Annex C

Additional material released

Submission/Briefing document provided to the First Minister on 3 April 2023.

From: Kevin Quinlan
Director Environment & Forestry
3 April 2023

1. **Deposit Return Background and Scheme Status Report**

2. **Priority and Purpose**

IMMEDIATE

1. The purpose of this advice is to:
   - Provide you with background and a status report on the Deposit Return Scheme (DRS) including current issues and risks; and
   - Provide you with a plan to provide further assurance following the Gateway review
   - Highlight work ongoing to provide options to descope and de-risk the scheme.

3. **Recommendation**

2. Recommend that you note the:
   - Background to the Deposit Return scheme
   - Latest Gateway Review "Amber/Red" status of assurance of delivery of DRS by 16 August 2023 and our plans to work intensively over the next one (or if needed two) weeks with Circularity Scotland Limited to further test their readiness for 16 August
   - Work already being taken forward on options to descope and de-risk and around timing considerations. Further advice on this will follow as soon as possible.
   - Options being considered for a delay to the launch of DRS

4. **Context and background**

3. The Deposit Return Scheme (DRS) will introduce a 20p deposit on single use drinks containers, which is refunded upon return of the container. DRS operates in more than 40 countries and territories around the world, and Scotland's DRS is modelled on other successful scheme across Europe. Further background is provided in Annex B.

4. **DRS policy objectives** are to:
   - Increase recycling rates from 50% to 90% of scheme materials – PET plastic, aluminium and glass, and in doing so:
   - Reduce CO_2 emissions by 4m tonnes over 25 years (equivalent to taking 83,000 cars off the road).
   - Reduce litter by a third - cutting the £46m p.a. public spend on clean-up.

- Increase the quality of recyclate.
- Create job and economic opportunities in the circular economy, including significant inwards investment in materials reprocessing.

5. **DRS operates successfully in more than 40 countries and territories** around the world, and is anticipated to become a requirement for EU member states following revision to the EU Packaging and Packaging Waste Directive. New schemes launching in Europe before 2025 include Turkey, Romania, and Greece in 2023; Ireland and Hungary in 2024; and Austria, England, Wales and Northern Ireland in 2025.

6. **There remains significant public support for the scheme**, with polling consistently indicating approximately 70%[1] public support for DRS. The DRS Regulations were passed by the Scottish Parliament on 13 May 2020. As a form of extended producer responsibility for packaging waste, the scheme places obligations directly upon producers of drinks contained within single-use packaging. As enabled by Regulations, drinks businesses and retailers established a new, private sector, not-for-profit business, Circularity Scotland Ltd (CSL), as a Scheme Administrator in March 2021. CSL acts on their behalf in order to comply with the regulations including logistics, deposit accounting, collection and reprocessing of material, and paying and charging appropriate fees. Apart from Scottish Government and SEPA official time, some grant support to Zero Waste Scotland and a £9m loan from SNIB, **there is no public money going to industry to run DRS.** The flip side is that whilst ultimately politically accountable for DRS success, **Scottish Government has very little direct control of CSL.**

7. **DRS is highly complex; establishing a new market eco-system from scratch in 2.5 years.** When DRS is established, CSL will handle 2.5bn containers and over £500m in deposits. Until the scheme launches CSL has no cashflow and is managing c.80 contracts to build the platform for delivery. To get producers and retailers to sign-up DRS and CSL is dependent on stakeholder confidence that it will launch as planned.

8. **For a company that started with no assets and cashflow, CSL has made remarkable progress** in sourcing financing, staffing up and letting and driving delivery contracts. Private investment committed to DRS is estimated [redacted] SNIB £9m [redacted] Furthermore as at 10 March, 671 producers responsible for c.2.4 billion drinks containers (or c.95% of the annual total volume of products) have signed producer agreements with CSL. These range from global brands to 600+ small producers.

9. Whilst DRS is very large in scale, CSL's analysis indicates that **40 (of an initial estimate of 4,000+) drinks producers account for about 90% of sales volume, and 9 (of c. 17,000) retailers account for 99% of those sales**. Securing agreement with these major players is central to CSL's plan to stand up a "minimal viable product" for DRS by 16 August 2023.

