

From: [Redacted]

Sent: 30 April 2018 17:59

To: First Minister <firstminister@gov.scot>; Cabinet Secretary for Finance and the Constitution <CabSecFC@gov.scot>

Cc: [Redacted]

Subject: FMEL - Contingency Options Update - Meeting with FMEL and CBC [30.04.18]

PS/First Minister

PS/Cabinet Secretary for Finance and the Constitution

1. Economic Development officials convened a four-hour workshop today (30 April) with Directors of FMEL and CBC to review the 5-year outlook for the business and to explore further the potential basis for new commercial investment to support the medium-term vision.
2. The meeting was very positive. FMEL were keen to stress the productive discussions they are having with potential customers and the pipeline they see over subsequent years for the business. Officials agree that the business case, at present, looks encouraging and we will be working with FMEL in the coming fortnight to fully explore and build upon their business plan.

[Redacted]

3. [Redacted] The stated intent of all parties is to try and get to heads of terms by the end of this fortnight if there is any possibility of a commercial deal being made.
4. The ability to strike a commercial deal should become clearer this week. FMEL have committed to providing a revised cash flow [Redacted]
5. As this takes shape officials will continue to work proactively to explore all possible options and will provide Ministers with regular updates.

Many thanks,

[Redacted]

Mary McAllan
Director of Economic Development
11 May 2018

First Minister
Cabinet Secretary for Finance and the Constitution
Minister for Transport and the Islands

DISCUSSIONS ON POSSIBLE PUBLIC INVESTMENT INTO FERGUSON MARINE ENGINEERING LTD (FMEL)

Purpose

1. To provide a summary of the meeting on this topic held on 10 May between the Cabinet Secretary for Finance and the Constitution, the Minister for Transport and the Islands, and officials from Economic Development, Finance and Transport Scotland.
2. To seek confirmation of the proposed next steps– principally, that Ministers are content that negotiations be commenced exploring scope for a commercial transaction with FMEL with the aim of developing head of terms (see recommendation at paragraph 9 below).

Timing

3. Urgent. It would be helpful if Ministers could respond by Monday 14 May to allow negotiations to commence next week.

Meeting summary

4. [Redacted]

5. A potential commercial structure had been developed by our commercial advisers, [Redacted], as a device for testing FMEL/Clyde Blowers Capital's (CBC) appetite for co-investment and for assessing the acceptability of certain terms. These initial discussions, conducted with no formal status or commitment by either side, had proceeded sufficiently well to provide enough confidence that a commercial arrangement might be reached through negotiation though this remains to be tested.

Emerging features

6. We reviewed with Ministers the key features of the potential commercial structure discussed between [Redacted] and FMEL/CBC. These are as follows:

[Redacted]

Recommendation

7. We recommend Ministers agree to officials commencing negotiations on the basis of the proposals above with a view to developing draft heads of terms
[Redacted]

8. Ministers should note that any draft agreement which may be developed would be subject to all normal processes of commercial diligence, financial and legal scrutiny (including State Aid considerations), Accountable Officer sign-off and Ministerial approval. This note has been agreed with the Chief Financial Officer.

Mary McAllan
Director of Economic Development
DG Economy

From: [Redacted] **On Behalf Of** Cabinet Secretary for Finance and the Constitution

Sent: 05 June 2018 21:36

To: Cabinet Secretary for Finance and the Constitution <CabSecFC@gov.scot>; DG Economy <DGEconomy@gov.scot>; [Redacted]

Cc: [Redacted]

[Redacted]

Liz and Gordon

Please see below a minute of the meeting between the Cabinet Secretary (DM) and Jim McColl (JM). [Redacted]

- [Redacted]
- JM set out the opportunities for the business to develop and the potential of new contracts. DM agreed that are opportunities for the yard and is keen to see the business grow.
- DM then moved on to the final points of negotiations and highlighted that he is focussed on protecting the jobs, supporting the yard and to ensure that the boats are delivered. DM emphasised that any support provided by Scottish Government must be on commercial terms and our advisors, [Redacted], are providing assistance in ensuring that this met.
- JM set out that CBC are willing to put further investment into the company to help it grow and he went through different scenarios of how this interacted with our investment (equity basis). DM stated that the current proposal is based on the commercial determination by [Redacted], which must be met in order to have sign off from the Permanent Secretary and the Lord Advocate. DM highlighted that officials have also been given a clear direction to ensure his three aims (above) will be met as well as the commercial requirement.

