk mitigant was that deposit return schemes were being used in a number of countries globally. The UK Government and various political parties in the UK, as well as the Scottish Government and the Welsh Government, had all shown their support for such a scheme. Our view at the time was that that was a positive backdrop for the Circularity Scotland business case.

As it turned out, there were nuances in the internal market act, which was new legislation that had been developed and was, I think, introduced in 2020. In some ways, it had not been tested—clearly, it was tested with the deposit return scheme. My understanding is that the feedback at the time was that the various Governments that I referred to, including devolved Governments, were still in support of deposit return schemes. The key issue was around the timing of some of the elements.

**Douglas Lumsden:** When making investments in future, will you have a closer eye on the United Kingdom Internal Market Act 2020 and the potential that it could—

**AI Denholm:** One would clearly take that into account as a lesson learned, if a similar analysis was required for a company that we were looking at. There is not that potential issue with all companies. As a learning organisation, we would do that. Having been an investor for 37 years, I know that there are always learning opportunities. A skilled investor will always learn lessons—the bank will not not learn from those lessons, if you see what I mean.

**Douglas Lumsden:** Do you think that the whole episode will put off investors from looking at certain areas of the circular economy?

**AI Denholm:** As I said in answer to Ms Dunbar's question, having clarity and consistency on regulation is absolutely important for any investment, particularly in a new area. In an established business area or part of the economy, that is less relevant but, when trying to create a new industry or service, it is very important to have that stability. If you are seeking to crowd in private sector investment, the more stability and transparency that can be produced, the better. That is part of what we are doing here in the committee.

**Douglas Lumsden:** You said that the bank has been going for three years. Scottish ministers were meant to set up an advisory board when the

bank was created, but there is no sign of that yet. Do you have any more information about when that advisory board will be created and what its role and function will be?

**AI Denholm:** You are right. When the bank was set up, there was provision for such an advisory board. We understand that it is not specifically our responsibility to do that; it is the responsibility of the Scottish Government to set up that board. I hope that, now that the issue has been raised, the Government will focus on setting that up.

In the meantime, the Scottish Government has oversight of the Scottish National Investment Bank in a number of ways. We have ministerial oversight and director-general economy oversight, as well as having a shareholder team that oversees us and responds on our behalf, and we appear at committee meetings. I stress that we are by no means unsupervised at this point, but that we are talking about an additional level of oversight that was written into the act.

**Douglas Lumsden:** The board is meant to provide

“advice on the Bank's objects, conduct and performance”.

I am slightly concerned about who is carrying out that role, if the board is not in place. Will those people also fit into your risk management framework? I imagine that they would.

**AI Denholm:** We agree philosophically that that board should be put in place, but the answer that I have just given is that there are a lot of people who assess us. In addition, we have an independent board that performs that role. Members of that board are very experienced and have a corporate governance skill set. They come from a number of sectors and from public as well as private sector backgrounds. Clearly, the element that you mention needs to be completed because that bit is missing just now, but day-to-day-governance is robust.

**Douglas Lumsden:** Thank you. I have more questions, but I think that we are out of time.

**The Convener:** We are almost out of time. I have a question about something that Douglas Lumsden asked about. You say that you hope to get back £1 million, which is quite a high rate for an investment of £9 million, when there are liquidated assets. There are not many assets in that. Are you really comfortable that you will get back £1 million?

**AI Denholm:** The feedback that we have had from the administrators is that that is a reasonable assumption at this point. However, the devil is in the detail, and we will find out in due course, once we have completed the process.

**The Convener:** I respectfully suggest that administrators' fees can be quite high. It will be interesting to see if you get your £1 million back.

I have a brief question. His Majesty's Revenue and Customs always gets paid first, before anyone else. There is an argument behind that. Should the Scottish National Investment Bank, because it uses public money, be up there with the priority creditors, or do you think that there is no reason to call for that?