10. Following a June 2021 Gateway Review, in February 2022, the Scottish Parliament approved regulations adjusting the launch date to 16 August 2023. Official advice

[1] Scottish Business Review 10 March 2023 https://scottishbusinessnews.net/polling-shows-strong-public-support-for-deposit-return-scheme-drs/

provided to Ministers in support of this revised launch date noted it as being challenging but deliverable but with significant risk and a “very tight contingency”. That contingency tightened further as it took longer than expected for CSL to source financing, then staff-up and put in place its 80 delivery contracts and longer than envisaged for UKG to address VAT and the still unresolved issues around an Internal Market Act exclusion and pricing display. The ambitious 16 August 2023 deadline focused minds and galvanised action. However, **the pace of delivery and the degree of change required for business (especially smaller business) has created a strong negative feedback loop in recent months. Handling this has diverted significant CSL and SG resources away from delivery**.

Current Delivery Confidence in DRS

11. The DRS launch date of 16 August 2023 is set out in the Deposit and Return Scheme for Scotland Regulations 2020 (“the DRS Regulations”), as amended in 2022.

12. There are currently a number of significant risks of feasibility [redacted] including:
    - DRS cannot operate practically [redacted] without UKG granting an exclusion from the **UK Internal Market Act** 2020. A decision by the UKG is needed by 17 April to enable launch on 16 August;
    - The March 2023 **Gateway Review** rates delivery confidence as “Amber-Red” noting very significant risks around delivery scope, programme management, incomplete and untested systems and CSL governance. With a more realistic, and agreed, delivery scope and schedule, the delivery confidence would be more positive;
    - **Small producers** have been pressing for a delay due to challenges of being ready in time and the perceived burden of the scheme on them;
    - [Readacted]
    - **Recent political pressures have created uncertainty** reducing some industry confidence in an August launch and slowing momentum on investment and readiness.

Current Risks and Issues

Internal Market Act

13. The Internal Market Act impacts on DRS because its effect is that various DRS requirements do not apply to producers based in other parts of the UK who wish to sell their products into Scotland. [Redacted]

14. Since October 2022, and in line with the agreed Common Frameworks IMA exclusion process, we have been pursuing a specific exclusion from the IMA with the UK Government so that DRS Regulations would apply to DRS scheme articles originating from other parts of the UK being sold in Scotland[2]. The exclusion process is not yet well established as it has only been used once before for the Scottish regulations to ban the sale and manufacture of certain single use plastics. The next formal step is discussion at the Inter-Ministerial Group (IMG) on Environment, Food and Rural Affairs on 17 April. We expect this meeting to be the trigger for DEFRA to initiate a Whitehall write-round

[2] Scottish Government previously pursued since 2021 a broad exclusion that would cover DRS as part of the Single Use Plastics exclusion implemented in 2022. However, UK Government did not agree to this approach.

(approximately 9 days' duration) to agree the UK Government position on an exclusion, unless DEFRA/ UKG agrees to initiate a write round at an earlier point (e.g. following a call with Scottish Ministers – see para 16).

15. **Even with a positive recommendation for an exclusion by DEFRA by 17 April, timing is tight to formally conclude the exclusion and** we will pursue approaches to mitigate the risks of delay in formalisation. **If the IMG outcome is inconclusive or negative, it is highly unlikely that an exclusion could later be agreed and formalised to enable DRS to launch [redacted] on 16 August**.

16. Officials in DEFRA indicated in February that the DEFRA Secretary of State is supportive in principle of an exclusion. However, in light of recent political uncertainty, we understand that she may seek a meeting with Scottish ministers to confirm the Scottish Government's approach on DRS. Such a meeting would be important to galvanise her support. Following the call between the First Minister and Prime Minister this week, the Deputy First Minister will write to Mr Gove on a number of matters including DRS, and we will provide a draft letter for the Cabinet Secretary for Net Zero and Just Transition to send to her counterpart in the UKG to seek urgent reassurance that the IMA exclusion is progressing and offering a meeting to discuss this. This letter will also seek resolution of issues around how deposits should be displayed under trading standards law.

