

**Cabinet Secretary for Economy, Jobs and Fair Work  
Cabinet Secretary for Finance and the Constitution  
Minister for Transport and the Islands**

**FERGUSON MARINE ENGINEERING LIMITED - SHIPBUILDING CONTRACT TWO 100 METRES DUAL FUEL FERRIES**

**Purpose**

1. To provide Ministers with an update in relation to progress on the two Dual Fuel Ferries that are currently under construction at the Ferguson Marine Engineering Ltd (FMEL) shipyard in Port Glasgow. To highlight Caledonian Maritime Assets Ltd's (CMAL) early concerns in regard to likely slippage in the timescale for delivery of these two vessels.
2. To respond to a recent query from the Cabinet Secretary for Economy, Jobs and Fair Work in relation to the use of Bank Guarantees and Surety Bonds in the shipbuilding contract for these two vessels and the broader issues for FMEL going forward.

**Timing**

3. Routine, although the narrative in the submission will be helpful background to the planned meeting between Mr Jim McColl, Clyde Blowers Capital, the owners of FMEL, and the Cabinet Secretary for Economy, Jobs and Fair Work and the Cabinet Secretary for Finance and the Constitution on Thursday 2 March 2017.

**Background**

4. In November 2015, CMAL placed orders at FMEL for the construction of two 100m Dual Fuel Ferries (LNG and Marine Gas Oil), currently referred to as Vessels 801 and 802.
5. The delivery dates of the vessels at contract signing were
  - Vessel 801 – 25 May 2018 – for subsequent deployment on the Arran service to Brodick.
  - Vessel 802 – 26 July 2018 – for subsequent deployment on the Uig Triangle service, serving Tarbert, Harris and Lochmaddy, North Uist service.
6. The value of the core contract is £97m: , £48.5m per vessel. In addition to the FMEL contract costs there are other costs associated with these vessels – design, construction supervision and mobilisation relating to the CMAL supervision team and the secondment of vessel based personnel from CalMac. The total cost Scottish Ministers is forecast at [Redacted-1].
7. There have been a number of challenges that are recognised throughout CMAL's experience with FMEL and these are outlined in more detail in Annex A under the following headings:-
  - Quality of Built
  - Payments
  - Challenges
  - Allowable days
  - Delivery prospects in more detail

- Future Progress
- Bank Guarantees and Surety Bonds
- Broader issues for FMEL

### Delivery prospects

8. There is an extremely high probability that the vessels will be delivered later than that indicated above. CMAL's view is that while it is potentially possible to deliver Vessel 801 by August 2018, with the current rate of progress this is most likely going to be missed and as a consequence the timescale for Vessel 802 will also slip considerably.

### Next Steps

9. CMAL continue to be supportive of FMEL, from both a technical and a financial perspective. It is clearly in all our interests to see FMEL flourish. Clyde Blowers Capital (CBC) are to be commended in their support of FMEL, as they continue to construct these two vessels for CMAL and for the substantial investment in modernising the yard.

10. A meeting has recently been arranged between Mr McColl and the Cabinet Secretary for Finance and the Constitution and the Cabinet Secretary for Economy, Jobs and Fair work on 2 March 2017 where the matters explored in the submission can be discussed. Following the meeting with Ministers it is proposed that a delegation of Economy, Transport and Finance officials could usefully meet with FMEL/CBC to explore the Surety Bond / Bank Guarantee matters in more detail.

11. While, respecting the requirements in their contract with FMEL and protecting the public purse, CMAL have indicated to FMEL and CBC that they are willing to further assist with cash-flow but that should be tied to a realistic and detailed plan for fabrication, equipment installation, outfitting, commissioning and achieving interim milestones.

### 12. Ministers are asked to note this update in relation to

- progress on the construction of the two vessels currently being built at FMEL and CMAL's early concerns in regard to likely slippage in the timescale.
- note the latest update in relation to the use of Bank Guarantees and Surety Bonds and the broader issues for FMEL going forward.

Graham M Laidlaw  
 Ferries Unit  
 22 February 2017

Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness
Cabinet Secretary for the Rural Economy and Connectivity			X		X
DG Economy DG Finance Roy Brannen, CE TS PS Transport Scotland Gordon Wales, Director of Financial Management					

TS Directors  
[Redacted]  
Richard Rollison, Innovation, Industries and  
Investment  
Mary McAllan, Directorate For Economic  
Development  
Press Transport Scotland  
[Redacted]  
Liz Lloyd, Special Adviser  
John McFarlane, Special Adviser  
Kate Higgins, Special Adviser

**Annex A**

## **FERGUSON MARINE ENGINEERING LIMITED - SHIPBUILDING CONTRACT TWO 100 METRES DUAL FUEL FERRIES**

### **Quality of Build**

1. It should be noted that the quality of the workmanship that CMAL has witnessed at FMEL to date is very good. This is seen as a significant positive indication, particularly for the subsequent reliability and longevity of the vessels.
2. The Minister for Transport and the Islands visited CMAL's offices on 12 December 2016 to hear more of CMAL's work in relation to vessels, piers and harbours. Following a briefing on the construction of the two vessels by CMAL senior personnel, highlighting a number of the messages in this submission, the Minister, TS officials and CMAL senior personnel, visited and toured FMEL's yard. We understand the Minister was reassured by FMEL's commitment to the two vessels and was impressed by the parallel work on the re-construction and modernisation of the shipyard.

### **Payments**

3. Within CMAL's contract with FMEL, there are various milestone payments that are required to be made at certain stages of the construction. To date the milestone reached has been up to and including milestone No. 8 (50% of the Hull fabrication). [Redacted-2]. CMAL has promptly paid FMEL all of these monies.
4. The total payments made up to and including the 50% fabrication milestone is [Redacted-3]. That leaves a further [Redacted-4] to be paid by CMAL to FMEL over the remainder of the construction period.
5. In relation to further interim payments, at the [Redacted-5] stage there will be an additional [Redacted-6] due for payment. At the launch of the vessels, there are further payments due in regard to painting and join up, amounting to a further [Redacted-7]. Taken together there are payments due amounting to [Redacted-8].
6. It is considered that this is a long period for FMEL to finance the level of expenditure that they will be putting into what will be an intense construction period for the two vessels, including employing some 350 staff and shipyard workers.

### **Challenges**

7. There have been a number of challenges that are recognised throughout CMAL's experience with FMEL as outlined below.

- The ship yard has a new owner as it was effectively in administration prior to Clyde Blowers Capital (CBC) stepping in.
- Whilst CBC are well versed in the manufacturing environment the ship building business was not known to them previously.
- The ship yard has a new management team and Board of Directors.
- There has been significant investment in the yard in terms of new build facilities, machinery, processes and IT of circa £25 million.
- There have been delays in vessel construction as various areas of the yard have been in refit and therefore unable to be fully utilised for ship building.
- The vessels are technically complex and planning has proved a difficulty for the yard.
- Fifteen months into the contract: FMEL has yet to issue a detailed plan for fabrication, equipment installation, outfitting and commissioning.

8. The net result of the above is that the original schedule envisaged has "slipped", as indicated below:-

- Milestone No.9 for 75% fabrication of Vessel 801 is not be expected to be achieved for another 2 months 4 months later than originally scheduled.
- the same milestone for Vessel 802 is not be expected to be achieved for another 4 to 5 months 6 to 7 months later than originally scheduled.

9. It is considered unlikely, if not impossible, for the delays incurred to date to be recovered. Going forward, it is considered likely that further delays will be incurred by FMEL, given the recent and current rate of progress and the complexity of the vessels. The current hull construction phase is considered to be a relatively easy task compared to the "outfitting" phase which is yet to come.