**AI Denholm:** That is not a question that I am qualified to answer; other people have a better view on that. I hope that the administrators will take those factors into account.

**The Convener:** HMRC always seems to get its money before anyone else.

Sarah Boyack has some questions.

**Sarah Boyack:** I have two brief questions. The first follows up on the issue of renewables regeneration. Mark Ruskell talked about repowering onshore wind. There are massive opportunities for offshore wind, but we have had many of those opportunities for 20 years. How can we take a circular economy approach, reusing existing infrastructure and making it last longer? You talked about ScotWind. There are huge opportunities, but how do we actually deliver opportunities for green industry in Scotland? What are your thoughts about that actually happening, rather than being just a good opportunity?

**AI Denholm:** We are short of time, so I will give a very quick overview. We are in active discussions with a number of projects that aim to deliver ScotWind in different formats. That includes speaking with field operators about offshore wind and with those involved in manufacturing the original equipment in Scotland.

Clearly, those are all commercial discussions, but there are a lot of those happening. As I am sure you know, the Scottish Government has also set up the strategic investment model structure to try and channel a number of those. We are liaising with people and expect to see a number of specific projects coming out of that process imminently. You are absolutely right: it is important that we deliver in this area and ensure that we fulfil the promise of ScotWind.

I see two elements of ScotWind as important. One is how the blades and the masts operate and deliver electricity; the other—which, for me, is just as important—is getting as much of that equipment as possible manufactured and serviced in Scotland, as that will ensure that we deliver the full economic benefit from the sector. We are focusing on both elements.

**Sarah Boyack:** That sounds good. We will keep our eyes open for that second element happening,

because it is not only the new construction that is important, but the reuse of existing equipment. That would be exciting.

**AI Denholm:** Yes, and the reuse of existing skill sets is also important. Jimmy Williamson talked about all the people who have been working in the oil and gas sector for many years and have a lot of transferable skill sets. If we can help transition those skills into this renewable area, that would be a big positive.

**Jimmy Williamson:** I would make one final point on that. We have structured our investment origination team around offshore wind as a specific vertical. That creates responsibility and accountability in our investment team around resourcing and originating those transactions, which makes the process more refined and more targeted to individuals, so that we can be clear in the ecosystem that we operate within that we are close to where those opportunities are likely to come from.

In a broader sense, observationally, having worked in many investment institutions, I can say that the pipeline that we have is real, credible and significant, and it covers many disciplines—manufacturers, ports and infrastructure as well as, potentially, generation opportunities.

**AI Denholm:** It includes support vessels, chains and so on.

**Jimmy Williamson:** Yes. As I say, our experience as commercial investors tells us that the pipeline looks and feels real and credible. The risks are around the fact that, as we have already discussed, interest rates and inflation are higher, which means that the situation is not easy for people who are looking to invest in capital projects just now. We are seeing things slipping to the right a bit, but that is similar across other construction sectors. However, as I said, the pipeline is real and credible—that is our view of what we are seeing on the ground.

**Sarah Boyack:** My second question concerns the local authority targets in the bill, which will mean a huge amount of new investment in things ranging from vehicles to infrastructure to waste processing. The SNIB is not allowed to invest in public bodies, but to what extent does the bill present us with an opportunity in terms of infrastructure investment, so that we are able to see that acceleration of projects, particularly when some local authorities are doing a mix of public and private investment, with the local authority providing part of the investment and working closely with the private sector?

**AI Denholm:** As you mentioned, we are not allowed to invest in that area but, as I said earlier, we are trying to work in the market creation role to bring commercial activity into some of those areas.

That is a nascent activity for us—we are three years old, but we are seeking to do that and have people who are working and having conversations with relevant authorities. We have also invested in a couple of electric vehicle charging businesses, which are up and ready to go as soon as some issues are smoothed out—for example, planning can sometimes be a major issue in relation to installation. We are supportive of trying to roll out charging points to support the move to electric vehicles and so on.