Gateway Review

17. The fifth independent Gateway Review of DRS (March 2023) concluded a delivery confidence assessment of Amber/Red[3]. The GR made a series of recommendations to:
    - reassess and strengthen governance and whole system programme management,
    - further evaluate delivery options and obtain clear Ministerial direction;
    - define a commonly agreed Minimum Viable Product;
    - assess resilience of workplans and identify any single points of failure;
    - ensure there are comprehensive plans for financial flow making clear accountability; consider a regulatory needs assessment;
    - review the exemption process to improve efficiency;
    - review full governance and leadership arrangements; and
    - pursue a more proactive communications and engagement approach across stakeholder groups.

    We are required to respond to these recommendations with an action plan within three weeks. The Minister for Green Skills, Circular Economy and Biodiversity committed to share the recommendations of the GR and the Scottish Government's response with the NZET Parliamentary Committee in due course. Previous GR reports have been published with some redactions for commercial sensitivity. The detailed recommendations from the Gateway Review can be found in Annex A.

18. The conclusion of the final report is reproduced verbatim below.

[3] Definition **Amber/Red** is: "*Successful delivery of the project is in doubt with major risks or issues apparent in a number of key areas. Urgent action is needed to ensure these are addressed and establish whether resolution is feasible*."

Gateway Review Delivery Confidence Assessment:	AMBER/RED

The Review Team finds that the delivery confidence assessment is Amber-Red in that major risks or issues apparent in a number of key areas. However, this assessment is made against an observed broad perception of delivery schedules and scope. A single clear and agreed delivery scope and schedule is not shared and articulated by all Programme delivery stakeholders.

This is an ambitious and courageous programme that pioneers a new relationship between the public and private sector, enabling each to bring their expertise to deliver economic, environmental, and societal good. Given the scale of this ambition it would be imprudent to expect this new arrangement to work smoothly and at first attempt. Further, as just one, but central part of this ambition, the scheme administrator is being required to stand-up from nothing a major company with multi-sector interfaces in little more than two years; this in itself is a major challenge and it would be unreasonable to expect the organisation to have mature and robust operating systems and relationships.

Consequently, a progressive and evolutionary change is recommended with expectations set accordingly with the public, retailers, wholesalers, producers, and public leaders, and recognising that there will be implementation challenges regardless of when the system is introduced. With a more realistic, and agreed, delivery scope and schedule, the Programme delivery confidence could be considered much more favourable.

The Review also considers that Scotland is effectively trialling DRS for the other UK nations, exposing and resolving the many system issues inherent across all approaches; recognising this value in the planning, and support, of the Scottish and other programmes would be a greater benefit to all parties.

[Redacted]

Regardless of addressing schedule options of most critical concern, very prompt attention is required to address weaknesses in whole Programme governance that will impact the Programme success in both the immediate and longer term. Further, certainty and clarity are urgently needed to maintain stakeholder cohesion and to build confidence.

19. [Redacted]

20. This work will provide a view on CSL readiness to deal with the challenges in time for Ministers to make decisions on the scheme before end April - the latest opportunity to adjust regulations in time for a 16 August launch date - and will provide necessary information which can be used to develop the Scottish Government Action Plan in response to the GR recommendations.

Business Readiness, Concerns & Response

21. **There is a spectrum of readiness and appetite for DRS launch amongst business**. There are five main groups to keep in mind when considering this spectrum: larger/ smaller producers, larger/ smaller retailers and hospitality. Generally, larger producers are ready and want to start. Some smaller producers are not ready and want to delay. There is also some longstanding, outright opposition to DRS, especially in the alcohol and glass sectors. There has been a significant campaign in recent months by those who are either not ready or opposed to the scheme.

22. Many large businesses have invested significant sums of money preparing for the launch of DRS and will be critical of significant delays. All want certainty on start date

and clarity on a range of outstanding technical issues. Recent political uncertainty has made some business pause their readiness preparations. Larger producers are very opposed to any kind of differential approach, including a delay for small producers only, which they see as anti-competitive. Larger producers are keen to ensure a level-playing field.

23. Most larger retailers are likely to oppose and consider legal challenge to any delay specifically for small producers given this will create more supply chain complexity and will increase complexity for their operations. Most of the large retailers would welcome a general delay for everyone to allow more time to prepare for the scheme, with Tesco, ASDA, Morrisons, Sainsburys and Waitrose all being noted as publicly calling for a delay to the scheme in a Daily Record article on 2nd April. ASDA and Tesco have confirmed these calls for a delay in recent discussions officials have had with them.