### **Allowable Days**

10. There are a total of [Redacted-9] allowable days within the contract for delays without penalties. The key challenge is that these "allowable days" will certainly be used and in all likelihood exceeded. That means that the "best case" scenario that CMAL can foresee is as follows:-

- the delivery of Vessel 801 will be in August 2018 (compared to 25 May 2018 envisaged at contract signing), and
- the delivery of Vessel 802 will be in October 2018 (compared to 26 July 2018 envisaged at contract signing).

### **Delivery prospects**

11. There is an extremely high probability that the vessels will be delivered later than that indicated above in the "best case" scenario at paragraph 10 above.

12. CMAL's view is that while it is potentially possible to deliver 801 by August 2018, with the current rate of progress this is most likely going to be missed.

13. Vessel 802 is a different matter as CMAL cannot foresee a delivery gap of only 2 months between Vessel 801 and Vessel 802, given the physical constraints that currently exist at FMEL. In CMAL's judgement there will be at least a 6 month gap between the delivery of the two vessels, so Vessel 802 could potentially be delayed until February 2019 or thereabouts

14. While the narrative at paragraph 10 above represents the "best case" scenario, the "more likely case" scenario that CMAL can foresee is set out below. It should be noted that CMAL consider it is not unrealistic for FMEL to slip further on the "more likely case" scenario set out below:-

- the delivery of Vessel 801 in late autumn 2018 to early winter 2018/19 (compared to 25 May 2018 envisaged at contract signing), and
- the delivery of Vessel 802 in early 2019 (compared to 26 July 2018 envisaged at contract signing).

15. This information on recent, and anticipated, slippage on the delivery timescales for these two vessels is not in the public domain. For the moment, we are using the line "*delivery of these first of the vessels is anticipated in the second half of 2018 with the second vessel following a few months later*".

#### **Future Progress**

16. The CMAL CEO has had two recent meetings with the CBC lead Director to discuss how CMAL can work even more closely with the FMEL Team to achieve a genuine programme of works and milestones that all sides can fully believe in. [Redacted-10].

17. CMAL will continue to have further meetings with FMEL, to look closely at the planning and address any issues that are expected to arise. CMAL confirm that they will continue to work closely with FMEL in all respects. The situation in relation to the delivery dates for Vessels 801 and 802 is an evolving one, but CMAL and Transport Scotland officials wish to highlight these concerns at this juncture to Ministers.

18. In the meantime, CMAL stand ready to provide any further immediate information to Transport Scotland and Scottish Ministers. Transport Scotland regularly discuss this important issue at CMAL Board meetings and in the monthly TS / CMAL Liaison Meetings. The most recent of these was on Thursday 16 February.

19. CalMac Ferries senior officials and Board members are also being kept fully informed by CMAL given the implications for CalMac in terms of vessel mobilisation, crew training, vessel deployment and service timetables for the Clyde and Hebrides ferry services.

20. Transport Scotland officials are also monitoring progress with a particular emphasis on financial planning and profiling and the interactions with associated planned pier and harbour infrastructure works for the Arran service and on the Uig Triangle. Transport Scotland officials will liaise closely with CMAL on this matter.

21. [Redacted-11].

#### **Bank Guarantees and Surety Bonds**

22. The Cabinet Secretary for Economy, Jobs and Fair Work has had several exchanges in relation to the use of Bank Guarantees and Surety Bonds in the shipbuilding contract for these two vessels and the broader issues for FMEL going forward. [Redacted-12].

23. [Redacted-13].

24. [Redacted-14].

25. [Redacted-15]:-

- [Redacted-16];
- [Redacted-17];
- [Redacted-18].

[Redacted-19].

26. [Redacted-20].

27. [Redacted-21]. However, from the vessel purchaser's perspective (in this instance CMAL), [Redacted-22]:-

- [Redacted-23];
- [Redacted-24].

28. [Redacted-25].

29. In the case of the Vessels 801 and 802, given the £97 million of public money involved, it is considered that appropriate financial assurance is in place to mitigate the risk of financial difficulties. [Redacted-26].

30. [Redacted-27].

31. [Redacted-28].

32. [Redacted-29]. A meeting has recently been arranged between Mr McColl and the Cabinet Secretary for Finance and the Constitution and the Cabinet Secretary for Economy, Jobs and Fair work on 2 March 2017 where such the matters can be discussed. Following the meeting with Ministers it is proposed that a delegation of Economy, Transport and Finance officials could usefully meet with FMEL/CBC to explore the Surety Bond / Bank Guarantee matters in more detail.

### **Broader Issues for FMEL**

33. The global ship building market is very weak. Worldwide, new build orders in 2016 are only at a level of 5% of the equivalent position in 2006. Shipyards are closing all over the globe due to lack of orders. Those shipyards that remain are aggressively chasing what little works remains – both in terms of the low prices being offered to buyers and acceding to the buyers' demands in relation to the terms and conditions associated with the contracts. It is undoubtedly a very competitive and difficult market place.

34. FMEL want to be "world class" and "secure global contracts" so it is likely that they will have to accept the normal practice of offering Bank Guarantees or Surety Bonds to secure such business. [Redacted-30].

**MINISTERIAL ENGAGEMENT BRIEFING: KEITH BROWN , DEREK MACKAY AND HUMZA YOUSAF**

<i>Engagement Title</i>	Meeting with Jim McColl of Clyde Blowers Capital, owner of Ferguson Marine Engineering Ltd.
<i>Timing</i>	Normal
<i>Organisation/Venue and full address including postcode</i>	Room T04.07 Scottish Parliament
<i>Date and Time of Engagement</i>	Date(s): Thursday 2 March 2017 Time(s): 10:15am – 11:00am
<i>Background/Purpose</i>	Please see outline Agenda and Key issues at <b>Annex A</b> .
<i>Relevance to Core Script</i>	Investment in Transport Infrastructure to support sustainable economic growth.
<i>Greeting Party and specific meeting point on arrival (if event is at a non SG Building</i>	N/A
<i>Specific entrance for Ministerial Car/parking arrangements</i>	None
<i>Venue contact Number</i>	Switchboard on 0800 092 7500 or 0131 348 5000
<i>Special Dress Requirements</i>	Suit
<i>Event Programme</i>	<b>Annex A</b> Key issues and attendees.
<i>Key Points</i>	<b>Annex B</b>
<i>Guest List or Meeting Attendees</i>	Included in <b>Annex A</b>
<i>Background</i>	<b>Annex C</b> Submission relating to the Shipbuilding contract – 2x100m dual fuel Ferries dated 22 February 2017  <b>Annex D</b> Performance Bonds/Guarantees  <b>[Out of scope].</b>

<i>Supplementary Info:</i>	N/A
<i>Directions including map(s)</i>	N/A
<i>Media Handling</i>	Non Media Event
<i>Official Support</i>	<p>Officials</p> <p><b>Names:</b></p> <p>[Redacted] Head of III : Financial Services and SME [Redacted]</p> <p>John Nicholls [Redacted]</p>

Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness
Cabinet Secretary for Rural Economy and Connectivity			X		
DG Economy DG Finance Roy Brannen, CE TS PS Transport Scotland Gordon Wales, Director of Financial Management TS Directors [Redacted] Richard Rollison, Innovation, Industries and Investment Mary McAllan, Directorate For Economic Development Press Transport Scotland [Redacted] Liz Lloyd, Special Adviser John McFarlane, Special Adviser Kate Higgins, Special Adviser					

## ANNEX A

### Attendees

Keith Brown  
 Derek Mackay  
 Humza Yousaf  
 Jim McColl  
 John Nicholls - Director - Aviation, Maritime, Freight & Canals  
 [Redacted] Head of III: Financial Services and SME

Mr McColl has suggested the following agenda:-

1. Contract 801/802
  - Contract Status
  - Funding profile
2. Update on Port Glasgow Facility
3. Future operating model for Scottish Ferry market **[We are not clear what Mr McColl will raise under this topic]** Scottish Ministers position is clearly stated in the Ferries Plan 2012-2024. In addition, a policy review into future tendering for Scottish Government ferry contracts has been launched.
4. AOB

#### **Key issues**

1. Jim McColl's concerns around the requirement in CMAL and other shipbuilding contracts for [Redacted-31]
2. Slippage in the construction of the 2 ferries by FMEL and CMAL's view that delivery dates are likely to be missed.

