[REDACTED]
Directorate for Economic Development
29 June 2020

Cabinet Secretary for the Rural Economy and Tourism

Copy: First Minister
Deputy First Minister and Cabinet Secretary for Education and Skills
Cabinet Secretary for Economy, Fair Work and Culture
Cabinet Secretary for Finance
[REDACTED]

LOCHABER GUARANTEE AND REIMBURSEMENT AGREEMENT AMENDMENT

Purpose

1. To inform you of our progress with the GFG Alliance on the amendments to the Lochaber Guarantee and Reimbursement Agreement (GRA) and to request your approval as the lead Minister for the Lochaber Guarantee to the terms agreed; in order to formalise the revised legal agreement and to **[REDACTED]**.

2. If you are content, the full legal documentation, which has now been agreed and prepared, will be available for signing by Liz Ditchburn DG Economy as the Accountable Officer for the Lochaber Guarantee in the coming days, at which point the agreement will become legally binding.

Context

3. In August 2019 the GFG Alliance **[REDACTED]** the establishment of an alloy wheels production facility at Lochaber. They were therefore **[REDACTED]** made with Scottish Ministers in December 2016.

4. Officials sought the opinion of **[REDACTED] [REDACTED]** on **[REDACTED]**. In summary, **[REDACTED]** indicated:

i. **[REDACTED]**
ii. **[REDACTED]**

5. Therefore the **[REDACTED]** to the **[REDACTED]**. Further detail on the background to **[REDACTED]** and legal opinions is provided in **Annex D** of the submission.

6. Officials have been in regular dialogue with the business since **[REDACTED]** and following their request to agree **[REDACTED]**. Officials and our advisors in these **[REDACTED]** negotiations have focussed our attention as you requested, on improving the position of Scottish Ministers relative to the current GRA provisions, by securing additional binding financial commitments and clear milestones to ensure

delivery by the business of their commitment to invest in a downstream manufacturing facility at their Lochaber operations.

7. Discussions with the GFG Alliance have been **[REDACTED]**. However, after a collective push and movement towards our position, particularly following your most recent interventon with Sanjeev Gupta, we have now reached an agreement on the commercial/legal drafting of the amended GRA that allows for **[REDACTED]** for the both parties to move forward to achieving the intended objectives envisaged under the Lochaber Guarantee when entered into in 2016. These amendments improve Scottish Ministers' position from the original GRA, not least requiring up to **[REDACTED]** of investment funds to be deposited **[REDACTED].**

Amended GRA Negotiations

8. Following the Heads of Terms (HoT) agreed between both parties in March (see **Annex A**), officials and our advisors have been negotiating with the business the amended Guarantee and Reimbursement Agreement drafting to reflect the agreed HoTs. **[REDACTED],** however officials have sought to protect and improve Scottish Ministers position as well as ensure the business delivers on its commitments as set out in the HoTs.

9. The revised terms for the amended GRA and identified risks are set out in the annexes below (see **Annex C**), the key highlights are:

i. The amended GRA has been structured to ensure significant investment funds will be lodged by the business in **[REDACTED]** and at various milestones until **[REDACTED]**;

ii. These funds will be **[REDACTED]**;

iii. On the Cabinet Secretary's recommendation, and to acknowledge the significant impact the global COVID-19 pandemic is having on businesses across the UK including the GFG Alliance, officials proposed a COVID-19 specific clause that pushed back all investment milestone dates by **[REDACTED]** months, including the initial **[REDACTED]**.

iv. There is also a mechanism for these dates to be postponed further if required, but only at Scottish Ministers' sole discretion;

v. **[REDACTED]**.

Process and Timing

10. Directorate for Economic Development officials and our advisors have sought to engage regularly with our Finance and **[REDACTED]** colleagues and kept them fully sighted during the negotiations and, in their capacities as our external legal and commercial advisors respectively, **[REDACTED]** and Deloitte have supported

officials throughout these negotiations, and fully endorse the position we have reached with the amendment to the GRA (see **Annex E**).

11. **The Accountable Officer for the Lochaber Guarantee, Liz Ditchburn DG Economy, has reviewed the revised terms and endorses the recommendation to proceed to signing.**

Recommendation

12. You are asked to consider the above advice and the details of the amended GRA (as set out in annexes below and in particular at **Annex C**) and for your approval as the Lead Minister for the Lochaber Guarantee both to the terms agreed and to official's request to proceed to signing the revised Lochaber Guarantee and Reimbursement Agreement.

[REDACTED]
Manufacturing and Industries Division
Directorate for Economic Development

ANNEX A

HEADS OF TERMS

1. In agreeing and signing the Heads of Terms (HoTs) in March, officials set out the basis for a new agreement with the GFG Alliance that made significant progress in moving the business towards our position, securing (a) the commitment of the business to deposit up to **[REDACTED]** of funds in SmelterCo on signing of a revised agreement and (b) milestones towards the fulfilment of the full **[REDACTED]** commitment, **[REDACTED]**.

2. Furthermore, it was agreed that the investment funds would be lodged **[REDACTED]**.

Key features

3. The key features of the agreed Heads of Terms were:

i. **[REDACTED]**;

ii. By 31 May 2020, the business would provide the Scottish Government with a Business Plan approved by GFG's Board for investment in a Downstream Activity that uses smelter aluminium and sustains the medium term viability of the smelter; the Business Plan will need to be agreed by Scottish Ministers 'acting reasonably' if it does not meet tests including sustaining the smelter, create GVA etc;

iii. Following Scottish Minister's approval of the Business Plan, **[REDACTED]**

iv. The milestone payments above would only be due if Scottish Ministers approve a Business Plan;

v. **[REDACTED]**

vi. **[REDACTED]**

4. The above terms, many of which were viewed as "red lines" by both sides, were agreed upon with a view to reaching agreement. In doing so, the HoTs, whilst not legally binding, did lay the foundations for Scottish Ministers **[REDACTED]**.

ANNEX B

KEY MOVEMENTS SINCE SIGNING HEADS OF TERMS

1. Our legal advisors have sought to stick to the essence of what was agreed in the HoTs into the legal drafting of the revised agreement, and this has led to some difficult and protracted negotiations over the last 3 months, arising from Covid-19 related (e.g. timing) and other commercial issues raised by the GFG Alliance (notably around the terms of the **[REDACTED]**). The proposed amendments were complex and with the Covid-19 pandemic having an unforeseen impact, the business have been reluctant to fully commit to certain aspects of the agreement as agreed in the HoT.

2. Fundamentally the business sought to **[REDACTED]**

3. However through continued negotiations officials have now reached an agreed drafting of the amended GRA that broadly enhances Scottish Ministers' position as well as facilitating the Lochaber Guarantee investment. A significant number of minor legal amendments have been made to the amended GRA, however the key provisions and movements from the HoTs that are now in the amended GRA are as following:

i. COVID-19 delay – All dates, including the initial investment of **[REDACTED]** subsequent milestone investment dates and the **[REDACTED]**, have been moved back by 3 months from the dates in the HoTs to take account of the current pandemic. Any further extensions are at the sole discretion of Scottish Ministers;

ii. **[REDACTED]**.

iii. A number of new matters also arose during negotiations, all of which were addressed in a manner consistent with the agreed HoTs. The most significant of these are that:

a. **[REDACTED]**

b. **[REDACTED]**

c. **[REDACTED]**

ANNEX C

PROPOSED STRUCTURE OF FINAL AGREEMENT

1. The Heads of Terms agreed in March this year have largely been incorporated in the final agreement in principle, save for the addition of the Covid-19 clause and some practical considerations requiring to be taken into account. The key terms as set out in the amended GRA are as follows:

i. **[REDACTED]**

ii. The GFG Alliance will present a business plan for investment approved by the company and ultimate group holding companies for a downstream activity with a minimum **[REDACTED]** investment no later than **[REDACTED]**;

iii. Once Scottish Ministers has approved a plan (or is deemed to be approved if it meets 6 tests including GVA as a Downstream Activity), milestone payments are made into **[REDACTED]** and capital spending drawn from that account;

iv. **[REDACTED]**

v. Scottish Ministers has the right to extend dates further, at its discretion, in relation to the effects of Covid-19; and

vi. **[REDACTED]**

2. Officials and our advisors believe these revised terms represent an improvement in Scottish Ministers' position relative to the terms of the existing GRA. There now exists a clear route map for investment at Lochaber from submission of business plans to milestone payments being made, **[REDACTED]**.

RISKS AND MITIGATIONS

3. In the context of the **[REDACTED]**, officials and our advisors believe with the agreed HoTs and subsequent tightening of key terms detailed above, very few risks exist in recommending the revised terms. However, it is worth noting the following for completeness:

i. Insolvency – Given the difficulties many businesses will be facing in light of the current COVID-19 pandemic and resulting contraction in the global economy, there is an increased risk to the GFG Alliance as well which would inevitably impact the Lochaber assets. **[REDACTED] [REDACTED].**

ii. **[REDACTED]**

iii. **[REDACTED]**

iv. **[REDACTED]** This will be addressed in the formal drafting.

ANNEX D

LOCHABER GUARANTEE

Background

1. In December 2016 we supported the GFG Alliance in their purchase of the Lochaber site comprising of an aluminium smelter at Fort William, an adjacent hydro power station and extensive estate lands from Rio Tinto Alcan (RTA).

2. The arrangement is captured in the form of a guarantee between Scottish Ministers and Liberty House Group (part of the GFG Alliance) that involves the Scottish Government standing behind the power purchase obligations of the smelter in the event that the business cannot fulfil its obligations to pay for contracted power from the associated hydro power station (owned by sister company Simec) over a 25 year period. The Guarantee allowed the GFG Alliance to raise funds that enabled them to acquire the aforementioned assets and to invest in downstream production.

[REDACTED]

3. In August 2019 Liberty House Group **[REDACTED]**

4. **[REDACTED]**:

   i. **[REDACTED]**

   ii. **[REDACTED]**

   iii. **[REDACTED]**

5. **[REDACTED]**

Legal advice and options

6. **[REDACTED]**.

7. Thereafter our external advisory team, including **[REDACTED] [REDACTED]**, provided advice around Ministers' options under the guarantee. The four main options being:

i. **[REDACTED]**
ii. **[REDACTED]**
iii. Agree to **[REDACTED]** and extension in time; or
iv. Re-negotiation of the GRA.