[Redacted]

Happy to answer any questions on this as well.

[Redacted]

Private Secretary to Derek Mackay MSP, Cabinet Secretary for Finance and the Constitution

The Scottish Government

St Andrew's House | Regent Road | Edinburgh | EH1 3DG [Redacted]

[Redacted]

From: [Redacted] **On Behalf Of** Cabinet Secretary for Finance and the Constitution

Sent: 06 June 2018 20:49

To: [Redacted] Cabinet Secretary for Finance and the Constitution <CabSecFC@gov.scot>

Cc: [Redacted]

Subject: RE: CMAL Procurement Review - release to CMAL - 22 May 2018

Richard

Just for completeness, below is the final minute of the meeting for the official record.

Thanks

Phone call with Jim McColl – 24 May 2018

[Redacted]

- [Redacted] DM reiterated SG's objectives around vessel delivery, jobs and the future of the shipyard. For that reason he wanted to focus on contingencies.
- JM confirmed that he was pleased with the ongoing engagement between FMEL and SG on a commercial agreement. DM and JM agreed that this was close to completion. DM noted it would need substantial SG investment and also investment from the partner.
- [Redacted]

[Redacted]

Private Secretary to Derek Mackay MSP, Cabinet Secretary for Finance and the Constitution

The Scottish Government

St Andrew's House | Regent Road | Edinburgh | EH1 3DG [Redacted]

[Redacted]

From: Mary McAllan
22 June 2018

Cabinet Secretary for Finance and the Constitution
Minister for Transport and the Islands

NEW LOAN AGREEMENT WITH FERGUSON MARINE ENGINEERING LTD

Purpose

1. To seek your approval for a £30 million commercial loan facility for Ferguson Marine Engineering (Holdings) Limited (FMEL).
2. The purpose of the loan is to improve the liquidity of FMEL. [Redacted]

Timing

3. Urgent. [Redacted]

Contents and structure of the advice

4. This advice presents the terms of the proposed loan agreement; it summarises the independent commercial and legal advice taken in negotiating the loan and the key accountability considerations underpinning the recommendation.
5. The advice is structured as follows:

I.	Consultation	page 2
II.	Background	page 3
III.	Loan agreement summary	page 5
IV.	Previous interventions to support FMEL	page 11
V.	Intervention case, options and assessment	page 13
VI.	Market economy investor principle	page 19
VII.	Accountable Officer considerations	page 20
VIII.	Parliamentary handling and communications	page 21
IX.	Completion	page 23
X.	Recommendation	page 23
6. The material below is supplemented by further detailed information held in the annexes to this paper. A due diligence report produced by [Redacted] ([Redacted]) (see executive summary at Annex A) and the loan agreement are contained in separate documents.

I) Consultation

7. The work leading to the loan agreement reflects input and advice from my Directorate, Transport Scotland, Finance, Procurement and SGLD. The

recommendation has been approved by DG Economy (Accountable Officer), the Chief Financial Officer and the Permanent Secretary (Principal Accountable Officer).

8. The Accountable Officer, Liz Ditchburn, has provided the following statement:

“I am content that this proposal goes forward to Ministers for decision. Having considered carefully the options to achieve Scottish Ministers objectives and the risks associated with these options, and supported by the appropriate legal and financial advice, I believe that the loan agreement as negotiated represents a legitimate basis for action, and on balance, the most appropriate mechanism to achieve our objectives. The Accountable Officer considerations of regularity, propriety, and value for money have been considered and I believe are satisfied on the basis of the evidence and advice available to me. Appropriate protections of SG interests have been built into the agreement and unreasonable demands from CBC/FMEL have been negotiated out. [Redacted] Close oversight and monitoring, including through securing appropriate expert advice on FMEL’s progress against their resourcing plan, will be important, particularly during the critical first months of significant drawdown of the facility.”