#### **Background to meeting**

The meeting has been set up at Jim McColl's request. We understand this follows up a conversation he had with Keith Brown in the margins of a meeting of the Council of Economic Advisers in January [Redacted-32].

#### **Jim McColl OBE Chairman and CEO of Clyde Blowers Capital**

Jim McColl left school at 16 to take up an engineering apprenticeship with Weir Pumps of Cathcart, Glasgow. After gaining City & Guilds certificates at lower and higher level, he gained a BSc Degree in Technology and Business Studies at Strathclyde University. He returned to Weir Pumps in 1978, studying for the next three years for an MBA. Joined Diamond Power Speciality Ltd in 1981, an engineering company supplying equipment to the power industry worldwide during his tenure he studied part time for a Master's degree in International Accounting and Finance. Head hunted by Coopers & Lybrand, in 1985 he became a consultant, working with companies in financial difficulties that needed guidance. In 1986 he left Coopers to become a self-employed "company doctor", during which he made money through two successful turnarounds resulting in his purchase of Clyde Blowers PLC going onto acquiring six of the 7 competitors. Over the past 10 years Clyde Blowers has developed into a truly global portfolio of 83 Companies in 27 different countries, employing 5,000 people around the world, with an annual turnover in excess of £1.4 billion. Ferguson Shipbuilders was bought in 2014 after which was renamed to Ferguson Marine Engineering Ltd. He was appointed Officer of the Order of the British Empire (OBE) in the 2001. Has been awarded two honorary doctorates, by Napier University and Glasgow University.

## Key points

### 1. Shipbuilding contracts – bank guarantees / surety bonds

[Redacted-33].

[Redacted-34]:

- [Redacted-35];

- [Redacted-36].

This meeting provides an opportunity for this latter point to be discussed and it is proposed that, as an outcome, **a delegation of Economy, Transport and Finance officials could usefully meet with FMEL/CBC to explore these matters in more detail**

### 2. Progress by FMEL with the construction of 2 new ferries

- Progress is behind schedule in the construction of two new ferries (see milestones below).
- Mr McColl and senior CBC and FMEL executives have been briefed by CMAL on their concerns around slippage and the implications for delivery dates. So this is not news for him although he has not to date indicated that he agrees with CMAL's assessment.
- CMAL's forecasts given the rate of progress to date are for:-
  - ◇ the delivery of Vessel 801 in late autumn 2018 to early winter 2018/19 (compared to 25 May 2018 envisaged at contract signing), and
  - ◇ the delivery of Vessel 802 in early 2019 (compared to 26 July 2018 envisaged at contract signing).
- CMAL are liaising with FMEL regarding the progress of the construction of the vessels and continue to be supportive from both a technical and financial perspective.
- CMAL have indicated to FMEL and CBC that they are willing to assist further with cash-flow provided that is tied to a realistic and detailed plan for fabrication, equipment installation, outfitting, commissioning and achieving interim milestones.

#### Milestones

##### **Vessel 1:**

On 9 December 2016, FMEL provided new milestones dates with a revised target date of 19 Feb 2017 for the next milestone (75% Fabrication) for Vessel 1. CMAL estimate with current output 75% fabrication milestone for Vessel 1 will not be achieved before mid April 2017 (4 months later than originally planned).

Actual fabrication as of 10 Feb 2017 was 58%. This indicates that currently FMEL have planning challenges not just long term, but also short term (over a 9 week period).

**Vessel 2:**

Next fabrication milestone for Vessel 2 is 75% fabrication with a revised target date of 5 May 2017 (5 months later than originally scheduled). CMAL estimate with current output 75% fabrication milestone for Vessel 2 will not be achieved before mid August 2017 (8 months later than originally planned).

**3. Other matters**

Mr McColl has very recently (last week) taken a personal interest in the HySeas hydrogen ferry project which is now being led by FMEL. It is therefore possible that he may take the opportunity to mention this. An update is attached (Annex D) which was also copied to both Cabinet Secretaries as part of a submission by [Redacted] dated 27 February 2017.

[See document 1: "Submission from Graham Laidlaw to Cab Sec EJFW, Cab Sec Finance and Transport Minister"]

### Briefing for meeting on 2<sup>nd</sup> March - Performance Bonds/Guarantees

#### Potential Options:

- Indicate as part of the new research underway, SMEs are being contacted to build a detailed understanding of the surety and performance bond market and potential need for public sector intervention. This work is nearing completion with the final report expected to be received by SE next week.
- Happy to offer a roundtable meeting with officials, including Scottish Enterprise (and possibly UK Export Finance), to sit down with the company to review the potential need for future investment, including guarantees, to strengthen the financial position of the company

#### Background

1. Both the Deputy First Minister and the Cabinet Secretary for Economy, Jobs and Fair Work wish further consideration to be given to the introduction of bonds or guarantees of a more significant scale around strategic sectors for the Scottish economy, for example in more traditional industries such as steel, shipbuilding or other forms of large-scale manufacturing. This would specifically target businesses which need to put money/working capital (in range of £10-20m+) 'on hold' as a performance bond to guarantee the fulfilment of a large, high cost capital contract for a customer, i.e. that money (either of their own or borrowed with a charge attached) is put aside pending the successful (undisputed) delivery, of the contract.

2. It is not clear that there is a strong demand for this type of intervention, and/or that the markets are not already providing appropriate capital. Officials will therefore need to reflect on options for how any guarantees of this scale might be administered and delivered effectively and with appropriate due diligence. A programme or scheme to provide this kind of large scale risk guarantee will require significant expertise and capacity to deliver.

3. We have made some initial enquires of Scottish Enterprise (SE) and Highlands and Islands Enterprise (HIE) on the issue. HIE indicated that a small number of fabricators have in the past experienced difficulties in securing contracts in the offshore wind sector due to bonds or performance guarantees being required, and respective balance sheets were such that they were not able to meet the necessary requirements. HIE's role here has been to encourage the development of partnerships or collaborations to strengthen the company's position. While price competitiveness is more to the fore now in terms of securing orders, it is possible that scale of resource (and ability to provide such bonds) could be a stumbling block in some instances for bidders who are otherwise price competitive. **However the number of incidents of this being a potential issue remains very low.**

4. Scottish Enterprise are currently looking at this area again following specific stakeholder request, and as part of its on-going research on the SME funding market in general. SE previously looked at this area

in 2012, and research was completed. The conclusion of the work at that time was that the private sector was satisfying requirements for surety bonds/contract guarantees and there was no need for public sector intervention. SE is currently commissioning another piece of research into this market to understand the updated position. Very few companies are approaching SE about issues related to securing performance bonds: there are only two that they are aware of specifically, and both of those ultimately secured private sector solutions.

### **Ferguson Marine**

5. We are aware that the issue of bonds/guarantees has been raised by Fergusons with Ministers, Scottish Enterprise and UK Export Finance (UKEF) on a number of occasions. Our own discussions with senior officials at UKEF, suggest that UKEF has also provided significant support to Fergusons and was instrumental in securing guarantee insurance for Ferguson's contract with CalMac, although Fergusons took some time to follow up and agree despite the significant savings provided by the product. More broadly we understand that UKEF can provide guarantees for bids/orders outwith the UK and stood ready to do so for a potential contract with Iceland that Fergusons ultimately did not bid for.