24. Alongside the businesses who are vocal about their concerns, there are many other businesses who are less vocal but want the scheme to go ahead as planned. The British Soft Drinks Association (BDSA) has issued a press release stating that they want the new First Minister to push ahead with the scheme on 16 August. They are also clear that they would oppose any differential approach for smaller businesses. The BDSA have also indicated the financial impact for their members of a delay and have suggested they may choose to seek compensation should there be a delay.

25. Once greater awareness of retailers' obligations is reached, we expect to hear concerns from small retailers about their readiness too. Much of this concern is around not having adequate time to prepare and set up the processes required to comply with the scheme by August. Many drinks businesses have raised concerns that August is a challenging month to launch a scheme of this scale. Some concerns relate to issues related to trading standards and issues around online take back.

26. Notwithstanding the above and that CSL is trying to do a great deal in a very short timeframe, [redacted] **7**

Options Being Considered to Descope and De-risk

27. In recognition of the likely impact of the risks outlined above **officials recommend that the descoping modifications are made to the scheme before launch**. Even with this descoping, the GR "Amber/Red" rating identified that very significant risks would remain for DRS delivery and hence a range of options for delaying the scheme are assessed.

28. Officials have been working with key partners and with stakeholders to consider options which may reduce risk to the scheme and may also respond to some of the criticism the scheme has recently received. Officials are working through these options to make sure these are feasible, fair and legal. This work is already underway but will need more time to test these points, in particular the issues around legality.

29. The more **straightforward de-scoping options** which are being considered which we believe would only require minor adjustments to the existing BRIA, would be supported by small producers, would cause less concern with larger producers and we are therefore more confident that they could be delivered (subject to legal testing) are:

i. Increased communications around a **regulatory support period for businesses** with a pragmatic and supportive approach to compliance in line with SEPA's general approach to compliance with new environmental regulation.

ii. **Exclude products selling less 5,000 units p.a.** from requiring a deposit and producer fees – would cover micro drinks business and specialist product runs.

iii. **Remove drinks containers below 100ml** ("miniatures") from the scheme (current limit is 50ml).

iv. Automatically **exempt hospitality retailers from operating as return points** when off-sales as less than a certain percentage of sales (e.g. 10%) rather than the current model which is opt out and requires retailers to apply for exemption. On sales and off sales would still charge the 20p deposit as every other retailer.

v. **Simplified CSL contracts for small producers**. .

30. The other **more contentious options** we are considering but which we believe would face greater opposition from some businesses, could increase costs for all (but particularly larger) businesses in the medium-long term, [redacted]:

vi. **A formal grace period of up to 12 months for small producers**. While we recognise that this was FM's preference during the campaign it is important to note that [redacted]

vii. **Automatically exempt small retailers with an internal footprint under 100 or 200 or 280 m^2.** Retailers with a footprint under 100m^2 and food-to-go retailers with a footprint under 280m^2 already benefit from a streamlined exemptions process.

31. Small businesses have requested other support particularly focussed on removing all costs for the smallest businesses. We do not believe these options are possible as they would be challenged strongly by other producers and would likely mean that currently supportive producers would no longer be so.

32. To address the GR recommendations, **immediate action is needed to address overall DRS governance**, programme management and communications on additional external and internal advice. Whilst Scottish Government has little direct control of CSL which is a private company, initial ideas for strengthening governance include:
    - [redacted]
    - Development of Codes of conduct, Business pledge, etc
    - Set up a consultative council (with e.g. Consumer Scotland; FSS; a disability rights group)

Scheme launch date and approach

33. As noted in para's 21 to 26 there are competing views on the preferred launch date across sectors and businesses. The significant risks highlighted by the Gateway Review also make a decision on any delay to a launch date difficult.

34. [Redacted], three options for launching DRS are being assessed:

- Option 1: Launch 16 August – with the list of remedial actions above and the undertaking of a rapid review of further support for small producers and retailers

- Option 2: Delay – as option 1 plus a 6 month,12 month or 2 year delay to start of scheme (Recommended option is 6 month delay)

- Option 3: Delay with phased launch – as option 2 but with the option of phasing in some elements before the full launch to test and show viability.