8. Thereafter we sought the opinion of **[REDACTED]** (**[REDACTED]**) on the Government's legal options in **[REDACTED]**. In summary, **[REDACTED]** concluded that **[REDACTED]**:

- **[REDACTED]**

- **[REDACTED]**

9. **[REDACTED]**

10. **[REDACTED]**

ANNEX E

ADVISOR ENDORSEMENTS

Deloitte LLP

4 June 2020

The Scottish
Government
St. Andrew's House
Regent Road
Edinburgh
EH1 3DG

For the attention of
[REDACTED]

Dear Sirs

Scottish Government Guarantee at Lochaber – Amendment to the Guarantee and Reimbursement Agreement (**OFFICIAL-SENSITIVE-COMMERCIAL)**

Deloitte LLP ("Deloitte") is acting as the financial adviser to the Scottish Government ("SG") under the terms of our contract dated 25 September, 2019 (the "Contract") in relation to the Scottish Government's guarantee for the Power Purchase Agreement (the "PPA") between the Lochaber aluminium smelter and the hydropower company at Fort William. The aluminium smelter business is Liberty Aluminium Lochaber Limited ("SmelterCo"), ultimately owned by Singapore based Liberty Holdings Limited, and Simec Lochaber Hydropower 2 Limited ("HydroCo"), ultimately owned by Hong Kong based Simec Group Limited. Both groups are ultimately controlled by separate members of Mr Sanjeev Gupta's family through an unincorporated Gupta Family Group Alliance ("GFG").

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Purpose

This letter summarises SG's negotiations with GFG in relation to the changes required to the principal guarantee documentation and in particular the Guarantee and Reimbursement Agreement ("GRA").

Background

The GRA was signed in December 2016 between SG and the various GFG entities. Subsequent to this transaction, Deloitte was appointed to advise SG on the management of SG guarantee under the GRA. One key requirement of the GRA was that GFG would invest not less than **[REDACTED]** in an alloy wheels factory within 18 months of planning consent being granted (GRA Clause **[REDACTED]**). Planning permission was granted by the Highland Council (subject to conditions) in February 2018 and the relevant date for investment to be made under the GRA was therefore August 2019. On 6 August, 2019 **[REDACTED]**under the GRA.

[REDACTED]

Over time, GFG presented a number of business plans to SG for an alloy wheels factory of different capacities, along with other possible business ideas. **[REDACTED]**

With hindsight it has become clear that **[REDACTED]**. In particular, **[REDACTED]**

- **[REDACTED]** to be invested in an alloy wheels factory within 18 months of planning consent; or
- **[REDACTED]**

Indeed, GFG indicated that, if necessary, **[REDACTED]**

[REDACTED]

SG was aware that its **[REDACTED]**

Initially GFG requested only a change to the date for which **[REDACTED]** of equity investment should have been applied to the establishment of an alloy wheels factory, with all other provisions of the GRA remaining unaltered. SG was clear that it required any amendment to include GFG providing milestones payments for the equity investment in SmelterCo and an agreed plan for the new “downstream activity”, whether the envisaged alloy wheels factory or some other aluminium based industrial processes, to be approved by SG.

Heads of Terms (“HoTs”)

After a long period of negotiation HoTs were agreed in March 2020 between SG and GFG. Key terms of these were:

i. **[REDACTED]** equity investment being made in SmelterCo upon signing of the variation, with milestone equity subscription in SmelterCo and thereafter quarterly from **[REDACTED]** until a total of **[REDACTED]** is subscribed by **[REDACTED]**, with no more than **[REDACTED]** being incurred on business planning costs prior to commencement of construction;

ii. **[REDACTED]**;

iii. GFG shall present a business plan for a "downstream activity" approved by the boards of SmelterCo and its ultimate parent by 31 May, 2020;

iv. SmelterCo should immediately progress its investment plan if it meets 6 key tests, including using SmelterCo's metal and creating at least the Gross Value Add ("GVA") originally forecast in December 2016;

v. **[REDACTED]**;

vi. No distributions would be made by the HydroCo or SmelterCo until **[REDACTED]** is invested in an approved downstream activity. **[REDACTED]**;

vii. **[REDACTED]**

viii. GFG having the right to request a review of the guarantee fee once the amended GRA terms have been documented and come into effect.

There were other more minor amendments agreed as described in the attached HoTs. Many of the terms above represented stated **[REDACTED]**.
The above HoTs gives more insight, control and comfort to SG that an industrial investment would be made at Lochaber than exists under the original GRA.

Negotiations and final terms

Negotiations are nearing completion, with all material points believed to having been settled. The amendments described in the HoTs are complex and this has been reflected in the complexity of negotiations required to reach final agreement. In addition, Covid-19 has had an impact and led to GFG seeking more time in meeting its investment pledges at Lochaber.

Key changes from the HoTs are summarised below:

i. All dates, including the initial investment of **[REDACTED]** and subsequent milestone investment dates, have been moved back by 3 months as a result of Covid-19. The **[REDACTED]** has also moved to **[REDACTED]**. Dates can be moved further back in response to Covid-19 at the sole discretion of SG;

ii. Details of the charged account arrangement have been finalised with: **[REDACTED]** and **[REDACTED]**. **[REDACTED]**;

iii. A number of new matters arose during negotiation, including **[REDACTED]**. These were a combination of points that arose from detailed drafting after the HoTs and new points raised by GFG. SG negotiated the terms with GFG and, as far as practical, sought to be consistent with the HoTs. The final documentation amending the GRA is being prepared by **[REDACTED]**, as legal advisers to SG. Three other matters worthy of mention in SG agreeing to the overall GRA amendment package are:

a. **[REDACTED]**

b. **[REDACTED]**

c. **[REDACTED]**

Agreed position of the Parties

It should be remembered that SG's assessment of its **[REDACTED]**

Through negotiation SG's position has improved in some of these areas. Specifically, there is a much clearer **[REDACTED]** in milestone payments compared to the original GRA Clause **[REDACTED]**, clear dates for presentation of business plans approved for investment and that **[REDACTED]**

There remain areas where SG might have wished to enhance its position further, for example **[REDACTED]**.
However, it was not possible to agree new terms of this type in the GRA at this stage with GFG. SG was always aware of its own negotiating position and that these additional terms had no connection with the **[REDACTED]** of Clause **[REDACTED]** – **[REDACTED]**.

[REDACTED]

On balance Deloitte, as financial adviser to SG, considers that the terms offered represent an improvement in SG's position, which will increase GFG's financial commitment that a downstream investment should be made at the smelter and also improves SG's commercial position from the original GRA. Deloitte also notes **[REDACTED]**. Securing agreement in the near term, as described in this letter, also mitigates the risk of the **[REDACTED]** identified by SG's legal advisers and ends an extended period of negotiation, so enabling SG and GFG to focus on the future investment to be made at Fort William.

We also understand that GFG is **[REDACTED]**. We expect it would be beneficial to continue this dialogue within the UK public sector to ensure a consistent approach.

We do not think that such on-going discussions should argue against SG's intention to sign an amended GRA at this stage.

Yours faithfully

Deloitte LLP

[REDACTED]

Background

In December 2016, the Scottish Ministers agreed to support the acquisition by Liberty House Group / SIMEC ("**Liberty/SIMEC**") of an aluminium smelter at Lochaber and a hydroelectric Plant also at Lochaber which were being sold by British Aluminium.

The key objectives at the time were that the acquisition would:

- Preserve economic activity at the smelter and attract investment and economic growth and employment through the development of a new Alloy Wheels Factory.

These objectives were to be achieved by the guarantee granted by Scottish Ministers for SmelterCo's obligations, which would enable **[REDACTED]** on the funds being sourced from Greensill. In return for the grant of the Security Package in the exact form granted (and valued at some **[REDACTED]**), Scottish Ministers agreed to grant the Guarantee to Greensill as, with that security, and the Fee to be paid by Liberty/SIMEC, the Scottish Ministers were advised that the said Guarantee would be state aid compliant in accordance with the "market investor equivalent principle".

This arrangement was documented in a Guarantee and Reimbursement Agreement ("**GRA**") between Scottish Ministers and Liberty/SIMEC group companies, and the GRA and other related documentation were signed by all parties in December 2016.

[REDACTED]

At the time of the acquisition Liberty/SIMEC set a number of expectations and commitments, including that planning permission for the factory would be applied for by 30 June 2017 and the factory completed and commencing operations by late 2019. This was represented by Clause **[REDACTED]** in the GRA which provided:-

> **[REDACTED]**
>
> **[REDACTED]**

In early 2019 Liberty/SIMEC indicated **[REDACTED]**.

Performance of the Clause **[REDACTED]** obligation was due by **[REDACTED]** and on **[REDACTED]**

Heads of Terms

The negotiations proceeded over several months until Heads of Terms were agreed and signed by Sanjeev Gupta on 9 March 2020.

The Heads of Terms contain several measures to aid in meeting the key objectives of Scottish Ministers:

Objective	**GRA Provision**	**Heads of Terms provision**

[REDACTED]	**[REDACTED]**	• **[REDACTED]**
		• **[REDACTED]**
		  ○ **[REDACTED]**
		• **[REDACTED]**
		  ○ **[REDACTED]**
		  ○ **[REDACTED]**
		  ○ **[REDACTED]**
		  ○ **[REDACTED]**
		  ○ **[REDACTED]**
		• **[REDACTED]**

Preserve economic activity at the smelter	• Clause **[REDACTED]** (see above) providing for not less than **[REDACTED]** of equity investment. This measure would primarily meet the 'economic growth' objective below but would also have enhanced the viability of the smelter. • LHG to fund or procure the funding of all trading losses at the Smelter • Liberty/SIMEC to provide up to **[REDACTED]** equity to the Smelter	• **[REDACTED]** • **[REDACTED]** • **[REDACTED]** • **[REDACTED]** • **[REDACTED]**
Not result in material	Financial risk was mitigated against mostly by means of	• **[REDACTED]** • **[REDACTED]**

financial or reputational risk to SG	the security package, which provides the ability for Scottish Ministers to recover a proportion of losses in the event of a call on the guarantee, and improvements to the viability of the smelter (and thus its ongoing ability to meet payments due to Greensill), which reduce the likelihood of a call on the guarantee. Reputational risk was mitigated against through advisor review of Liberty/SIMEC's proposals, binding and ongoing undertakings on Liberty/SIMEC in the GRA and in a side letter committing Liberty/SIMEC to carry out the proposed Alloy Wheels Plant development.	
Comply with wider budgetary and state aid requirements	Value of security package and level of guarantee fee gave Scottish Ministers assurance that the guarantee was State Aid compliant on the market economy operator principle	• **[REDACTED]** • **[REDACTED]**

Changes Since Heads of Terms

Following signing of the Heads of Terms in March 2020, Scottish Ministers' advisers have been engaged with advisers for Liberty/SIMEC in agreeing the detailed drafting of the restated GRA.