### **Support To Fergusons from Scottish Enterprise**

6. [Redacted-37].

7. [Redacted-38].

**Directorate for Economic Development - 1 March 2017**

[OUT OF SCOPE]

**From:** Nicholls J (John) (TRANS)

**Sent:** 02 March 2017 13:18

**To:** [Redacted] Minister for Transport and the Islands Cabinet Secretary for Economy, Jobs and Fair Work Cabinet Secretary for Finance, Economy and Fair Work

**Cc:** Cabinet Secretary for the Rural Economy DG Economy DG Scottish Exchequer Mailbox Brannen R (Roy) Transport Scotland Secretariat Director of Financial Management Transport Scotland Directors [Redacted] Rollison R (Richard) McAllan M (Mary) [Redacted] Lloyd E (Elizabeth) McFarlane J (John) Higgins K (Kate)

**Subject:** RE: Jim McColl meeting with Keith Brown and Humza Yousaf 2 March 2018 final

PS/Ministers (an action for PS/Mr Yousaf below)

This is to record the main points of this morning's meeting insofar as they related to ferries.

#### Contract 801/802 : contract status

- Mr Yousaf asked about CMAL's assessment that delivery could be 6-7 months late. [Redacted-39].
- It was noted that the build quality so far was good, and that CMAL and FMEL had established a good working relationship. Noting the novel nature of the build, [Redacted-40].
- Mr Brown noted the need to expand the narrative around FMEL in public communications – 350 jobs, shipbuilding renaissance on the Clyde, leading edge technology etc.
- **Action:** Mr Yousaf to meet with CMAL in a fortnight for an update on progress. PS/Mr Yousaf to take forward please.

#### Contract 801/802: funding profile

- Mr McColl tabled the attached paper setting out the FMEL position on cashflow. [Redacted-41].
- Mr Mackay indicated that he would, as a matter of urgency, consider this further on advice from transport and finance officials and CMAL. Whilst noting that proper account would need to be taken of the likely risks, he wanted to be as helpful as possible. He asked for advice from officials, to include impacts on CMAL cashflow **Action:** TS Ferries colleagues to pursue with CMAL and TS/SG Finance.
- [Out of scope].

John



# Cash Funding Situation

Private and Confidential

2 March 2017



# Cash Forecast to Dec 2018

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## Cash Forecast To December 2018



- Cash flow forecast above assumes current CMAL 801/802 payment milestones

- [Redacted]

- [Redacted]

- [Redacted]

Support on (a) [REDACTED] & (b) [REDACTED]  
amendment to [REDACTED]



[REDACTED]

- Alternative cash forecast above assumes (a) [REDACTED] and (b) [REDACTED] per vessel.

- [REDACTED]
- [REDACTED]

Support on (a) [REDACTED] & (b)



- CMAL are willing to move some smaller interim payments but at the moment are not in a position to offer a step change to the final delivery payment [REDACTED]

[REDACTED]

- At the time of rescue and contract negotiation the CBC forecasted investment requirement in establishing a modern ship building capability in Port Glasgow was significantly lower. CBC has fulfilled all obligations to achieve this objective and secure the future capability and skilled employment for the local area. [REDACTED]

[REDACTED]

**From:** [Redacted]

**Sent:** 24 March 2017 17:18

**To:** Minister for Transport and the Islands Cabinet Secretary for Economy, Jobs and Fair Work  
Cabinet Secretary for Finance, Economy and Fair Work

**Cc:** Cabinet Secretary for the Rural Economy DG Economy DG Scottish Exchequer Mailbox Brannen R (Roy) Transport Scotland Secretariat Director of Financial Management Transport Scotland Directors [Redacted] (SPD) [Redacted] Rollison R (Richard) McAllan M (Mary) Press Transport Scotland [Redacted] Lloyd E (Elizabeth) McFarlane J (John) Higgins K (Kate) [Redacted]

**Subject:** Jim McColl meeting with Keith Brown, Derek Mackay and Humza Yousaf - follow-up note - 24 March 2017

PS/Ministers

At the meeting on 2 March with Jim McColl, Mr Mackay requested advice from TS Ferries, with input from SG/TS Finance and CMAL, on the 2 proposals put forward by Mr McColl to ease FMEL's cashflow position (see attached; Mr McColl has written today in similar terms to the Chair of CMAL, Erik Ostergaard, copied to all 3 Ministers - also attached):

Please see attached update and advice note, which has been cleared with Finance and SGLD colleagues.

In summary, our note suggests the following:

- [Redacted-42]. The output of this work could be a report back to Ministers by CMAL outlining options, risks and potential mitigations;
- [Redacted-43];
- Continuing the work underway by Economic Development Directorate and Scottish Enterprise colleagues into the provision of government-backed guarantees to FMEL when bidding for third party contracts;
- Providing Ministers with options for the terms and conditions around payments, bonds and guarantees for future CMAL vessel procurements.

There are financial implications and legal risks with these options; these are summarised in the note.

In terms of next steps, if Ministers agree to CMAL taking this forward then they may wish to inform Mr McColl of this directly themselves either by phone or in writing.

[Redacted]

Transport Scotland Ferries

Ext [Redacted]



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Erik Ostergaard  
Chairman  
Caledonian Maritime Assets Ltd ("CMAL")  
Municipal Buildings  
Fore St  
Port Glasgow  
PA14 5EQ

24 March 2018

Dear Erik

**'NEWBUILDCON' Standard Newbuilding Contract between the Ferguson Marine Engineering Limited (the "Company") and CMAL dated 16 October 2016 as amended on 2 November 2016 for the construction of a Euro Class B Dual Fuel Passenger Ferry with Builder's Hull Number 801 (the "801 Build Contract")**

**'NEWBUILDCON' Standard Newbuilding Contract between the Company and CMAL dated 16 October 2016 as amended on 2 November 2016 for the construction of a Euro Class B Dual Fuel Passenger Ferry with Builder's Hull Number 802 (the "802 Build Contract")**

I refer to the 801 Build Contract and the 802 Build Contract (together the **"Build Contracts"**)

**"Milestone Payments"**), together with the two Refund Guarantees (as defined in each Build Contract) issued by HCC International Insurance Company plc (**"HCCI"**) to CMAL on 2 November 2016.

As I believe has been communicated to Kevin Hobbs and Jim Anderson previously, [REDACTED]  
[REDACTED]  
[REDACTED]

Taking each of these aspects of the Build Contracts in turn:

1. At present, [REDACTED] of the contract price for each Build Contract [REDACTED] is retained and payable by CMAL on delivery.



Our understanding is that your desire for [REDACTED] remain incentivised to achieve the delivery dates. As you are aware, since saving the Ferguson shipyard from administration, the only major contract wins for the Company have been the three vessel orders from CMAL. The success in delivering the vessels under the Build Contracts on time, or indeed ahead of schedule as we did for the Catriona vessel (build contract 727), is imperative to the ongoing success of the Company. Having invested £25.8m to date into the Company, we are therefore already highly incentivised not to default under the Build Contracts. I am also hopeful that following the visit by Kevin Hobbs and Jim Anderson to the yard this morning, that they will be able to give you the required assurances that the build of each vessel is indeed on track to meet the contractual delivery dates.