35. It should be noted that, given DRS is an industry funded system that needs to pay for itself, **any modification or risk mitigation action will create winners and losers.** For example, if CSL were to remove producer fees for small producers to resolve that financial burden on them, then CSL would need to increase the producer fees for the larger producers to ensure adequate income to fund the scheme, including to pay the retailer handling fee. As noted previously, larger producers are very opposed to a differential scheme for this reason and those businesses supportive of the scheme will be less so if there is differentiation.

36. We intend to provide more advice on the feasibility of maintaining the August launch date or adjusting that date once we have completed the work with CSL on delivery assurance (as noted in paras 19 and 20) and when we have considered the options in para's 29 and 30 more fully.

Communications

37. Officials will work with communications colleagues to provide detailed communications advice as we get more clarity on the readiness of CSL as outlined in paras 20 and 21 and once we have provided further advice on the issues in para 29.

38. In the meantime there will be significant interest in the scheme and particularly whether there will be any delay. To have any ability to deliver the scheme successfully in August we need businesses to continue to prepare at pace. The following line has been used in response to media queries regarding a potential delay to the scheme:

"Scotland's deposit return scheme will be a major part of our efforts to reduce litter, cut emissions and build a greener, more circular economy. We are committed to this important scheme, and continue to work to identify further feasible, fair and legal options to support small producers, such as a grace period. Businesses should continue their preparations for its launch working, where appropriate, with Circularity Scotland and their sector bodies."

5. Bute House Agreement Implications

39. The DRS Regulations were made in 2020 prior to the Bute House Agreement being entered into. The Bute House Agreement Shared Policy Agreement states "The Scottish Government and Scottish Green Party share an ambition to advance Scotland's circular economy, as an essential contribution to tackling the twin crises of climate change and biodiversity loss. We therefore agree to discuss the development of policies to achieve this aim, including extended producer responsibility, potential fiscal incentives, and

consideration of what requirements may need to be included in a Circular Economy Bill later in this parliamentary session". DRS is part of extended producer responsibility and any significant delay or reduction in the ambitions of the DRS may risk this agreement.

6. Financial and Legal Considerations

40. [Redacted]

7. Sensitivities

41. This work is commercially sensitive and any decision is likely to have a market impact. As above we will provide further advice on this.

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11.
12. Conclusions and next Steps

42. We ask you to:

- Note the background to the Deposit Return scheme.
- Note the latest Gateway Review "Amber/Red" status of assurance of delivery of DRS by 16 August 2023 and our plans to work intensively over the next 2 weeks with Circularity Scotland Limited to test their readiness for an August launch.
- Note the work already being taken forward on options to descope and de-risk and around timing considerations. Further advice on this will follow as soon as possible.

43. Ms McAllan intends to take another meeting on this in due course, which FM or FM SpAds may want to join.

Kevin Quinlan, Director for Environment & Forestry

Annexes
Annex A – Gateway Review Recommendations
Annex B – Context and Legal Obligations

Cabinet Secretaries and Ministers Copy List	For Action	For Information Portfolio interest	For Information Constituency interest	For Information General awareness
Deputy First Minister Cabinet Secretary for Net Zero and Just Transition		X X X		

Cabinet Secretaries and Ministers Copy List	For Action	For Information Portfolio interest	For Information Constituency interest	For Information General awareness
Cabinet Secretary for Constitution, External Affairs & Culture		X		
Cabinet Secretary for Rural Affairs Land Reform & Islands		X		
Cabinet Secretary for Wellbeing Economy, Fair Work and Energy		X		
Minister for Green Skills, Circular Economy & Biodiversity				X
Lord Advocate				X
Solicitor General				