9. The Lord Advocate has been briefed by SGLD during the preparation of the proposed loan and has had the opportunity to ask questions and received replies. [Redacted]

[Redacted]

II) Background

[Redacted]

Ministers’ objectives

10. The Cabinet Secretary for Finance and the Minister for Transport restated their three principal policy objectives at a meeting with officials on 10 May – vessel delivery, employment and the shipbuilding capacity of the yard:

- Vessel delivery – The Minister for Transport wrote to the Rural Economy and Connectivity Committee in November 2017 stating that 801 (MV Glen Sannox) would be delivered in winter 2018/19. [Redacted] Affected island communities in Arran and the Western Isles, where the vessels will be deployed, are concerned at the impact of delays given the capacity and reliability benefits that these new vessels are intended to bring, particularly in light of recent well-publicised disruption on the Clyde and Hebrides network due to mechanical breakdowns.
- [Redacted]
- Shipbuilding capacity of the yard – FMEL is a unique asset as the last commercial shipyard on the Clyde and the only Scottish yard that has the physical capacity to build the larger ferries in CalMac’s fleet. [Redacted]

11. In pursuit of these three objectives Ministers sanctioned negotiations between officials and FMEL/CBC with a view to developing a commercial proposition to support the business (see update note of 11 May at Annex C).

Due diligence

12. [Redacted] are our independent commercial advisers [Redacted]

13. [Redacted]

III) Loan Agreement Summary

Purpose

14. The purpose of the loan is to fund FMEL to “assist with the long term viability and enhanced capabilities of the businesses carried on at the Property” and for “other general working capital purposes of FMEL, all as identified in the Business Plan and/or Financial Model” [Redacted]

[Redacted]

V) Intervention Case, Options and Risk Assessment

[Redacted]

15. [Redacted]

16. Ministers’ policy priorities (vessels, jobs and yard) have been foremost in our thinking throughout the negotiations and are captured in the options assessment. The frame of reference also included costs to SG and deliverability.

[Redacted]

VI) Market Economy Investor Principle (MEIP)

17. Article 345 of the Treaty on the Functioning of the European Union requires neutrality in the treatment of public and private undertakings and one of the implications of that provision is that public authorities are free to invest in undertakings and extend loans, guarantees, inject capital, subscribe to shares or purchase outright any company. Equally, they must behave in the same way as a private investor would behave in similar circumstances to avoid there being state aid present in any state intervention.

18. Application of the 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. The test for MEIP is therefore an economic one and not a legal one.

19. At its most basic the test for MEIP is whether in similar circumstances a private investor, having regard to the foreseeability of obtaining a return, and leaving aside all social and regional policy conceptual considerations, would have subscribed the capital in question. The only considerations that can be taken into account in this context are profitability and optimisation of return of capital.

[Redacted]

VII) Accountable Officer Considerations

20. The Public Finance and Accountability (Scotland) Act 2000 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.

21. This latter consideration should also take into account the sustainability of the proposal in the context of the wider public finances, that is, the extent to which it affects cumulative future financial commitments and risk. 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.

Regularity (legal competence)

22. Regularity concerns whether there are underlying legislative powers with which to commit expenditure.

23. Section 7 of the Industrial Development Act 1982 provides the necessary enabling 'statutory authority'¹ for selective financial assistance to be given to promote industry which will safeguard or develop jobs. The shipyard is in an assisted area: Ward 2 of Inverclyde is listed as an assisted area in terms of Schedule 2 to the Assisted Areas Order 2014.

24. The purpose of the loan is to fund FMEL to "assist with the long term viability and enhanced capabilities of the businesses carried on at the Property" and for "other general working capital purposes of FMEL, all as identified in the Business Plan and/or Financial Model". [Redacted]

Propriety

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

26. The written agreement between SG and the Finance Committee specifically requires Ministers to seek the approval of the Finance Committee where they are proposing a transaction that gives rise to a contingent liability (e.g. a guarantee). On the basis that this transaction is a loan we do not consider that there is a need for specific Finance Committee approval. However, we recommend that the Finance Committee is informed at an early stage (see next section on Parliamentary handling below).