2. Due to the lack of trading history of the Company, in order for HCCI to issue the two Refund Guarantees in November 2016, in addition to securing all of its physical assets (including the land and buildings), [REDACTED]

[REDACTED] Under each of the Build Contracts, CMAL receives title to each of the vessels as they are built. [REDACTED]

As noted above, the combination of the foregoing factors is placing [REDACTED] cash pressures on the Company. Accordingly on behalf of the Company we would like to request that the board of CMAL consider as a matter of urgency the following specific requests:

**Request Number 1:**

[REDACTED]

**Request Number 2:**

[REDACTED]

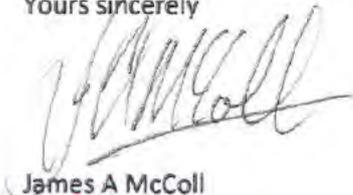
Our request for such amendments to the Build Contracts should be considered against the backdrop of our commitment to re-establish the Ferguson Shipyard in 2014.

We, Clyde Blowers Capital, have invested heavily to establish a modern shipbuilding capability in Port Glasgow. The investment required to do this has been far greater than had been anticipated but notwithstanding this, we have made the investment and fulfilled our obligations in this regard. In doing so we have secured the future capability and skilled employment for the local area. What we are therefore now requesting is that CMAL and the Scottish Government ensure that the delivery of the vessels under the Build Contracts does not place the Company under such cash pressure as to put the future of the Company and the workforce at risk. We remain firm in our belief that it is important for Scotland and in particular the Scottish ferry fleet and therefore CMAL, that a modern competitive shipbuilding capability be retained on the Clyde.

So critical is this issue that I have already briefed the Scottish Government and Transport Scotland in full on this matter and I believe I have their full support for the requests made above.

Due to the momentous importance of this issue to the Company and its workforce, it is essential that I have your outline written commitment to the requests no later than 30 March 2017.

Yours sincerely

A handwritten signature in black ink, appearing to read "James A McColl".

James A McColl

Chairman and CEO

c.c Derek Mackay MSP, Cabinet Secretary for Finance and Constitution  
Keith Brown MSP, Cabinet Secretary for the Economy, Jobs and Fair Work  
Humza Yousaf MSP, Minister for Transport and the Islands

## FERGUSON MARINE – CASH FUNDING SITUATION

### Background

Ministers met Jim McColl on 2 March 2017. Mr McColl presented a paper on FMEL's cash flow situation and made 2 proposals to address this:

- 1) [Redacted-44];
- 2) [Redacted-45].

Mr Mackay requested advice from Finance and Transport officials on these proposals.

Mr McColl has now written (24 March 2017) to the CMAL Chair, Erik Ostergaard, copied to Ministers, with the same requests.

### Summary

In response to the concerns raised by Mr McColl, we suggest the following:

- [Redacted-46]. The output of this work could be a report back to Ministers by CMAL outlining options, risks and potential mitigations;
- [Redacted-47];
- Continuing the work underway by Economic Development Directorate and Scottish Enterprise colleagues into the provision of government-backed guarantees to FMEL when bidding for third party contracts;
- Providing Ministers with options for the terms and conditions around payments, bonds and guarantees for future CMAL vessel procurements.

There are financial implications and legal risks with these options; these are summarised later in this note.

1) [Redacted-48]

[Redacted-49].

[Redacted-50]<sup>1</sup>.

[Redacted-51]).

[Redacted-52].

[Redacted-53].

---

<sup>1</sup> [Redacted-54].

[Redacted-55].

[Redacted-56].

2) [Redacted-57].

The overall value of the 2 contracts is £97m of which [Redacted-58].

[Redacted-59].

[Redacted-60].

[Redacted-61].

[Redacted-62].

[Redacted-63].

[Redacted-64].

#### Legal issues

Whilst this option is worth further examination, it cannot be considered a definite possibility at this stage. CMAL as the contracting authority would need to take their own independent legal advice in relation to any proposed changes to the contracts. [Redacted-1].

[Redacted-2].

[Redacted-3].

#### Financial implications

[Redacted-65].

Potentially more significantly for TS, although the overall contractual costs (£97m) have been approved by SG Finance, the Budget allocation for 2017/18 is set according to the payment profile [Redacted-66].

The changes proposed by Mr McColl would [Redacted-67]. This would need to be managed within Transport Scotland.

[Redacted-68].

#### Alternative approaches

Looking ahead, there are 2 areas where further work is either underway or could be taken forward:

1) Mr McColl has made the case that FMEL is disadvantaged when bidding for shipbuilding contracts which require refund guarantees in competition with yards from some other EU Member States which have governmental guarantee schemes in place.

Although, for reasons set out above, it would be difficult for SG to provide guarantees to FMEL for delivery of SG contracts, this could potentially be considered for FMEL bids for contracts with other shipowners subject to detailed consideration of the implications, e.g. around State aid – though we are aware that schemes in place elsewhere in the EU do seem to have received State aid approval by the EC.

The issue of bonds/guarantees has been raised by Jim McColl and FMEL with Ministers, Scottish Enterprise and UK Export Finance (UKEF) on a number of occasions. Industry Directorate's discussions with senior officials at UKEF, suggest that UKEF has also provided significant support to FMEL [Redacted-69]. More broadly we understand that UKEF can provide guarantees for bids/orders outwith the UK and stood ready to do so for a potential contract with Iceland that FMEL ultimately did not bid for.

As previously advised, as part of the new research underway, SMEs are being contacted to build a detailed understanding of the surety and performance bond market and potential need for public sector intervention. This work is nearing completion.

Officials would be willing to offer a further roundtable meeting with FMEL, including Scottish Enterprise (and possibly UK Export Finance), to sit down with the company to review the potential need for future investment, including guarantees, to strengthen the financial position of the company;

2) [Redacted-70].

[Redacted-71].

[Redacted-72].

We will discuss options, and associated risks and consequences, with CMAL and report back to Ministers. In a competitive procurement exercise, whatever arrangements are put in place would apply equally to all bidders. [Redacted-73].

### Conclusion

In conclusion, we would:

- [Redacted-74];

- [Redacted-75];

- continue work on wider support for FMEL

- come back with options for future shipbuilding procurements

Transport Scotland  
24 March 2017

**From:** [Redacted]

**Sent:** 24 March 2017 17:26

**To:** Minister for Transport and the Islands; Cabinet Secretary for Economy, Jobs and Fair Work; Cabinet Secretary for Finance and the Constitution

**Cc:** Cabinet Secretary for the Rural Economy and Connectivity; DG Economy; DG Finance Mailbox; Brannen R (Roy); PS/Transport Scotland; Director of Financial Management; Transport Scotland Directors; [Redacted] Rollison R (Richard); McAllan M (Mary); Press Transport Scotland; [Redacted] Lloyd E (Elizabeth); McFarlane J (John); Higgins K (Kate); [Redacted]

**Subject:** Jim McColl meeting with Keith Brown, Derek Mackay and Humza Yousaf - follow-up note - 24 March 2017

[Redacted]

Following on from [Redacted] advice below regarding the Ferguson Marine Engineering Ltd (FMEL) Cash Funding Situation, I forward an e-mail update from Kevin Hobbs, CEO of CMAL in relation to progress on the delivery timescale for the two 100m vessels currently being constructed at FMEL.

This update from Kevin follows Mr Yousaf's meeting with Kevin on this matter on Tuesday 14 March. Since the Minister's meeting with Kevin, and at Mr Yousaf's insistence, there have been a series of meetings between CMAL and FMEL, including a meeting this morning that involved Jim McColl.

As the Minister is aware, earlier advice from CMAL, based on CMAL's own considerable ship-building experience, was that there was already significant slippage in the delivery timetable for the delivery of these vessels and with every chance that slippage was likely to get worse.

[Redacted-76].

[Redacted-77]

*[Redacted-78].*

I trust the Minister is assured by this change of approach from FMEL and the positive feedback from CMAL.