Amendments and additions have been made to the agreed position since March, and the key ones can be summarised as follows:

1. COVID 19 Delay. Scottish Ministers have offered to allow a delay of 3 months on all payment dates for the Milestone Investments, the business plan delivery date and the longstop date, with further delays at Scottish Minister's discretion. **[REDACTED]**

2. Charged Account – **[REDACTED]**

3. Equity Investment. The original GRA had envisaged the **[REDACTED]** being made by way of equity, to avoid burdening SmelterCo with even more debt. Scottish Ministers have agreed to allow the Milestone Investments to be made by way of subordinated debt, on the basis that this debt is as close to equity as possible. **[REDACTED]** of Milestone Investments has been spent. There is no material prejudice to the Scottish Ministers' security package in agreeing to this;

4. **[REDACTED]**

5. **[REDACTED]**

[REDACTED] Advice

[REDACTED] obtained written opinions from **[REDACTED]** on 24 July 2019, 21 November 2019 and 6 May 2020, and also conducted consultations with **[REDACTED]**, most notably on 5 August 2019.

[REDACTED] key advice in relation to Scottish Ministers' response to the **[REDACTED]** comprised:

[REDACTED] Advice	**How this was implemented by Scottish Ministers**
[REDACTED]	• **[REDACTED]** • **[REDACTED]** • **[REDACTED]**
[REDACTED]	**[REDACTED]** The drafting also had to take into account that Scottish Ministers would, **[REDACTED]** Accordingly the approach taken by Scottish Ministers was to require **[REDACTED] [REDACTED]** • **[REDACTED]** • **[REDACTED]**;

	[REDACTED] ○ **[REDACTED]** ○ **[REDACTED]** ○ **[REDACTED]** • **[REDACTED]** • **[REDACTED]** **[REDACTED]** ○ **[REDACTED]** ○ **[REDACTED]** **[REDACTED]** **[REDACTED]**

Current Agreed Position

Scottish Ministers key objectives at Lochaber have not yet been achieved. Although the ideal outcome for Scottish Ministers would have been timeous compliance by Liberty/SIMEC with Clause **[REDACTED]** in the original GRA, through a sustained and committed process of negotiation over a substantial period of time Scottish Ministers have reached an agreed position which is more beneficial to Scottish Ministers' key objectives in many respects than the original GRA. Principal among these are the Milestone Investments, **[REDACTED]** and the charge over the account.

Scottish Ministers did seek certain provisions they were not successful in achieving, such as **[REDACTED]** of investment with Scottish Ministers or **[REDACTED]** but this was in the context of a **[REDACTED]**. **[REDACTED] [REDACTED]**

[REDACTED] and should enhance the prospects for Scottish Ministers of securing the future of the smelter and growing investment and employment in the Fort William area.

Yours faithfully

[REDACTED]

From: DG Economy
22 November 2016

First Minister
Cabinet Secretary for the Rural Economy and Connectivity
Cabinet Secretary for Finance and the Constitution
Cabinet Secretary for Economy, Jobs and Fair Work
[REDACTED]

RIO TINTO'S LOCHABER STRATEGIC REVIEW: GOVERNMENT GUARANTEE

Purpose

1. To seek your approval for a financial guarantee that the Cabinet Secretary for the Rural Economy and Connectivity has agreed in principle to provide to the GFG Alliance (Liberty House and SIMEC) in relation to the Lochaber aluminium complex.

2. **Priority**

Immediate. Your response is sought by 17:00 on 22 November. Rio Tinto wants to sign a sale agreement with the GFG Alliance today.

3. Finance Committee has scrutinised the proposal today in a private session from 12:30 to 14:00, on the basis of information sent to them last week (also sent to your offices and attached again alongside this submission. The Committee confirmed that it has signed off the proposal. It highlighted two "footnotes"
(i) it would like SG to explore with the GFG Alliance whether they pay the Living Wage (please note that we have since been informed that GFG Alliance pay the Living wage at all of its UK sites) and if they are prepared to sign the Scottish Business Pledge;
(ii) it would like us to ensure that all of the GFG Alliance undertakings to us are legally binding (please note that the guarantee documents, due to be signed by 16 December will be legally binding.

4. Rio Tinto plans to conclude a sale agreement with the GFG **Alliance today Tuesday 22 November** (now that the Finance Committee has approved) and to **announce the sale to investors tomorrow** (Wednesday 23rd), informing the workforce at the same time, and to complete the sale on or by the 16th December. This sequence has shaped our timings for Ministerial approval and Finance Committee scrutiny.

5. Work to finalise all the necessary legal documentation is in its final stages. The guarantee will only come into effect once all the documentation of the guarantee and the securities has been completed to the satisfaction of **[REDACTED]** (SG legal advisers for the transaction) and **[REDACTED]**. In addition to the conditions attached to the guarantee we are seeking from Liberty House a letter of undertaking.

Policy objective

6. The Lochaber complex currently owned by Rio Tinto is a key part of Scotland's industrial capability and is a major employer in the West Highlands.

7. Our motive in offering the guarantee is to prevent the fragmentation of the Lochaber complex, to secure the smelter's long-term future viability and to realise further industrial and employment opportunities on site. The guarantee proposed has the potential to: (i) secure around 150 direct jobs; (ii) stimulate new capital investment (valued at around **[REDACTED]**); and (iii) fund construction of a new manufacturing plant for automotive parts creating over 200 direct jobs.

Advice

8. I am the Accountable Officer and have taken advice from a range of sources internally and externally. **[REDACTED]** have provided commercial legal advice and Ernst & Young (EY) have undertaken commercial due diligence on the PPA guarantee, negotiation of terms, commentary on the business plans of the GFG Alliance, commentary on the value for money case, the Government's exposure, the guarantee fee and state aid issues.

9. The Permanent Secretary has approved the provision of the proposed guarantee. This approval is conditional on:

- The Finance Committee giving its approval (which of course it now has);
- Ministers and the FM giving their approval;
- First Minister and Cabinet Secretary for Finance:
  a) recognising potential consequences for SG's financial choices and commitments in the future
  b) approving the creation of a reserve for the purpose of this deal (and future financial commitments of this nature)

10. You can be satisfied that we have worked with our independent legal and commercial advisors to interrogate the proposal, challenge assumptions and negotiate a position that satisfies these key considerations whilst producing potential benefits to the Scottish economy and mitigation measures that reduce the risk to the Scottish Government.

11. **The recommendation is that:**

- **You consider and approve the guarantee proposed.**
- **The First Minister and Cabinet Secretary for Finance and Constitution confirm:**
  (i) recognition of the potential consequences for SG's financial choices and commitments in the future; and
  (ii) approving the creation of a reserve for the purpose of this deal (and future financial commitments of this nature).

Liz Ditchburn
DG Economy

ANNEX A

CONTENTS – LIST OF ANNEXES

Annex B - Summary

Presentation

1. Significant supporting detail is available beyond these annexes in further background materials which have informed the policy rationale and the decision by the Cabinet Secretary for Rural Economy and Connectivity to offer this support in principle. That policy detail is not the focus of this submission.

2. The key areas that officials have considered within this proposal are:

- Whether it is novel and has the potential to set future precedent
- The overall quantum of financial risk and whether it is appropriate and proportionate to what is being supported
- The strength of the security package on offer and the level of unmitigated risk that arises from one year to the next
- The term of the guarantee and associated uncertainty (as time passes the overall quantum falls but the level of uncertainty around the security package increases)
- The benefits to be gained from entering into the proposal
- Whether it is commercial in nature and therefore able to satisfy State Aid tests
- The sustainability of this proposal in the context of other financial commitments and risks being carried by the Scottish Government
- Cost of capital being supported by the provision of the guarantee.

3. **[REDACTED]** has been briefed regularly throughout the process by **[REDACTED]** and our legal advisers; he has received recent advice from **[REDACTED]** and **[REDACTED]**. He has provided a formal opinion to say that he is content on vires.

State Aid

4. **[REDACTED]** was also asked to provide a view on the state aid issues which only arose when the further draft EY report was provided and in particular to advise on the Commission Notice on the application of Treaty principles for dealing with guarantees. In summary, however, **[REDACTED] [REDACTED]** has concluded that **[REDACTED]**".

5. Our commercial advisors have confirmed that the market economy investor principle has been met on a commercial basis.

6. **[REDACTED] [REDACTED] opinion gives us a clear route to ensuring legal compliance with respect to State Aid; the key test being whether the terms are such as a commercial operator would expect and insist on. As stated above, our external advisers have confirmed this to be the case.**

7. The remaining supporting material is detailed in three annexes: (i) Annex H – State Aid; (ii) Annex L – **[REDACTED] [REDACTED]** full opinion; **On this basis, the clear advice is that the Government would be acting lawfully in providing this guarantee.**

8. **[REDACTED]**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

9. **[REDACTED]**

Affordability and Sustainability

10. A detailed briefing session was undertaken with Cabinet Secretary for Finance and Constitution on 16 November, during which he was appraised of the overall scale of financial risk posed by the guarantee. He was advised of the increasing resource DEL commitments arising from NPD, borrowing and other fixed commitments in relation to the overall **[REDACTED]** cap of total DEL expenditure set for these items. He was also advised that the scale of the undertaking poses a risk in two regards:

- The opportunities that may have to be forgone for other guarantees generally; and,
- A specific risk to the Scottish Growth Scheme, should the Finance Committee deem that the scale of undertaking for the two proposals combined is incompatible with a level of financial commitment deemed appropriate by the Committee. .

11. Some specific further developments have arisen in recent days on which there has been further advice given to Ministers for their consideration:

- A proposal for a guarantee scheme associated with District Heating has been withdrawn from Ministerial consideration until its impact in relation to this proposal can be carried out
- The DFM has intimated that he would likely wish to see the guarantee limit on the Scottish Growth Scheme (currently proposed as £5 million per individual business) raised to take account of larger industrial companies. Advice is being developed on this point but initial feedback to Ministers has been on the basis of accommodating any change within the scheme's overall total (£500 million), rather than being additional.

Turning to technical financial matters, it is possible we may have to score the guarantee fees as resource AME INCOME since all transactions involving guarantees (before they are called) are not normally recorded in the National Accounts.

The Director of Financial Management flagged this last week and we are seeking a view via HMT/ONS. For now the SG should take a cautionary view and include in our AME INCOME estimates. The point being that this type of AME currency cannot usually be used automatically to offset DEL expenditure, it would always need HMT agreement, and the SG will have to agree how this can be transported into the new Scottish Reserve which takes effect from April 2017.

This is in addition to the AME cover for the guarantee itself – assuming all signed this year, it would score in this year, and the values we are now quantifying (£21 million) which the SG will be able to accommodate.

In any event, if the guarantee is called it would be capital DEL that would be required rather than resource to pay the crystallising charge. As indicated in the accompanying paper, budget holders should be required to keep a capital sum flexible in year to mitigate the risk.

Finally on this point, the Cabinet Secretary for Finance and the Constitution, Derek MacKay has indicated a willingness to look at proposals for further fiscal principles to be developed on the level of financial commitment that is being carried by the government at any one time (both fixed and that which is contingent). Proposals here would supplement existing controls around the relationship with the Finance Committee and the 5% total DEL commitment cap currently in place.