[Redacted]

27. We have undertaken appropriate due diligence of the loan agreement proposal and alternatives to establish costs and benefits, identify risks and develop

¹ The term used by the Scottish Public Finance Manual to describe legislative powers.

mitigations. External commercial and legal expertise has been applied via consultancy services delivered by [Redacted] and [Redacted] to shape an acceptable agreement that balances benefits against risks. [Redacted]

Value for money and affordability

28. 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. It is also important to consider affordability, opportunity cost and overall financial sustainability.

[Redacted]

29. IX) Completion

30. Pending Ministerial approval the remaining steps to execution of the loan agreement are final checking of legal documentation and confirmation by SG's commercial and legal advisers that all conditions precedent are satisfied.

31. All the necessary legal documentation is agreed. The loan agreement will only come into effect once all the necessary documentation has been signed.

X) Recommendation

32. We have taken a commercial approach with our independent legal and commercial advisers to negotiate an option that delivers Ministers' policy priorities.

33. The proposed loan agreement has been thoroughly scrutinised and tested against a range of alternatives to bring forward a package that benefits the Scottish economy and manages risk to SG.

Our independent advisers ([Redacted] and [Redacted]) are satisfied the loan agreement is in line with market conditions.

34. The recommendation is that:

- **Ministers review the contents of this submission and agree that we proceed to offer the proposed loan to FMEL/CBC.**

Mary McAllan
Director of Economic Development

Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness
First Minister					X
Deputy First Minister					X
Cabinet Secretary for Economy, Jobs and Fair Work					X
Cabinet Secretary for the Rural Economy and Connectivity					X
Minister for Business, Innovation and Energy					X
Lord Advocate					X
Permanent Secretary					
DG Economy					
DG Scottish Exchequer					
DG Organisational Development and Operations					
Chief Financial Officer					
[Redacted]					
Roy Brannen					
John Nicholls					
Mike Baxter					
Liz Lloyd					
Colin McAllister					
Callum McCaig					
Stewart Maxwell					
Kate Higgins					
Caroline Beattie					
[Redacted]					
Ainslie McLaughlin					
[Redacted]					
Kerry Twyman					
Fran Pacitti					
[Redacted]					

[Redacted]

ANNEX C

Mary McAllan
Director of Economic Development
11 May 2018

First Minister
Cabinet Secretary for Finance and the Constitution
Minister for Transport and the Islands

[Redacted]

Purpose

9. To provide a summary of the meeting on this topic held on 10 May between the Cabinet Secretary for Finance and the Constitution, the Minister for Transport and the Islands, and officials from Economic Development, Finance and Transport Scotland.

10. To seek confirmation of the proposed next steps– principally, that Ministers are content that negotiations be commenced exploring scope for a commercial transaction with FMEL with the aim of developing head of terms (see recommendation at paragraph 8 below).

Timing

11. [Redacted]

Meeting summary

[Redacted]

Recommendation

12. [Redacted]

13. Ministers should note that any draft agreement which may be developed would be subject to all normal processes of commercial diligence, financial and legal scrutiny (including State Aid considerations), Accountable Officer sign-off and Ministerial approval. This note has been agreed with the Chief Financial Officer.

Mary McAllan
Director of Economic Development
DG Economy

HEADS OF TERMS

ANNEX D

[Redacted]

SUBMISSION FROM DG ECONOMY [Redacted]

PS/Cabinet Secretary for Finance

IMMEDIATE - COMMERCIALY CONFIDENTIAL [Redacted]

[Redacted]

DG ECONOMY

[Redacted]

ANNEX F

[Redacted]

ANNEX G

ANNEX H

VATIS Ltd
18 Crofton Way
Swanmore
Hampshire
[Redacted]

Mary McAllan
Director of Economic Development
Scottish Government
5 Atlantic Quay
150 Broomielaw
Glasgow G2 8LG

[Redacted]

[Redacted]

A handwritten signature in black ink, appearing to read 'Luke van Beek', with a large, sweeping flourish extending from the end of the name.

Luke van Beek
VATIS Ltd
Review Team Leader

[Redacted]

[Redacted]

ANNEX J