We will of course continue to manage and monitor the situation and keep Ministers appraised of progress.

Thanks

[Redacted]

**From:** [Redacted]  
**Sent:** 24 March 2017 12:27  
**To:** [Redacted]  
**Cc:** Nicholls J (John) (TRANS) [Redacted]  
**Subject:** Meeting FMEL/CBC 24th March 2017

[Redacted]

I refer to an "Action" requested by the Minister, Mr Yousaf, in regard to the progress of Hulls 801/802

[Redacted-79].

[Redacted-80];

- [Redacted-81];
- [Redacted-82];
- [Redacted-83];
- [Redacted-84];
- [Redacted-85];
- [Redacted-86];
- [Redacted-87];
- [Redacted-88];
- [Redacted-90];

[Redacted-91].

[Redacted-92].

The Plans, as we see them, are credible but will require metronomic precision in terms of planning and delivery. Equally all of the sub-contractors and the major equipment must be full resourced and delivered when planned.

We would point out that despite the dates mentioned above there are also 80 days which are allowed under the Contractual Terms. This may or may not be needed but on balance probably will but only time will tell.

On this basis we have asked for a revised schedule of milestones on which we will be able to judge whether the revised plan is being adhered to.

[Redacted-93].

Overall CMAL Team are encouraged that there is renewed vigour surrounding the Project – we will assist FMEL with our knowledge; as indeed we always have done.

Best Regards,  
Leis gach deagh dhùrachd,

**Kevin Hobbs**  
**Chief Executive Officer**  
**Árd-oifigear**

Caledonian Maritime Assets Limited | Stóras Mara Cailleannach Eta  
Municipal Buildings  
Fore St  
Port Glasgow  
PA14 5EQ

[Redacted]

**From:** [Redacted]  
**Sent:** 27 March 2017 09:28  
**To:** [Redacted]  
**Cc:** [Redacted]  
**Subject:** FMEL Cash Flow and Draft Accounts 2016  
**Importance:** High

Good Morning [Redacted]

It was good to see you at the Meeting on Friday with the Team from FMEL

It was mentioned in the meeting that FMEL will see a [Redacted-94] in the context of the 2 Dual Fuel Vessels under construction. Can you give us the background to this please.

In addition you shared the 16 month accounts to 31/12/15 with Gillian and I last month. Are you in a position to share the accounts for year ending 2016?

As I am sure you are aware I was handed a letter by Jim McColl when leaving in regard to the financial position of the ship yard including requests relating to cash flow and also the Surety Bond. We have a CMAL Board Meeting tomorrow 28/3/17 and the Letter has been included in our Board Pack. I am sure that it will form a significant point of discussion.

Any information gladly received.

**From:** [Redacted]  
**Sent:** 27 March 2017 20:30  
**To:** [Redacted]  
**Cc:** [Redacted]  
**Subject:** RE: FMEL Cash Flow and Draft Accounts 2016

Hi [Redacted] hope things are well with you both.

We are in the process of finalising our 2016 accounts with a view to having them fully signed off by our Auditors in May. I can however share with you the Draft Management accounts For **Ferguson Marine Engineering Limited** as they currently stand, including the 2015 numbers for reference as follows :

	2016	2015
	<u>Ferguson</u>	<u>Ferguson</u>
	<b><u>DRAFT</u></b>	<u>Actual</u>
	£M	£M
Total Revenue *	[Redacted-95]	11.4
Profit /(Loss)	[Redacted-96]	(1.6)
EBITDA	[Redacted-97]	(1.6)
Underlying EBITDA	[Redacted-98]	(1.0)

Kevin you will remember in Fridays meeting that Jim commented on the fact that we are expecting [Redacted-99] as we establish the new facility and workforce, with our priority being on time delivery of the vessels. It should also be noted that the financial results over the life of the project (801 & 802) will have a significant impact of around [Redacted-100].

In addition to the losses that the business will incur in the first few years, Clyde Blowers has made significant investment both in terms of Equity (£25.4m) and Working Capital loans which are currently forecast at [Redacted-101].

[Redacted-102] :

1. [Redacted-103].
2. [Redacted-104].
3. The balance is a result of accumulated losses

For your information I have attached the presentation that Jim made to the Scottish government at his recent visit with the Transport and Finance ministers.

Feel free to call me in the morning if you need to discuss or require additional information.

[Redacted]

## **Cabinet Secretary for Finance and the Constitution**

From Roy Brannen  
Chief Executive  
Transport Scotland

### **FERGUSON MARINE ENGINEERING LTD (FMEL) CASH FUNDING SITUATION - OPTIONS**

#### **Introduction**

1. Further to the advice previously provided on 13 April 2017 and 24 March 2017 from [Redacted] we undertook to seek further advice from CMAL regarding the legal, technical, procurement and financial issues arising from the request from FMEL in respect of the potential removal of the Surety Bond and the bringing forward of stage payments to a different milestone schedule than that set out in the contract.

2. Further advice is set out below. This has been cleared by DG Economy, DG Finance, SGLD and with input from colleagues across Scottish Government and Transport Scotland.

#### **Legal and Procurement Advice**

3. [Redacted-4].

4. [Redacted-5].

5. [Redacted-6]

#### **Technical Advice**

6. Vessel 801 steel work has reached [Redacted-105] and vessel 802 has achieved [Redacted-106] steel fabrication. [Redacted-107].

7. Clyde Blowers appointed a Project Management Team in order to look at every aspect of the new build project to date and also put into place credible plans to achieve delivery dates that were in line with the contracts. A revised strategy has been adopted by the FMEL team in order to address the delays and improve performance. In essence the performance and output of the shipyard is monitored daily and the FMEL and CMAL Team are able to see the progress against the plan.

8 [Redacted-108].

9. There is now an identifiable plan for each vessel [Redacted-109].

10. [Redacted-110].

#### **Financial Advice**

11. [Redacted-111].

12. [Redacted-112]. SG Finance has confirmed that, given the scale of the overall capital programme that this pressure can be managed corporately within SG and is therefore affordable.

13. Taking into account the advice received, the challenge therefore is to explore what support would be appropriate to FMEL to ensure the business remains stable to allow the continued progression towards completion of the two contracted ferries on CMAL's behalf whilst maintaining a prudent and legally compliant position and demonstrating [Redacted-113].

### **Accountable Officer Consideration**

14. In providing advice as Accountable Officer I am required to consider the propriety, regularity and value for money of any proposed course of action. In order to form a view in this regard my advice reflects advice and input from Transport Scotland, SGLD and SG Finance.

15. My advice has considered the propriety and regularity issues with regard to [Redacted-114].

16. [Redacted-115].

17. [Redacted-116].

18. [Redacted-117].

19. I would highlight however that in recommending such a course of action, [Redacted-118].

### **Recommendations**

20. Consequently, and drawing on the advice from CMAL and SGLD, it is suggested that the viable options available or the recommended course of action for Ministers are

- [Redacted-119];
- [Redacted-120].
- [Redacted-121].
- [Redacted-122].
- [Redacted-123].
- [Redacted-124].

21. [Redacted-125].