Securities

12. A robust securities package to mitigate the risk to Scottish Government has been a priority during negotiations. Our legal advisers, **[REDACTED]**, have led this work and have been meticulous and tenacious. The full list of securities is given in Annex G. In **[REDACTED]** summary opinion they state: "***[REDACTED]***."

Assurance on completion

Protection of the Government position and adequate management of the risks requires us to gain assurance that all of the elements of the deal on which this advice is based are properly reflected in the final documentation. Documentation preparation is advanced and is working to achieve this. It will be critical that SG colleagues from **[REDACTED]**, finance and policy, together with external advisers, perform a final and comprehensive check before signature. I will ensure that this happens. The guarantee will only come into effect once all the documentation of the guarantee and the securities has been completed to the satisfaction of **[REDACTED]** and **[REDACTED]** and signed by both parties.

Financial monitoring

13. The Guarantee and Reimbursement Agreement document that provides the legal basis for the securities package includes a series of undertakings in relation to financial monitoring. These include will ensure that:

- A Business Plan for the Alloy Wheels Plant will be completed and sent to the Guarantor by 30 June 2017;
- Planning consent for the Alloy Wheels Plant shall be applied for by 30 June 2017;
- Demonstrable investment of not less than **[REDACTED]** of equity investment (i.e. not borrowed or grant-aided) shall be applied to the establishment of an Alloy Wheels Plant within 18 months of the grant of Planning Consent;
- A model audit for each of HydroCo and SmelterCo will be delivered to the SG by 31 March 2017;
- The SG will be supplied with copy management accounts for each of the parent companies within 3 months of the relevant period end, or more frequently if the relevant business produces these;
- Confirmation will be given by the LHG to the SG in respect of each accounting period that each invoice rendered to SmelterCo under the Customer Agreement has been paid on that occurring;
- A Net Worth Certificate, duly completed on the basis of year end management accounts, will be provided to the Guarantor in respect of each of the Corporate Undertakers within 90 days of their respective year end.

ANNEX C

RIO TINTO'S STRATEGIC REVIEW AND GOVERNMENT INVOLVEMENT

Rio Tinto Aluminium (RTA) owns and operates the UK's last remaining aluminium smelter at Fort William in Lochaber. The smelter is relatively small by global standards but has benefitted from recent investment and its carbon emissions are significantly lower than the global average. Lochaber produces amongst the greenest aluminium in the world – emitting up to five times less CO2 than coal-fired smelters from which the majority of the world's aluminium is produced today.

Strategic review

In January 2016, Rio Tinto announced a strategic review of the company's operations in Lochaber. These encompass the smelter, the hydro-electric power stations at Fort William and Kinlochleven and estate lands east of Fort William and across the Highlands (c. 115,000 acres).

Sale options

Following the strategic review Rio Tinto issued a sale prospectus in April this year and sought bids for the purchase of its assets in Scotland. The proposed sale of the assets, the Lochaber smelter in particular, raised concern for the operation's future and any would-be closure would result in the loss of around 150 direct FTE jobs and several hundreds more in the Lochaber area and through the supply chain.

The sale was offered in two alternative lots: (i) *as a whole* – smelter complex, both hydro stations and estate lands or (ii) a *'power-only'* option which would segregate the power stations from the aluminium operation.

In the case of a power-only bid, Rio Tinto would continue to operate the smelter and offer a Power Purchase Agreement (PPA) to the buyer of the Lochaber hydro. Rio Tinto has stated that the smelter will continue operating for **[REDACTED]** as this is deemed essential to manage the water moving through the reservoirs and hydro power station at Lochaber. **EY has produced economic modelling that shows the proposed intervention makes a net positive impact on the economy of [REDACTED]**

<u>If the hydro and smelter are sold as a combined package, it would be the buyer's responsibility to arrange power sale and purchase arrangements between the power plant and the smelter.</u>

The Government's discussions with Rio Tinto and shortlisted bidders indicated that power-only bids were likely to be more competitive (higher) than bids for the whole operation due to economic factors making it challenging to keep the smelter operational.

These factors led to the conclusion that without Government intervention a power-only sale was the most likely outcome of the bidding process; in that event, Rio Tinto would begin a transition process by which the smelter would be wound down as grid capacity for power exports increased.

Case for intervention

In a power-only scenario the hydro power stations could be very profitable but all indications suggest that the aluminium smelter would struggle for profitability if the original connection with the hydro-electric power station – a low-cost stable power source – was severed. At present, this connection ensures the smelter has a consistent stream of reliable low-cost power without which the commercial outlook for the smelter is poor. The current co-dependence of the smelter and hydro power station at Fort William persists only because the Fort William hydro station has very limited ability to export power to the national power grid – essentially, the bulk of the power is 'stranded' at the site and cannot be sold at a higher price into the GB wholesale electricity market.

The Fort William hydro station produces around **[REDACTED]** equivalent of power on average over the course of the year (**[REDACTED]**), but its grid export capacity is currently limited **[REDACTED]**. Grid export capacity will rise to **[REDACTED] [REDACTED]** by May 2017. The next major network upgrade of export capacity to **[REDACTED]** was due for completion in **[REDACTED]** but SSE the network owner has suggested that, given a host of uncertainties, a safer assumption would be completion around **[REDACTED]**.

While the profit potential of the Fort William hydro as a stand-alone entity is strong it is the smelter operation which overwhelmingly contributes to local employment and economic activity (the Lochaber smelter has 144 full time employees; Lochaber power station has 13 employees; Kinlochleven employees 2 people).

Government's offer of support

To enable any bidder seeking a *power-plus-smelter* purchase to compete effectively with power only bidders (who would take on fewer commitments – e.g. employees and environmental liabilities), the Government offered in early September a "*firm letter of intent to continue to assess*" options for a power purchase agreement (PPA) or guarantee of a PPA with "*a view to determining whether or not we can* [in terms of our public accountability tests] *enter into such an arrangement*."[1]

Rio Tinto was content for a Scottish Government letter of intent to be offered. All bidders received the same letter of intent and the vendor (Rio Tinto) confirmed it was content with the offer in respect of the integrity of its sale process.

Bids received and preferred bidder

Rio Tinto received **[REDACTED]** bids by mid-September. To our knowledge only one of these, the bid of the GFG Alliance[2], contained firm plans to operate the smelter over the long-term and develop additional higher value downstream manufacturing. The key element of which is a new production facility for auto-motive parts that would utilise hot aluminium from the smelter for casting. The nature of the GFG Alliance, compared to the Rio Tinto Group, and its existing activity within metals industries, downstream activity and links into supply chains enabled it to demonstrate the possibility of a sustainable future for a smelter of this size.

[1] The letter of intent (9 September) signed by Cabinet Secretary Ewing was conveyed to all **[REDACTED]** shortlisted bidders.

[2] The consortium is the GFG Alliance – comprising the Liberty House Group and SIMEC Group.

Rio Tinto announced to its Lochaber workforce on 21 October that the company's Board had agreed to consider a sale of its Lochaber assets and exclusive discussions with a preferred bidder had begun with a view to agreeing the terms of a sale within several weeks. The identity of the preferred bidder, the GFG Alliance, was shared with Scottish Ministers only and on a strictly confidential basis.

ANNEX D

KEY FEATURES OF THE GUARANTEE

We have been working with the GFG Alliance for several months to explore a range of options for government support to improve the long-term prospects of the smelter and secure new investment.

As a way to enhance the prospects of a smelter-plus-power bid and to underpin an injection of new investment, the GFG Alliance proposed a government guarantee of the aluminium smelter's power purchase obligations.

Officials and expert advisers have exercised considerable vigilance and tenacity through extensive negotiations with Liberty House/SIMEC to achieve the best deal possible. In the latest iteration, DG Economy wrote to Jay Hambro (Chief Investment Officer, SIMEC Group) on 14 November to seek an additional **[REDACTED]**

Over the preceding weeks of negotiation, however, SG has substantially reduced **[REDACTED]** The Government's risk and the quantum of its net exposure have reduced by putting in place a robust and sizable security package. The remaining residual exposure has been priced at commercial rates and is reflected in the premium Liberty will pay for the benefit of the guarantee **[REDACTED]** in total).

Purpose of the PPA guarantee

The rationale for the power purchase agreement (PPA) and guarantee is to: (a) provide long-term stable energy for the smelter (via a 25-year contract for renewable power); (b) provide revenue certainty to the hydro asset owner; (c) reduce the risk of stranded power arising from early closure of the smelter; and (d) underpin a strong funding package (ie debt raising) to avoid a power-only solution and enable fresh investment.

By standing behind the smelter's payment obligations in this way the Government insulates SIMEC from the default risk of the smelter and therefore enhances its capital-raising potential. The Government's credit worthiness allows funding to be raised on more favourable terms than would otherwise be the case.

In this instance, we understand that SIMEC propose to sell the power purchase revenue stream to Greensill Capital in order to raise approximately **[REDACTED]**immediately to fund the acquisition of the Lochaber assets (the smelter and hydro station at Fort William plus the estate lands) and fund a capital investment programme valued at around **[REDACTED]**. This new investment would renovate the power assets at Fort William and fund construction of a new facility to manufacture parts for the automotive industry, creating over 200 new direct jobs.

Terms of the PPA

The GFG Alliance will split ownership of the Lochaber complex: (i) the Lochaber hydro station will be owned by the SIMEC Group (SIMEC Lochaber Hydropower Ltd, owned by PK Gupta) and (ii) the Lochaber smelter will be owned by Liberty House (Liberty Aluminium Lochaber Ltd, owned by SK Gupta).

The power purchase agreement will be between SIMEC (seller) and Liberty House (purchaser). The Scottish Government is not a party to the power purchase agreement but is the guarantor of the obligations of Liberty House.

The PPA guarantee involves the Government guaranteeing to meet the future power purchase obligations of the aluminium smelter at Fort William in the event that the smelter's owner, Liberty House Group, is unable to pay for the power the smelter is contracted to take from its neighbouring hydro power station. The PPA is for 25 years with prices over the lifetime of the PPA **[REDACTED]**according to the forecast of a leading industry consultancy **[REDACTED]**

SG is guaranteeing [REDACTED] of the value of the PPA – ranging between £13m in year 1 (2017) to £30m in year 25 (2041). The annual exposure increases in-line with inflation and forecast energy price rises; however net exposure reduces as mitigation increases through increased grid connection capacity.