**Sarah Boyack:** That is useful feedback, because I have had feedback from the local authority side that there are worries about supply chains in terms of, for example, new vehicles that could be required. There is also an issue about accountability with regard to the benefit of having local authorities owning infrastructure as part of this process while also using private sector investment and expertise. It would be good for the committee to get feedback on what you think comes next on that, because it is a now issue.

**Al Denholm:** As I said, we have two companies that we are actively invested in and seeking to roll out, so we could probably get some feedback on the challenges that they are experiencing and feed that back to you.

**Sarah Boyack:** Thank you.

12:00

**Douglas Lumsden:** The convener mentioned the use of public money. Last year's accounts showed a loss of almost £20 million, but you are still paying bonuses. Last year, the acting chief executive officer received a bonus of about £77,000. How can the use of public funds to pay bonuses be justified when there are such big losses?

**Al Denholm:** We reported those losses last year. The vast majority of those were unrealised, which is the result of the mark-to-market accounting procedure. We talked about the movement of interest rates. If we have a fixed instrument and interest rates move, that creates a mark-to-market loss on our balance sheet. I stress that that does not necessarily mean that that is a bad credit risk and that we expect a loss. That is more of an accounting procedure.

The vast majority—from memory, it is £14 million-worth of those losses—were unrealised losses as a result of the mark-to-market accounting procedure. That is to be expected in what I would call a development bank. You will see that volatility early on, and we have seen it in a number of other entities when they were set up and in their early stages. You see that volatility before some realised profits come through.

In addition, I stress that the income that we are receiving on our investments is now significant. I think that we earned £10.7 million last year on income in our portfolio. If that figure is not 100 per cent correct, I will come back to the committee to correct it. That means that we are very close to being self-sustainable on a cost-income ratio.

**The Convener:** What is the rate of return on the investment? That figure of £10 million could be good or bad figure, depending on—

**Al Denholm:** Our portfolio is a blend of debt, equity and fund—

**The Convener:** How much money have you put out to get £10 million?

**Al Denholm:** The bank has £460 million out in investment. That is the in-year investment on that money, and we would expect that to grow over time as that investment is drawn down.

**The Convener:** That is not a great rate of return, is it?

**Al Denholm:** The figure of £460 million is the committed figure.

**The Convener:** Sorry?

**Al Denholm:** Our income on our investments so far is £10.7 million, on that calendar-year basis—that reporting-year basis.

**The Convener:** I am sorry. I might have got this wrong. You said that you have lent the equivalent of £460 million.

**Al Denholm:** We have committed it, yes.

**The Convener:** You have committed £460 million, and you have got £10 million back. Is that right, or have I got that wrong?

**Al Denholm:** No, we have not got it back. It is not a case of getting it back. That is the income on the debt.

**The Convener:** That is the income. If I gave a bank £460 million with a base rate of 5 per cent, what would my return be? It would be more than £10 million, surely.

**Jimmy Williamson:** An important point to take into account is that we are deploying a mix of debt and equity. This is a development bank, so the expectation is that we will not achieve a return on equity investments in the early years as we take development risks, for example. The returns will come later, which is quite consistent with equity investors. For example, private equity and venture capital portfolios will not have significant returns in the early stages of the funds, but they will be expected to achieve returns when the companies are sold. Therefore, for the committee's understanding, our portfolio is a mix of debt and equity.

**The Convener:** I understand that, but I am just saying that it is not even a 5 per cent return; it is about a 2 per cent return on the money that is out there. Anyway, thank you for that. I understand that.

As there are no other questions, I thank the witnesses for attending this morning.

The committee's stage 1 report on the Circular Economy (Scotland) Bill will be published in early 2024. I am not going to put an exact date on it.

That concludes the public part of our meeting and we will now go into private session.

12:04

*Meeting continued in private until 12:36.*



This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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