### **Next Steps**

22. Given the urgency attached to this by Mr McColl I would welcome your early views.

**ROY BRANNEN**  
CHIEF EXECUTIVE  
TRANSPORT SCOTLAND

Ext 27114

Copy to

First Minister  
Deputy First Minister and Cabinet Secretary for Education and Skills  
Cabinet Secretary for Economy, Jobs and Fair Work  
Cabinet Secretary for the Rural Economy and Connectivity  
Minister for Transport and the Islands

Permanent Secretary  
DG Economy  
DG Finance  
[Redacted]  
PS/Transport Scotland  
Director of Financial Management  
Transport Scotland Directors  
[Redacted]  
Rollison R (Richard)  
McAllan M (Mary)  
[Redacted]  
Lloyd E (Elizabeth)  
McFarlane J (John)  
Higgins K (Kate)  
Maxwell S (Stewart) (Special Adviser)  
McAllister C (Colin)

**From:** DG Economy  
**Sent:** Wednesday, 10 May 2017 18:35  
**To:** DG Economy Cabinet Secretary for Finance and the Constitution  
**Cc:** McAllan M (Mary) Lord Advocate Permanent Secretary DG Finance Mailbox Brannen R (Roy)  
PS/Transport Scotland Director of Financial Management Lloyd E (Elizabeth) McAllister C (Colin)  
[Redacted]  
**Subject:** RE: URGENT - Confidential: Submission on FMEL

[Redacted] / Cabinet Secretary for Finance and the Constitution

### **FMEL Update**

Further to Mary McAllan's submission of 5 May, I can provide a further update on our work and engagement on FMEL's cashflow difficulties.

I spoke with Jim McColl yesterday evening (4 May). It was a positive exchange and Jim is keen to understand more about a number of potential options for support.

During the call I re-stated that our firm preference for delivering our shared objective - of sustaining the economic future of the yard - is to do so [Redacted-126] We discussed three specific options that might support this, and where further work could be done:

1. Loan finance
2. [Redacted-127]
3. [Redacted-128]

The timescales for delivering any offer associated with each of these options are a minimum of 3-4 months (with a number variable many of which are outside SE control). [Redacted-129]

The next step is for SE to draft a short illustration for each mechanism that we can share with Mr McColl to illustrate what each of these things might look like in some more detail, with associated necessary caveats. We will aim to get this to him by the end of the week. There are different and in some cases significant challenges associate with these options, this initial description of potential options will be to enable us and Mr McColl to focus on which option offers the most potential.

[Redacted-130] During the call I therefore simply reflected that considerations on this are on-going and that we will discuss further in due course. [Please note that this work is separate to the on-going discussions between CMAL and FMEL [Redacted-131] (the background to which has been set out in previous exchanges, attached for reference). [Redacted-132]

We will continue to keep in close contact with Mr McColl and provide you with a further update no later than Monday 15 May.

Liz

From: Roy Brannen  
Chief Executive  
Transport Scotland  
11 May 2017

## **Cabinet Secretary for Finance and the Constitution**

### **FERGUSON MARINE ENGINEERING LTD (FMEL) CASH FUNDING SITUATION - OPTIONS**

#### **Purpose**

1. [Redact-133].
2. This advice has been cleared by DG Economy, DG Finance, SGLD and with input from colleagues across Scottish Government and Transport Scotland.

#### **Priority**

Urgent

#### **Background**

3. You accepted the advice in my submission of 29 April (attached at Annex A). You have also asked officials to consider any further options of support or investment, outwith the contract that would enable the yard to manage the cash profiling issues it is facing. Separate advice will be provided on this.

#### **Update**

4. As reported in Mary McAllan's note of 5 May, CMAL/TS and FMEL met on 4 May to discuss [Redact-134]. The key elements are as follows:
  - [Redact-135].
  - [Redact-136].
  - [Redact-137].
  - [Redact-138].

#### **Milestone payments**

5. Existing and proposed milestone payments are set out in the attached payment schedule (Annex B). This shows that existing milestone payments become due at particular points during the construction process – e.g. at certain stages of fabrication, hull inspection, launch etc. [Redact-139].
6. [Redact-140].
7. CMAL have been in detailed discussion with FMEL on what the [Redact-141] will be spent on. The major items are as follows:

- [Redacted-142];
- [Redacted-143];
- [Redacted-144];
- [Redacted-145];
- [Redacted-146];
- [Redacted-147]
- [Redacted-148]
- [Redacted-149]
- [Redacted-150]

In addition, CMAL have sight of more detailed breakdowns of a large number of smaller items, and will continue to closely monitor this with FMEL. [Redacted-151].

8. [Redacted-152].

9. [Redacted-153]

#### **Legal and procurement advice**

10. SGLD have considered the key elements of the proposal as set out above. [Redacted-7].

#### **State aid**

11. [Redacted-8].

#### **Financial advice**

12. [Redacted-154]. SG Finance has confirmed that, given the scale of the overall capital programme that this pressure can be managed corporately within SG and is therefore affordable. [Redacted-155].

#### **Accountable Officer consideration**

13. [Redacted-156].

14. [Redacted-157].

15. From a value for money perspective, the overall payments due under the contract remain unchanged and I am satisfied that such an arrangement, [Redacted-158] represent value for money for the taxpayer.

16. With respect to the contract for the two vessels, the assessment is that this is the maximum flexibility that can be recommended to ministers at this time

**Recommendation**

17. Against this background, and having considered advice from CMAL and SGLD, I am satisfied that the changes proposed are compatible with procurement regulations and state aid requirements and that any risk of challenge is minimised. I therefore invite you to:

- Note the update on developments set out above, and the key terms of the proposed arrangements between CMAL and FMEL
- [Redacted-158]
- [Redacted-159].
- [Redacted-160].

Roy Brannen  
 Chief Executive  
 Transport Scotland  
 11 May 2017

Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness
First Minister Deputy First Minister and Cabinet Secretary for Education and Skills Cabinet Secretary for Economy, Jobs and Fair Work Cabinet Secretary for the Rural Economy and Connectivity Lord Advocate Minister for Transport and the Islands					<b>X</b>

Permanent Secretary DG Economy DG Finance [Redacted] Director of Financial Management Transport Scotland Directors [Redacted] Rollison R (Richard) McAllan M (Mary) [Redacted] Lloyd E (Elizabeth) McFarlane J (John) Higgins K (Kate) Maxwell S (Stewart) (Special Adviser) McAllister C (Colin)
---

[See Document 7 - Submission from Roy Brannen to Cab Sec Finance (29 April 2017)

**ANNEX B**

[Redacted-161]

**From:** [Redacted] **On Behalf Of** DG Economy

**Sent:** 30 May 2017 16:49

**To:** DG Economy Somers J (John) First Minister Deputy First Minister and Cabinet Secretary for Education and Skills Cabinet Secretary for Finance and the Constitution Cabinet Secretary for Economy, Jobs and Fair Work Cabinet Secretary for the Rural Economy and Connectivity Minister for Transport and the Islands

**Cc:** Maxwell S (Stewart) (Special Adviser) McAllister C (Colin) Lloyd E (Elizabeth) [Redacted] Director of Financial Management PS/Transport Scotland Nicholls J (John) (TRANS) [Redacted] Permanent Secretary [Redacted] McAllan M (Mary) [Redacted] Brannen R (Roy)

**Subject:** RE: IMMEDIATE: meeting with Jim MColl

John

As indicated in Thursday's update, Liz spoke to Jim McColl this afternoon as part of a regular series of catch ups on FMEL and ahead of FM's meeting with him tomorrow.

Key points as follows:

- The agreed process is on track – SE meeting with FMEL team today (Tuesday) to secure financial information which SE will use to produce analysis of FMEL's new projected cash flows [Redacted-162] and health of the company generally. SE should be able to produce an initial analysis by the end of this week. We will use this to consider and inform next steps.
- [Redacted-163].
- Jim and Liz also discussed on-going concerns that Jim has raised around the contract with CMAL. It is clear from Initial feedback from CMAL that there are differences in opinion which they would be happy to discuss in person with Jim. Liz therefore offered to arrange a meeting between Jim and the CMAL Chair (Erik Østergaard) and Chief Exec (Kevin Hobbs), with SG present as broker. Jim agreed to this and we'll look to set something up next week.