Officials Copy List
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Annex A

Gateway Review Recommendation

1. The SRO should most urgently **re-assess and implement <u>alternative governance options</u>** to provide much more rigorous control of the whole DRS Programme in both the immediate and longer term.
2. The SRO should most urgently **<u>evaluate delivery options</u>** and whilst recognising that all options carry significant risk, gain ministerial support for a clear decision.
3. In collaboration with all Programme stakeholders, the SRO should **define an initial <u>whole system MVP</u> and subsequent delivery phases**, confirming agreed vision, scope, a set of go live success criteria for all parties, and critical path with dependency mapping for all participants.
4. The SRO should request that an **assessment should be made of the <u>resilience of workplans</u>, timetables, capacity and capability to deliver** (without undue risk) a very challenging series of requirements. Particular attention should be paid to identifying single points of failure and ensuring these vulnerabilities are managed.
5. The SRO should request that a **comprehensive design, documentation and testing plan of <u>financial flows</u>** is prepared involving all affected parties with clear accountability and timescales.
6. The SRO should pursue **confirmation of the <u>regulatory</u> <u>task</u>**, (aligned with SG/SEPA's their tolerance for noncompliance) and including an assessment of resource need and ensure it is appropriately funded if there is a shortfall in registration revenue
7. The SRO should **urgently review the <u>Exemption process</u>** and make improvements to its efficiency, practicality and resourcing.
8. In-line with a significant review of Programme governance, and flowing from this, the SRO should **review and agree the full governance, leadership and scope of <u>communications</u> activities** across parties.
9. The SRO should vigorously pursue a **significantly more proactive <u>communications</u> strategy** and actions to drive the societal change, and gain cohesion across the whole society stakeholder groups.

Annex B

Context and Legal Obligations

1. The primary powers to legislate for DRS were introduced in the Climate Change (Scotland) Act 2009. An intention to introduce DRS in Scotland was announced in the 2017 Programme for Government. Legislation was developed from 2018-2020, including full consultation and impact assessments, and was passed by Parliament in 2020.

2. The scheme introduces a 20p, refundable deposit on all single-use glass, PET plastic, steel and aluminium drinks containers sold in Scotland between 50ml and 3L in size. The scheme is regulated by SEPA. As an example of producer responsibility, obligations are placed directly upon drinks producers to implement the scheme. Drinks producers could choose to appoint one or more scheme administrator (SA) to exercise certain obligations on their behalf. This approach had cross party support, since it enables greater flexibility and was considered to encourage greater efficiency, which would in turn reduce costs for businesses and consumers [redacted]

Timescales for changes to the Regulations

3. Any change to the scheme set out in the DRS Regulations can only be made by a further set of amending Regulations approved by the Scottish Parliament. The Regulations are subject to affirmative procedure which means any change to the Regulations requires a debate in the Parliament which would have to happen before the start of the summer recess i.e. the w/c 26th June.

4. Under normal Parliamentary timelines any regulations to amend the scheme should be laid in the Scottish Parliament in draft w.c. 24th April. Regulations can be expedited subject to negotiation with the Parliament.

[Redacted]

Support from CSL to businesses

9. Scottish Government officials and CSL continue to regularly engage with businesses to discuss their issues and concerns. Between November and February, CSL has engaged with over 1,500 businesses through roadshows and other engagements. The Scottish Government and CSL have always been committed to listening to concerns and resolving legitimate concerns where possible. As such the following actions have been taken:

- In November 2022, Scottish Government updated the return point exemptions guidance and application process to make it simpler for more small retailers to apply and obtain an exemption from acting as a return point.
- In December 2022, Minister Slater confirmed the intention to remove online takeback obligations from the majority of businesses, and proposed that obligation would apply only to the largest grocery retailers.

- In December 2022, CSL announced new producer fees that are 8%, 30% and 40% lower than originally planned for glass, PET plastic and metal containers respectively.
- In January 2023, CSL increased the retailer handling fee – the amount a retailer will be paid per container to cover their operational costs as a return point – by up to 19%, meaning Scotland has the highest retail handling fee in the world.
- In February 2023, CSL announced a package of support to improve cashflow for producers which equates to £22m of support and includes:
    - Removal of the day one and month one charges for all producers, up to a threshold of three million units per year;
    - Above a three million unit threshold, the Day 1 payments for producers using UK wide barcodes was reduced by two thirds, from 2.4 months of fees to 3 weeks of fees;
    - Providing two month credit terms on deposits and fees up to the same volume threshold to reduce the working capital impact on all producers;
    - CSL offering the option to use self-adhesive barcode labels for producers placing less than 25,000 units per year of a specific product on to the Scottish market, alleviating administrative burden.

There is no registration fee for producers with an annual turnover of £85,000 or lower or producers that only fill and seal single-use drink containers at point of sale. For all other producers, the registration fee will be £365 (annually).