PPA Guarantee Summary:

Element	**Proposed PPA guarantee**
Gross Guarantee	£586m
First 5-years' Exposure	**[REDACTED]**
Pricing	**[REDACTED]**
Term	25 years
PPA Power Volume	**[REDACTED]**
SG's Guarantee Share **[REDACTED]**	The PPA revenues minus **[REDACTED]**
Guarantee Fee (paid to SG)	**[REDACTED]**

PPA revenues represent SG's *unmitigated exposure* – the Government's guarantee may never be called and if it is called substantial offsetting securities and mitigations have been put in place to limit the Government's net exposure.

Risk mitigation

The Government has sought to mitigate its risks under the PPA in several ways:

- first, via corporate on-demand guarantees from the four parent companies (Liberty House and SIMEC, both UK and overseas (Singapore and Hong Kong)
- second, via the value of the tangible assets secured under the security package. This value (**[REDACTED]** at this time) **[REDACTED]**
- third, via step-in rights to operate the hydro and smelter operations in order to sell unused power and achieve maximum recovery in the event of a lasting default
- fourth, by structuring the PPA to ensure: **[REDACTED]**

ANNEX E

ACCOUNTABLE OFFICER CONSIDERATIONS

The Public Finance and Accountability (Scotland) Act 2000 (PFA) requires of Accountable Officers the need to demonstrate the regularity and propriety of the finances under their stewardship and for the economic, efficient and effective use of all related resources. These are personal responsibilities that require decisions to be consistent with the proper performance of the functions of the PAO and Accountable Officers are answerable directly to the Scottish Parliament.

1. Regularity (legal competence)

In the context of this decision, regularity concerns whether there are underlying legislative powers with which to commit expenditure (which would be the likely outcome of any call on the guarantee where the financial risk cannot be fully mitigated). In addition, there is a need to ensure that other prevailing legislative requirements (such as State Aid) have been considered.

Advice – Legislative authority

[REDACTED]

Advice – State Aid

State Aid considerations have twin aspects of (i) regularity (compliance with the Market Economy Investor Principles) and (ii) propriety (operating within the spirit of the State Aid regime as a whole).

(i) Regularity

[REDACTED]

EY reviewed the financial models provided and concluded that the capital structures of the companies that will own the smelter and hydro at Fort William (debt to equity) and associated return on investment appear to be in line with market expectations. They also calculated the fee for the guarantee on a commercial basis with reference to the credit rating of the business and the value of the security package underpinning the guarantee.

They conclude that: "*subject to the final legal and security documentation reflecting the points above and providing the protections expected in a commercial transaction, it is our view that the transaction elements are proposed on a commercial basis for the guarantee.*"

[3] The term used by the Scottish Public Finance Manual to describe legislative powers

[REDACTED]

(ii) Propriety

[REDACTED]

[REDACTED]

[REDACTED]. The advice of this submission, on the basis of the extensive due diligence undertaken and the commercial terms of the final proposal, plus strong and documented arguments to show why this is not a state aid, is that the propriety risk is low. **[REDACTED]**. Proactive communication may be beneficial if challenge or speculation occurs. Ultimately, this is a matter of judgement.

2. Propriety

Propriety is concerned with meeting high standards of public conduct, including **robust governance** and the relevant parliamentary expectations, especially transparency.

In addition to the references to propriety on the preceding section on state aid, other considerations are critical here: such as whether the Government has been **even-handed in its approach**, has sought to exercise impartial decision-making (for which striking a commercial deal is important), has undertaken appropriate **due diligence to establish and mitigate risks** and, critically, whether the commitment is **visible to the Parliament**, and complies with the Scottish Public Finance Manual with regards to the rewarding of Guarantees

Approval by the Finance Committee under the terms of the extant agreement on the approval of government guarantees is deemed to be the only way in which these transparency requirements can be met.

Advice – Even-handedness

With the prior consent and support of Rio Tinto the Government had dialogue with all shortlisted bidders in the strategic review process to offer equal assistance in the maintenance and creation of employment connected with Rio Tinto's businesses in Scotland.

The Cabinet Secretary for the Rural Economy and Connectivity offered on 9 September (the expected closing date for firm bids to Rio Tinto)[3] a *letter of intent* to the GFG Alliance to assess options for a power purchase agreement (PPA) or guarantee of a PPA to support the Lochaber smelter. The same commitment was shared with all bidders in the process who had an opportunity to adjust their bids as a result. Rio Tinto was aware of SG's offer before it was communicated to bidders and was content that SG's offer would not disturb the integrity of its sale process. In addition, once the letters of intent had been circulated, the Cabinet Secretary wrote again to all remaining bidders to offer a further round of Ministerial engagement to

[4] The letter of intent (9 September) signed by Cabinet Secretary Ewing was conveyed to all **[REDACTED]** shortlisted bidders.

explain the purpose of Government's offer in supporting the Government's policy objectives.

Advice – Due diligence

The Government has utilised specialists (legal and commercial) to undertake extensive due diligence of the guarantee proposal and alternatives to establish costs and benefits, identify risks and develop mitigations. External commercial, legal and technical expertise has been applied via consultancy services delivered by Ernst & Young, **[REDACTED]**, **[REDACTED]**, **[REDACTED]** to shape an acceptable option that balances benefits against risks.

Advice – Visibility to Parliament

The Cabinet Secretary for the Rural Economy and Connectivity alerted the Finance and Constitution Committee to the potential for early engagement on this matter post the October recess. He wrote to the Convener, Mr Crawford, on 4 October to advise of the Government's active consideration of a guarantee and to seek assurance that early consideration of the matter would be possible. The date for a meeting with the Committee is 22 November.

The scale of the undertaking that is being proposed will be fully assessed by the Finance Committee (as a proxy for the wider Parliament) through an extant procedure that operates under an agreement between the Scottish Government and the Finance Committee that supports the annual Budget process. The procedure requires that Scottish Ministers bring all proposed guarantees exceeding £1 million to the Committee for approval. It has been in place over the life of the Scottish Parliament and its purpose is to ensure that contingent liabilities (that is, financial commitments that might arise in the future) that do not flow through the Budget Act are visible to the Parliament as they could bind future administrations to specific expenditure.

Due to the commercially confidential nature of the proposal, the Convener has agreed to hold the evidence session in private. This is unusual for Committee business but is not unprecedented.

3. Value for money

Ensuring the economical, efficient and effective use of resources is concerned with demonstrating **value for money**, that is, **whether the benefits to be gained from agreeing to the proposal can be assessed as being appropriate to the level of financial risk** that is being taken on by the government. This is a wide-ranging test that necessarily has to go beyond the quantifiable financial and economic implications and considers intangible and unquantifiable benefits, such as those for community amenity.

In addition to these requirements as defined in the PFA (Scotland) Act 2000, it is also important to consider and bring to the Minister's attention how this proposal sits alongside broader considerations of **affordability and overall financial sustainability**. This requires the decision to be taken not only on its own merits but also within the context of existing binding financial commitments, provisions for payments where timing or amounts are uncertain and other quantified and unquantified contingent liabilities that may materialise over the term of the guarantee.

Advice – Value for money

EY have not provided an overall assessment of value for money but their commentary considers three elements of the proposals: (i) the quantity of debt raised, (ii) the pricing of the finance, (iii) and the economic output benefit following the intervention and how this compares with the potential exposure for supporting the transaction.

For (i), EY understands how the finance raised will be used in relation to the vision of buying the assets and the planned investment programme. **[REDACTED]**This has not been agreed by the GFG Alliance but there are undertakings within guarantee that could trigger default if not met that place a very strong incentive on them to deliver the plans and use the capital as intended.

For (ii), EY concludes the pricing of the finance should not exceed **[REDACTED]**in normal circumstances (Liberty's cost of capital is**[REDACTED]**although SG's exposure has been calculated on an implied cost of capital of**[REDACTED]**but they also note the timing constraints associated with the transaction and acknowledge that matching their benchmark may not be possible in the timeframe required for the deal. Further information from Rio Tinto as the vendor has substantiated the timing constraints: they intend to sign and announce to investors on the 22/23 November and complete the sale on or by 16th December. They have stated that they are not willing to extend these periods. An approach to the market would require at least 8 – 10 weeks and is not compatible with these timeframes. The cost of capital therefore includes a premium for immediate readiness which is reflected in a higher guarantee fee. To illustrate, the guarantee fee calculated by EY is **[REDACTED]** but had Liberty achieved **[REDACTED]** the guarantee fee would have been **[REDACTED]** lower at **[REDACTED].** However it is, important to consider both the wider package for the SG (already rehearsed) AND that any commercial investor will look at a deal in the round. **[REDACTED].**

For (iii), EY expect the proposal to generate positive benefits over costs under a range of scenarios.

The public expenditure implications of the 25-year PPA guarantee are hard to pinpoint accurately in advance as they will depend on the default risk of Liberty House as the expected future owner of the smelter. EY has valued SG's net exposure (gross exposure minus the value of assets secured) and the guarantee fee has been calculated on a commercial basis to reflect both the level of risk and cost of capital.

In the most favourable scenario, where Liberty House does not default but meets all its payment obligations under the power purchase agreement, the Government will collect a payment each year for providing the guarantee (amounting to circa **[REDACTED]** over the 25-year PPA duration).

In the worst case scenario of an instant and enduring default over the whole 25 years of the PPA, with no offsetting recovery of assets or mitigation in the form of power sales, SG would be bound to meet the full cost of £586m, which equates to 25 annual payments rising from £14m in 2017 to £32m in 2041 (**[REDACTED]**). The Scottish Government is embedding in the legal agreement a range of securities to mitigate this exposure.

More difficult to assess is the effectiveness of any of the security measures at any particular point in time. The risk exposure therefore depends on how successful each measure would be at the time invoked – whilst the assets have a long life and are therefore reasonably predictable, the profitability of the new companies being set up to operate the assets and their parent companies cannot be reasonably predicted over such a lengthy period (with the level of uncertainty increasing as each year passes).

The SG is modelling a range of possible scenarios, based on a range of probability-driven events in order to assess the likelihood of the guarantee being called under specific conditions in any particular year. This is required to assess the immediate non-cash AME budget scoring of the guarantee (in effect a best estimate of the value that might be called over the guarantee period). Although it has no bearing on the gross exposure faced each year, it is required to support the annual carrying value of the guarantee in the SG's Balance Sheet (and will, over time, assist in supporting wider consideration of the cumulative financial risk being carried across all guarantees).

If a default does occur SG will look to do a combination of three things: (i) call the corporate on-demand guarantees from the four parent companies, (ii) realise the tangible assets secured, and (iii) step-in to operate the hydro and smelter operations in order to sell unused power and achieve maximum recovery.

Advice – Affordability and financial sustainability

Given the changing risk environment with new fiscal powers, decisions made by Accountable Officers that have significant, or the risk of significant, financial implications should not be taken in isolation and only on their own merits, rather they must be taken in the knowledge of the existing quantum of fixed forward commitments and other financial risks prevalent at the time of decision. That context is within a discretionary Scottish Budget that has been falling in real terms and by 2020 will be 10.6% lower than in 2010. Although the Chancellor has indicated an impending shift in approach to the UK's public finances, he will not make any announcements until 23 November in the Autumn Statement and consequently, no assumptions can be made at this stage about a reversal of the decline in spending power. Other factors affecting the overall Scottish Budget are set out below.

There are a range of new financial commitments in areas such as the provision of childcare, raising attainment and real-terms uplifts on health and police spending along with a plan to reduce Air Passenger Duty when it is devolved, all of which add additional expenditure to the Scottish Budget. Decisions on how to create the necessary headroom need to be made as part of the on-going Spending Review process for 2017-18 and beyond – this is not yet satisfactorily resolved. Decisions could involve deprioritising other spend, transforming services to reduce expenditure or utilising other tax raising powers. At this stage, a balanced position has not been achieved but it will be necessary to achieve that before the Draft Budget is published in December. Work continues to secure a draft budget for 2017-18.

New borrowing powers were introduced by the Scotland Acts 2012 and 2016. These provide Ministers with the ability to secure net additional capital spending power up to a ceiling of £3 billion, with an annual borrowing limit of currently £300 million, rising to £450 million from 2017-18. This provides net additional capital DEL spending power but there is other spending that has to be foregone in the resource budget – there is interest to pay on borrowing and the repayments of principle are taken as a first call on tax receipts (i.e. they are a call on the Resource budget). Together they reduce over the term of the borrowing the amount of resource DEL that is available to pay for existing public services. In this category too are the long-term resource DEL commitments arising from legacy PFI and the more recent Non-Profit Distributing (NPD) projects that fix resource DEL payments for many decades ahead. In addition there are a number of City Deals and other financial instruments such as the Growth Accelerator model that have fixed long term forward commitments.

Modelling of these commitments is undertaken as a key part of the decision-making process for future infrastructure planning and with a view to an overall cap of spending commitments not exceeding 5% of total DEL (i.e. resource and capital). The most recent modelling indicates that if the current assumptions on planned spend bear out and Ministers choose to borrow the maximum that they can each year then during the first five years of the guarantee proposal, during which there is likely to be the greatest level of risk exposure, the fixed percentage of total DEL spend on these commitments will rise from **[REDACTED]**

There are, in addition, a number of existing financial risks that are being carried or which may materialise over the term of this proposal. They include:

The recent Programme for Government announcement to create a Scottish Growth Scheme through guaranteeing lending of up to £500 million for Small to Medium Enterprises. The scheme will operate over three years but the guarantees will be carried over a much longer period. Only when the scheme is fully subscribed will we have a clear idea of the quantum of risk that is being carried and an assessment of the likelihood of calls being made. It is possible that the Finance Committee, in deciding to support this proposal, may then take the view that an additional £500 million of guarantee risk is too great to carry, so preventing the scheme from proceeding. Ministers have been alerted to this risk in considering this proposal, recognise the potential it has to disrupt the scheme but have indicated they wish to proceed.

From 2017-18 more than half of all spending will be raised from tax receipts. As a consequence, the government may need to borrow for resource purposes if tax receipts fall short of forecasts and there are insufficient funds in the new Scottish

Reserve, or a decision is taken not to reduce corresponding spending. Clearly it is not possible to predict whether such borrowing will be needed now (the limit on which is £1.75 billion). Devolved tax receipts in 2015-16 were £74 million above forecast and that has been placed in reserves. Initial indications for 2016-17 are that these taxes will fall short of their forecast. Like capital borrowing, interest charges are payable and repayment (over a much shorter period of 3-5 years) must be made from resource DEL.

• The impact of the UK's decision to leave the European Union on the economy is not certain. The effects on growth, tax receipts, inward investment, the cost of goods and services purchased by the public sector and the ending of subsidies from the EU for farming and fisheries and infrastructure investment are incalculable at this time but remains a clear and present risk. Capital stimulus of £100 million has been announced in 2016-17 along with other measures (including the Scottish Growth Scheme) to assist in increasing certainty for business.

A range of existing contingent liabilities, guarantees, indemnities, letters of comfort and other possible financial commitments that the government is either carrying on behalf of itself or a range of public bodies (in the case of the latter should they not be able to meet obligations of their own). Examples include possible shortfalls or cost overruns on major sporting events, commitments to make good pension fund deficits and possible compensation arising from loss caused by major transport infrastructure projects. Many of these cannot be quantified and/or their potential timing is wholly uncertain but they are monitored closely and reviewed in detail every six months by DG Finance. It is consequently not possible to map to any reasonable level the risk that will be prevalent in any one financial year and against which this proposal can be measured although of those that can be quantified, many are measured in the tens of millions, some in the hundreds of millions. As a consequence of this proposal and announcement of the Scottish Growth Scheme, work is underway to develop a financial framework and underpinning financial model that will allow future guarantee decisions to be made within specific boundaries.

These factors all suggest that the environment in which this decision is being made is one of **[REDACTED]** There is also an opportunity cost associated with this proposal. Its scale, in supporting one business over such a lengthy period, in contrast to initiatives such as the Scottish Growth Scheme which will support many over a much shorter period, means that there may be other proposals involving guarantees that might arise in the future that have to be foregone. This is most likely to be because the Finance Committee (or indeed Ministers themselves) takes the view that the overall quantum of risk that is being carried has reached a maximum capacity. Again, these risks have been highlighted for Ministers.

It is also appropriate for Ministers to consider, in addition to the securities package, a range of further mitigating measures to offset the risk that will be carried by the proposal. Under the new powers arising from Scotland Act 2016 there is the ability to create a Scottish Reserve. This provides scope for Ministers to set aside funding in perpetuity to provide the necessary means to offset the risk of contingent liabilities arising. **Officials would therefore require that Ministers agree**:

- **[REDACTED]**

- Portfolios entering into guarantees make the necessary provisions within their budgets each year to the level of the annual exposure, to provide the means to make payment if called. This is a prudent measure because in the event of default the SG would need to make the payment immediately but there would be a lag associated with the SG's ability to then recover the funds (possibly through litigation, in the first instance).

ANNEX F

ECONOMIC ASSESSMENT AND VALUE FOR MONEY

1) Commitments to deliver

As undertakings in the guarantee, Liberty House/SIMEC agree:

- The Business Plan for the Alloy Wheels Plant will be completed and sent to SG (the Guarantor) by 30 June 2017
- Planning consent for the Alloy Wheels Plant shall be applied for by 30 June 2017
- Demonstrable investment of not less than **[REDACTED]** of GFG Alliance Moneys (i.e. not borrowed or grant aided) shall be applied to the establishment of an Alloy Wheels Plant within 18 months of the grant of Planning Consent.

2) Predicted economic benefits

Economic value of Liberty / SIMEC's plans

Liberty House / SIMEC's plans for Lochaber are focused on maintaining the aluminium smelter and building and operating a complementary on-site alloy wheels factory to serve the UK car industry.

When fully operational the integrated facility (smelter and new alloy wheels factory) is expected to:

- create an additional 218 FTE jobs on site and a further 240 indirect and induced jobs – in **total the wheels factory will create 458 additional jobs**
- generate **[REDACTED]** and
- during the two-year construction phase, create 350 direct jobs per annum with an associated **[REDACTED]**

According to EY's estimates, the plans of Liberty / SIMEC have the potential over 25 years to generate total **[REDACTED]** comprising:

- **[REDACTED]**
- **[REDACTED]**

Compared with a realistic counterfactual which would see the smelter **[REDACTED]**, the plans of Liberty / SIMEC create **[REDACTED]**

2) Economic significance of RTA's existing operations

Research prepared for HIE indicates the direct, indirect and induced economic impacts of RTA's activities in terms of employment and Gross Value Added (GVA).

Current employment

- Taking direct, indirect and induced employment together, RTA's on site smelting activity currently sustains **213 FTE jobs in Lochaber, a further 11 across the Highlands and Islands and a further 51 across the rest of Scotland – 275 FTE jobs in total.**

- The Fort William smelter complex (smelter and hydro) **directly employs 163 people** of which 160 are full time.

- **Indirect employment** generated by RTA's purchase of goods and services in the local economy creates 22 FTE jobs in Lochaber and a further 5 jobs across Highlands and Islands and a further 30 jobs across the rest of Scotland – **57 jobs in total**.

- **Induced employment** - that is, jobs generated by the spending power of the wages of those directly and indirectly employed in shops and restaurants etc. generates 29 jobs in Lochaber, a further 7 jobs across the Highlands and Islands and a further 20 jobs across the rest of Scotland – **56 jobs in total**.

- In addition to the above, **RTA's on-site contractors** directly employ 13 FTE people, with indirect and induced employment generating a further two jobs in Lochaber, an additional FTE job across Highlands and Islands and a further 2 across the rest of Scotland – **18 FTE jobs in total**.

- **RTA's estate activity** on the Killiechonate and Inverlair and Mamore Estate and the Glenshero Estate in areas such as stalking, commercial forestry, visitors and agricultural tenancies generate 8 FTE jobs (direct, indirect and induced) in Badenoch, 3 in in Lochaber and a further 2 across the rest of Scotland – **13 FTE jobs on total**.

- The on-site activities of RTA, its on-site contractors and its estate operations therefore generate a total of 8 jobs in Badenoch, an additional 231 jobs in Lochaber, an additional 12 jobs across the Highlands and islands and an additional 55 jobs across the rest of Scotland – **306 FTE jobs in total.**

Current Gross Value Added

Gross Value Added (GVA) measures the value of goods and services produced in an area, industry or sector.

- The direct **GVA impact of the smelter** is estimated at £10.3m with a further £1.27m in indirect impacts and £1.31m in induced impacts In Lochaber – **a total GVA for Lochaber of £12.88m**.

- The smelter provides an additional £607k in indirect and induced GVA impacts across the Highlands and Islands and an additional £3.22m across the rest of Scotland – **a total GVA for all Scotland of £3.83m.**

- In addition to the above, the direct GVA impact of **RTA's on-site contractors** is estimated at £632k with a further £55k in indirect impacts and £60k in induced impacts in Lochaber – **a total GVA for Lochaber of £747k.**

- RTA's on-site contractors provide an additional £27k in indirect and induced GVA impacts across the Highlands and Islands and an additional £176k across the rest of Scotland – **a total GVA for all Scotland of £950k.**

- The direct, indirect and induced GVA impacts of RTA's **estate activity** is estimated at £181k in Badenoch and £78k in Lochaber with additional impacts of £14k across the Highlands and Islands and an additional £57k across the rest of Scotland – **a total GVA of £330k**.

The on-site activities of RTA, its on-site contractors and its estate operations therefore create a total GVA impact (direct, indirect and induced) of £181k in Badenoch, £13.7m in Lochaber, an additional £649k across the Highlands and Islands and an additional £3.45m across the rest of Scotland – a total estimated GVA impact of £17.98m for Scotland as a whole.

ANNEX G

SECURITY PACKAGE: ASSETS SECURED AND RISK MITIGATION

Key Points

Our commercial legal advisers **[REDACTED]** have through negotiation with the lawyers for the GFG Alliance agreed a security package over the Lochaber assets and a range of other risk mitigants and conditions to protect the Government's long-term interests. The securities and conditions agreed have the potential greatly to reduce the Government's net financial exposure under the guarantee, particularly in the earlier years before grid export capacity is increased. This package is factored into the premium to be paid by the GFG Alliance for the guarantee. The proposed guarantee shall be subject to Scots law and to the jurisdiction of Scottish courts.

Note: Work to finalise all the necessary legal documentation is in its final stages. The guarantee will only come into effect once all the documentation of the guarantee and the securities has been completed to the satisfaction of [REDACTED] and [REDACTED].

Undertakings made in the Guarantee

- The Business Plan for the Alloy Wheels Plant will be completed and sent to SG (the Guarantor) by 30 June 2017
- Planning consent for the Alloy Wheels Plant shall be applied for by 30 June 2017
- Demonstrable investment of not less than **[REDACTED]** of GFG Alliance Moneys (i.e. not borrowed or grant aided) shall be applied to the establishment of an Alloy Wheels Plant within 18 months of the grant of Planning Consent
- Liberty / SIMEC shall keep SG (the Guarantor) fully informed at all stages of the development of the Lochaber Hydro Plant, the Smelter Factory, the Alloy Wheels Plant and any other proposed development on land subject to the Security Documents
- A model audit for each of HydroCo and SmelterCo will be delivered to SG (the Guarantor) by 31 March 2017
- SG (the Guarantor) will be supplied with copy management accounts for each of the relevant Liberty / SIMEC entities within 3 months of the relevant period end, or more frequently if the relevant business produces these
- Confirmation will be given by the Purchaser (SmelterCo) to SG (the Guarantor) in respect of each accounting period that each invoice rendered to SmelterCo under the PPA has been paid
- A Net Worth Certificate, duly completed on the basis of year end management accounts, will be provided to SG (the Guarantor) in respect of each of the Corporate Guarantors within 90 days of their respective year end

Securities granted in favour of the Scottish Government

The security package will come into place at the time the guarantee is agreed.

- Corporate securities
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**

- Lochaber hydro power station
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**

- Lochaber smelter
  - **[REDACTED]**
    - **[REDACTED]**
    - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**

- Land (proportion of circa 115,000 acres owned)
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**

- Scottish Ministers Guarantee / Other Points
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**
  - **[REDACTED]**

Notes: Terminology Guide

"Counter Indemnity": An undertaking/assurance by SIMEC Liberty Group to SG which protects against an anticipated loss or detriment caused by an event, or act by one of the parties or third person. Generally, the value of indemnities is only as strong as the group providing the promise.

"Share Pledge": A fixed security over a share whereby the share is transferred to SG from the outset with the terms of the security enshrined in a pledge agreement. This requires the directors of the company to update the register of members of that company to reflect the change in shareholding. The share pledge agreement will state that rights to take dividends and voting rights at AGMs etc. will remain with the company (SIMEC/Liberty) - unless the security is called.

"Floating Charge": A charge/security that floats or hovers above specific, or (as in this case) all of the assets/property that the company has. The company is free to transfer property and assets whilst the charge floats, although a letter of non-crystallisation is normally asked for to show that the charge hasn't attached. SG would issue as the charge holder. If the company defaults, the charge "crystallises" and attaches to the specified class of asset/all of the assets at that date. The charge does not attach to assets that have been disposed of.

"Standard Security": The only method in which a fixed security can be taken over land and buildings in Scotland. A domestic mortgage is an example of a standard security. In the event of default by the debtor the creditor has the power to sell the property, enter into possession of the property, carry out any necessary repairs, or apply for a decree of foreclosure (whereby the debtor forfeits ownership). The form and terms of standard securities are stipulated by the Conveyancing and Feudal Reform (Scotland) Act 1970. All standard securities must be registered at the Land Register. No effective security is created until registration. The effective date of the standard security is the date of registration rather than the date of execution. Standard securities created by UK companies or limited liability partnerships (LLPs) must also be registered at Companies House.

"Assignation": the transfer of rights from one party to another. An assignation must be intimated (notice a step in a legal process is being taken) in order for a security interest to be created in the asset."

ANNEX H

STATE AID – MARKET ECONOMY INVESTOR PRINCIPLE (MEIP)

State Aid considerations have twin aspects of (i) regularity (compliance with the Market Economy Investor Principles) and (ii) propriety (operating within the spirit of the State Aid regime as a whole).

I) Regularity

The **market economy investor principle** (MEIP) is designed to determine whether financial transactions between public authorities and enterprises constitute state aid. Application of MEIP requires analysis of the financial and economic position of the project, taking account of the level of capital investment, the risk profile, the profitability and the future return on investment.

It is not sufficient to merely demonstrate that a project generates enough income to cover its on-going revenue costs. A viable project will need to demonstrate an adequate return on the full investment.

European Commission Notice section 3 "Conditions Ruling out the Existence of Aid" considers that the fulfilment of four cumulative conditions will be sufficient to ensure that a government guarantee is not a State aid. They are:

1. The borrower is not in financial difficulty
2. The extent of the guarantee can be properly measured when it is granted
3. The guarantee does not cover more than 80% of the loan or other financial obligation
4. A market oriented price is paid for the guarantee.

We have used these conditions to assess the transaction; we are not however, relying on them to demonstrate that this is not an aid. **[REDACTED]** opinion addressees the application of the Commission's guidance, particularly the **[REDACTED]** condition. The **[REDACTED]** condition is not an absolute (pass or fail test) but it offers a 'safe harbour' when assessing compliance. On this point **[REDACTED]**

Advice on the conditions

Condition 1: EY do not consider the firm receiving the guarantee (SIMEC) to be in difficulty and thus the **condition would be assessed to be met**.

Condition 2: Requires the guarantee to be linked to a specific financial transaction, for a fixed maximum amount and limited in time. **EY considers this condition would be met** as the proposed guarantee is based on a defined income stream for 25 years. The exposure is calculated as the present value of future cashflows.

Condition 3: Relates to the guarantee not covering more than 80% of the financial obligation would also be considered to be met *if* **[REDACTED]**.

The initial EY modelling made a number of assumptions; in particular, that the Power Purchase Agreement was considered to be the primary transaction, and therefore assessed the project to broadly comply with the state aid requirements. **[REDACTED]**

Greensill (a commercial lender) assessed the risk of the transaction and have priced their financing to account for the spread (interest differential) between this and other types of tradeable debt securities, the nature of Liberty / SIMEC as private companies, and broader contextual uncertainty. The Greensill finance sits alongside **[REDACTED]** of equity funding being injected by the GFG Alliance which places the overall debt to equity ratio within commercial norms for the sector **[REDACTED]**

Although there is a risk that the Commission could take a different view State Aid unit and SGLD colleagues agreed that a reasonable interpretation of "financial obligation" would be the **[REDACTED]** The **[REDACTED]** was asked to review **[REDACTED]**, State Aid Unit's and EY's interpretation and to offer an opinion.

The formal opinion of **[REDACTED]** was received on 16 November 2016. **[REDACTED]** considers that the **[REDACTED]** criterion should be applied to the **[REDACTED]** The relevant extract on this from his opinion is as follows:

[REDACTED]

[REDACTED] [REDACTED]

- **[REDACTED]**

  [REDACTED]

- **[REDACTED]**

So according to EY the associated return on investment is assessed to be in line with market expectations. Moreover, the guarantee fee has been calculated on market terms, and "subject to the final legal and security documentation reflecting the points above and providing the protections expected in a commercial transaction, it is our view that the transaction elements are proposed on a commercial basis for the guarantee."

[REDACTED]

It is clear from this that there are different interpretations of the relevant financial obligation. Indeed, it may be that both PPA and financing arrangement could be seen as relevant given the structure of the transaction.

Our advisers have been working under instruction to secure a commercial deal. As such, taking **[REDACTED]** of the interpretation of MEIP and our external advisers' view of the commercial and legal terms, including a market-oriented guarantee premium set with reference to the commercial risks and the securities package, our assessment is that **[REDACTED]**

Condition 4: This condition would be met as EY have calculated a market-oriented price for the guarantee.

II) Propriety

[REDACTED] advice also records that the Commission's Notice states that:

[REDACTED]

[REDACTED]

In his supplementary note, he confirms:

[REDACTED]

Should the subsequent public profile of this transaction cause **[REDACTED]** The arguments that we would set out would be the MEIP test (described above), the extensive package of securities and the delivery obligations.

In light of the extensive due diligence undertaken and the commercial terms of the final proposal plus strong and documented arguments to show why this is not a state aid, the advice of this submission is that the propriety risk is low.

If the option of a courtesy information to **[REDACTED]**then this option of course remains open to us.

ANNEX I

COMMUNITY INTEREST IN RTA'S LAND ASSETS

Background and context

East Lochaber and Laggan Community Trust (ELLCT) was established as a community-led response to the announcement of Rio Tinto's strategic review. The potential loss of production at Rio Tinto Alcan and uncertainty regarding future land management would impact most directly on those communities in close proximity to Rio Tinto's land holdings. Community representatives considered it essential that their concerns were represented and that they were able to participate in future development plans regarding the company's assets. ELLCT was incorporated in April 2016 to facilitate the future involvement of the community which extends to the community council areas of Laggan; Spean Bridge, Roy Bridge and Achnacarry; Inverlochy and Torlundy; Caol; Kilmallie; Fort William; Nether Lochaber and Kinlochleven.

ELLCT has conducted over 15 well-attended public meetings across the affected area and has secured the support of over 1,000 members from a population of approximately 11,000 adults.

The land assets

The land asset is extensive and comprises four separate estates extending to 115,000 acres. It includes over 50 properties ranging from bothies to Victorian shooting lodges, 3 in-hand farms, forestry interests, stalking and grouse shooting and lease income from Aonach Mor Ski Resort, Ben Nevis Industrial Estate and Ben Nevis Inn, a small-scale hydro and quarry income. We understand in confidence that collectively the estates are currently running at an **[REDACTED]**and it is thought direct employment stands at 8FTE and 6 part-time/casual staff members.

Community aspirations

ELLCT aims to own and maximise the land asset for the long-term sustainable development of the community. From an initial financial analysis, based on the estate's management accounts, they conclude that the land asset is a profitable going concern and is under-utilised at present. ELLCT's financial projections indicate an**[REDACTED]**This is dependent on lease income from **[REDACTED]**

In the short-term (up to 3-5yrs) ELLCT would continue with existing estate management activities but would look to manage this directly rather than retaining **[REDACTED]** as managing agents. In the longer term, ELLCT will look to further a number of development opportunities to sustain the organisation and deliver added social and economic impacts. New development opportunities will be delivered directly by the Trust or in partnership with others.

We understand from HIE that these are still being worked up but so far include:

Housing

- Development of the former Kinlochleven smelter to provide mixed-use housing and community facilities as identified in West Highland Local Development Plan.
- Working with housing providers to facilitate the development of affordable and social housing in other settlements to help address the existing high demand for housing in the area.

Outdoor sports and activities

- Development of mountain biking trails within the Mamore Estate to build on the growing recognition of Kinlochleven as a key hub for mountain biking activity.
- Further developing the East Highland Way, linking the West Highland Way to the Speyside Way.
- Working with Nevis Partnership to improve the path from Loch Meall an t-Suidhe to the CIC Hut.
- Improving interpretation related to wildlife tourism and the new Lochaber Geopark.
- Facilitating others to take forward existing development plans related to outdoor sports, including Kinlochleven Community Trust's aspiration to construct a community trail bike and water activity park.

Property lets

- Developing letting units and possibly a bunkhouse within Garvamore Kingshouse.
- Establishing a long-term use for the currently empty Mamore Lodge, either through sale or lease to a third party. There is potential for this to be developed into an outdoor learning centre to accommodate university field trips which regularly visit the area.

Land Use

- Development of small-scale hydro energy generation.
- Improving and possibly extending woodland cover and shelter belts and investigating the potential to create woodland crofts.
- Examining the potential to create opportunities for new entrants to farming through the creation of appropriate farming opportunities.

Business

- Should the land around the periphery of the smelter become available, ELLCT would seek to develop this as an industrial estate.

<u>Support provided</u>

HIE and Scottish Government (Community Land Team) have both provided extensive support to ELLCT. HIE has provided case officer advice and financial support to the value of **[REDACTED]** to provide start-up costs and the commissioning of legal and accountancy professionals to support due diligence pertaining to their buyout aspirations. Scottish Government's Community Land Team has provided detailed advice and guidance regarding a possible community right to buy application over the land asset.

ELLCT has worked up an application to the Scottish Land Fund for **[REDACTED]**. This would require Cabinet Secretary approval and Ms Cunningham is aware of the situation. In view of the current situation and likely developments (i.e. the need for ELLCT to negotiate with the preferred bidder rather than RTA) work on the community proposals has temporarily been put on hold. In due course, ELLCT is hopeful of **[REDACTED]**

<u>Extent and significance of Rio Tinto land holding in relation to Scottish Government policy aspirations:</u>

Community ownership is at the heart of Scottish Government's community empowerment agenda. The acquisition and management of land can make a major contribution towards creating stronger, more resilient and more independent communities. The Scottish Government has an important role in supporting communities who have the ambition to take on ownership of land. Landownership is increasingly seen as an enabling tool by many communities, with the ability to achieve wide-ranging benefits and contribute to the continuing resilience of Scotland's communities.

In 2013, the former First Minister announced a **target of having one million acres of land in Scotland in community ownership by 2020.** The Scottish Government set up a short life working group to develop a vision and strategy for achieving the target. The group's final report was published in December 2015 and work is now underway to implement its recommendations. Both the Community Empowerment Act (Scotland) 2015 and Land Reform Act (Scotland) 2016 created additional opportunities for communities to own assets and the Scottish Land Fund (2016-2020) has been enhanced – it now extends to urban and rural land in Scotland and has an increased budget of £10m for 2016/17.

There is currently around 540,000 acres of land in community ownership. The addition of a further 115,000 acres would contribute significantly to this target. To put this in context, this is almost 1.5 times the total area of land brought into community ownership through the Scottish Land Fund over the four years from 2012-16; (an investment of **[REDACTED]** to support 52 acquisitions extending to a total of 83,829 acres of land).

While the target is set in (and clearly measures) acres, it is widely recognised that the impact of community ownership cannot be measured in acres alone. When the former First Minister set the target, he stated: "….size of acreage is not the only thing that matters. Of course land matters for economic, strategic, sometimes symbolic reasons, not just a question of size". Increased community ownership will contribute to a more diverse and dispersed pattern of land ownership. At a local level, community ownership will result in more empowered, enterprising and resilient communities, capable of making a greater contribution to community wellbeing, economic growth and local services and amenities.

Given the uncertainties of what will be offered or available to the community, it is too early to assess the potential impact of the RTA land asset in community ownership. ELLCT are in the early stages of developing their business and development plan for the estate. Other lands in community ownership have delivered strongly, over time and with additional post-purchase public and private investment, against community empowerment and sustainable development objectives. Some community ownership initiatives experience challenges regarding ongoing sustainability. Each initiative is unique so it is not possible to make an assessment regarding **[REDACTED].**

Within the constraints of what information can be shared in the current circumstances, HIE and the Community Land Team remain in contact with the community group and in particular **[REDACTED]** the ELLCT chair and will be ready and able to offer assistance as and when appropriate.

ANNEX J

DUE DILIGENCE PROCURED

Key Points

In order to minimise and manage financial and reputational risks, ascertain key information on business viability and consider all necessary legal issues the Government has undertaken extensive due diligence.

External commercial, legal and technical expertise has been applied via consultancy services delivered by Ernst & Young (EY), **[REDACTED]**, **[REDACTED]** to shape an acceptable option that balances benefits against risks.

Commercial Advice

1) Ernst and Young

EY were been commissioned to provide expert independent financial advice on the GFG feasibility for the aluminium complex at Fort William and in particular the guarantee proposal of the GFG Alliance. EY is supporting preparation for obtaining internal authorisation and the Parliament's approval. Specifically, advice has been sought from EY on:

- the viability of the smelter business plan and its key associated risks, the robustness of assumptions and risks in relation to any Government guarantee – e.g. aluminium market trends and future investment needs
- the financial scope and extent of the guarantee structure and suggested mitigations, offering a view as to the potential gross and net financial exposure
- providing guidance sufficient to support design of PPA heads of terms including securities and conditions attaching to any guarantee
- the potential form of the guarantee, including alternatives to the specific structure proposed by the GFG Alliance, together with an analysis of the associated costs and risks
- the appropriate market premium to be charged for the guarantee proposed, consistent with Market Economy Investor Principle
- the public sector value for money case underlying the proposed power purchase guarantee and commentary on state aid compliance issues
- financial models of SIMEC/Liberty
- details of the power purchase agreement (PPA) between SIMEC and Liberty
- commercial negotiations with the GFG Alliance (SIMEC/Liberty) to formulate a 'workable' solution'

2) ***[REDACTED] [REDACTED]*** *via* ***[REDACTED]***

- early stage development of commercial terms and design of the EY scope
- necessary scoping and outputs of external advice
- liaison between advisers, including EY and **[REDACTED]**
- review, analysis and commentary on key commercial documents

Legal Advice

3) ***[REDACTED]***

[REDACTED] is the contracted legal advisor to Scottish Ministers on commercial matters. They represent SG in commercial negotiations with **[REDACTED]** LLP (acting for SIMEC/Liberty) in preparation of the guarantee agreement. In order to assess and mitigate relevant and commercial risks, **[REDACTED]** has provided advice to **[REDACTED]** and **[REDACTED]**

The firm is providing commercial legal advice to SG on the proposed PPA guarantee, particularly advice on the identification of commercial risks from a legal perspective and the obtaining of an appropriate securities package to reduce the financial exposure of Scottish Ministers.

Technical Expertise (energy markets and grid connection issues)

4) ***[REDACTED]***

In addition to advising on the original proposed PPA from a commercial perspective, **[REDACTED]** was commissioned to advise SG on issues relating to the supply of energy and licencing considerations, in particular:

- the ability of a public sector body to become an energy supplier
- the process for becoming an energy supplier if required and achieving all associated licencing
- the difference made by utilizing a sole-use private wire network
- exemptions that apply to private wires and their surrounding implications

This advice was obtained at an earlier stage in the review process as was required to perform analysis of electricity supply options. This option was subsequently discounted and not pursued

5) ***[REDACTED]***

[REDACTED] grid specialist (**[REDACTED]**) was commissioned to provide independent grid analysis and associated technical due diligence. Advice has been sought and received on:

- gird connections
- planned transmission upgrades
- contracted position in terms of Rio Tinto's existing power export / import contracts
- contracted dates and dependencies
- export capacity and limitations

[REDACTED] is responsible for verification of all grid assumptions and scrutinising the conclusions of National Grid and SSE, offering advice to SG on relevant technical capability.

ANNEX L

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

1. **[REDACTED]**
2. **[REDACTED]**
3. **[REDACTED]**
4. **[REDACTED]**
5. **[REDACTED]**
6. **[REDACTED]**
7. **[REDACTED]**
8. **[REDACTED]**

    (1) **[REDACTED]**

    (2) **[REDACTED]**

    (3) **[REDACTED]**

    (4) **[REDACTED]**

    (5) **[REDACTED]**

    (6) **[REDACTED]**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

ANNEX M

ADVICE FROM [REDACTED] ON SECURITY PACKAGE

In accordance with our instructions we have advised Scottish Ministers in relation to the legal aspects of the proposed support by Scottish Ministers of a purchase and future development by the GFG Alliance of the Lochaber Hydroelectric Power Station, Lochaber Smelter and associated last assets.
As part of that exercise we have drafted, negotiated and settled a security package which, taken as a whole will have the effect of reducing any risk to Scottish Ministers from the transactions envisaged.

As part of that security package, we have secured (or will before delivery of the Guarantee by Scottish Ministers have secured) signed copies of):

- **[REDACTED]**
- **[REDACTED]**
- **[REDACTED]**
- **[REDACTED]**
- **[REDACTED]**
- **[REDACTED]**
- **[REDACTED]**
- **[REDACTED]**
- **[REDACTED]**

The guarantees and payment undertakings given (both from us and from GFG Alliance, under the GRA and the Payment Agreement) and the security taken are given on the usual legal and commercial bases. Whilst the GRA and the Payment Agreement are, **[REDACTED]**, the reasoning behind them and the protection that they give is sound. The security taken in favour of Scottish Ministers represents the fullest package possible to us and provides a realistic level of mitigation to the risks assumed by Scottish Ministers.

In common with all commercial transactions, this does not mean that all risks have been or will be avoided. We remain of the opinion that risk exists in this transaction, chiefly around **[REDACTED]**, but we have secured the best available security package to mitigate these risks.

In summary, subject to signature and delivery of the final legal and security documentation reflecting the points above and providing the protections expected in a commercial transaction, it is our view that the security package as proposed is in keeping with that which would be secured by a private sector lender on a commercial basis for the guarantee by Scottish Ministers.