[Redacted]

**From:** [Redacted] **On Behalf Of** DG Economy

**Sent:** 31 May 2017 11:06

**To:** Nicholls J (John) (TRANS)

**Cc:** Maxwell S (Stewart) (Special Adviser) McAllister C (Colin) Lloyd E (Elizabeth) Director of Financial Management [Redacted] Permanent Secretary Cameron DA (Donald) McAllan M (Mary) [Redacted] Brannen R (Roy) DG Economy [Redacted] First Minister Deputy First Minister and Cabinet Secretary for Education and Skills Cabinet Secretary for Finance and the Constitution Cabinet Secretary for Economy, Jobs and Fair Work Cabinet Secretary for the Rural Economy and Connectivity Minister for Transport and the Islands Lord Advocate

**Subject:** RE: IMMEDIATE: meeting with Jim MColl

**Importance:** High

John

Following FM's meeting this morning she has asked for further information on the following:

- Briefing on the surety bond, including how it was detailed in the tender information, how it was accounted for at the point of contract award and how it has evolved since.
- The legal advice regarding any further changes to the contract arrangements.

I think this information largely exists already but very helpful if you could pull it together, particularly the legal advice which I think is spread across different submissions and email exchanges. Grateful if you could also reflect the view the [Redacted-1] gave on 12 May as part of this as well.

Can you please get a draft for Liz to consider by 4pm today?

Thanks

[Redacted]

**From:** [Redacted] **On Behalf Of** DG Economy

**Sent:** 02 June 2017 15:40

**To:** DG Economy First Minister

**Cc:** Maxwell S (Stewart) (Special Adviser) McAllister C (Colin) Lloyd E (Elizabeth) Director of Financial Management PS/Transport Scotland [Redacted] Permanent Secretary [Redacted] McAllan M (Mary) [Redacted] Brannen R (Roy) Somers J (John) Deputy First Minister and Cabinet Secretary for Education and Skills [Redacted] Cabinet Secretary for Finance and the Constitution Cabinet Secretary for Economy, Jobs and Fair Work Cabinet Secretary for the Rural Economy and Connectivity Minister for Transport and the Islands Lord Advocate [Redacted]

**Subject:** RE: IMMEDIATE: meeting with Jim McColl

PS/FM

Following the meeting on 31 May with Jim McColl, we understand FM asked for further information. I have set this out here on behalf of DG Economy, it is the result of various input and consideration by officials in Transport Scotland, Finance and SGLD.

- 1. The surety bond, including how it was detailed in the tender information, how it was accounted for a the point of contract award and how it has evolved since.**

[Redacted-164].

[Redacted-165].

[Redacted-166];

[Redacted-167]

[Redacted-168]

[Redacted-169].

[Redacted-170].

[Redacted-171].

[Redacted-172].

[Redacted-173].

[Redacted-174]

- 2. The legal advice regarding [Redacted-8].**

[Redacted-9].

[Redacted-10].

[Redacted-11].

[Redacted-12].

[Redacted-13]:

[Redacted-14]

[Redacted-15].

-ends-

[Redacted]

**From:** Ditchburn L (Liz) **On Behalf Of** DG Economy

**Sent:** 16 June 2017 15:33

**To:** First Minister DG Economy Cabinet Secretary for Finance and the Constitution Cabinet Secretary for Economy, Jobs and Fair Work

**Cc:** Maxwell S (Stewart) (Special Adviser) McAllister C (Colin) Lloyd E (Elizabeth) Director of Financial Management PS/Transport Scotland [Redacted]Permanent Secretary Cameron DA (Donald) McAllan M (Mary) [Redacted]Brannen R (Roy) [Redacted]Deputy First Minister and Cabinet Secretary for Education and Skills [Redacted]Cabinet Secretary for the Rural Economy and Connectivity Minister for Transport and the Islands Lord Advocate [Redacted]

**Subject:** RE: IMMEDIATE: meeting with Jim McColl

First Minister, Cab Sec Finance and Constitution, Cab Sec EJFW

Following Mr McColl's continuing concerns expressed to me about the nature of the contract with CMAL, I met with Mr McColl together with Keith Mitchell (of CBC) and Erik Ostergaard, Chair of CMAL and Kevin Hobbs, CEO of CMAL on the 7<sup>th</sup> June in Glasgow. John Nicholls, Transport Scotland, was also present. Given that there appeared to be different opinions held by FMEL and CMAL with respect to the nature of the contract and the process leading up to it, the objective of the meeting was to enable these differences to be bottomed out one way or another, ideally enabling us to move forward to work on potential solutions that lie outside of the contract.

The meeting was frank and open.

Mr McColl reiterated his concerns in relation to cashflow issues and what he saw as the restrictive nature of the contract, [Redacted-175].

CMAL addressed his detailed points, emphasising that the contractual terms on which the tender had been conducted were industry standard, and [Redacted-176].

[Redacted-177]. I confirmed that we shared a strategic objective in seeing a successful shipbuilding activity in Scotland, including for the domestic market, and that we were keen to continue to discuss options, both in the short term with FMEL, and the more strategic, market-wide issues [Redacted-178].

We agreed three actions:

1. That CMAL and FMEL should continue to operate within the current contract terms, maintaining the close monitoring and frequent contracting authority / supplier engagement that was in place. Achieving the launch of the first hull in August was an important milestone.
2. FMEL and SG/SE should work to pursue alternative support mechanisms outside the contract. This work had started but had been paused as Mr McColl was keen for this meeting to go ahead first. Mr McColl agreed that this work should continue and that he would ensure that the necessary financial information was made available to SE. I stressed that SE was operating in this context for themselves but also for SG, and that we would look at support options from both SE and / or SG as appropriate.
3. For the medium term, SG would pursue the discussion with interested parties, including FMEL and with sector expertise from CMAL, as to whether there were government actions that could be undertaken, [Redacted-178].

Liz

**Liz Ditchburn**  
Director General Economy  
Scottish Government

**From:** [Redacted]On Behalf Of DG Economy

**Sent:** 14 July 2017 11:50

**To:** Chief Financial Officer DG Finance Mailbox [Redacted]McAllan M (Mary) Rollison R (Richard) Nicholls J (John) (TRANS) Brannen R (Roy) PS/Transport Scotland [Redacted]

**Cc:** DG Economy [Redacted]

**Subject:** FW: Fergusons paper

Please see attached the financial information on FMEL. You will be aware that we asked SE to look at support options [Redacted-179].

Please review this document and give thought to options, including SG options that would not necessarily be part of the SE core offer. I would like us to meet to discuss this next week, but I know that availability may be a challenge. We may work to meet first as SG and then with SE (or vice versa). To note that Cab Sec is meeting Jim McColl on Wednesday next week. I told Jim on Wednesday that I had just received the report but that we had not had a chance to review it yet. Once we are clear on what if any options are feasible, we will want to meet Jim again. My office / I should keep him updated on timeframes for that meeting.

Liz Ditchburn  
DG Economy

## Ferguson Marine Engineering Limited Review of financial position

### Executive Summary

Scottish Enterprise (SE) has undertaken a high-level internal review of the financial information and forecasts provided by Ferguson Marine Engineering Limited (FME), including management accounts for the four months to April 2017 and financial forecasts (including P&L, balance sheet and cashflow) for 2017 and 2018.

[Redacted-180]. SE stands ready to commission detailed commercial and financial due diligence to help build the case for investment if significant progress can be made on these issues.

### Introduction

SE has been engaged with FME on FME's funding need since spring 2016. [Redacted-181]. Since then, SE has been engaged with FME and SG colleagues to explore options to support the business in the short to medium term.

### Review of Financial Position

SE has carried out an internal high-level review of the financial forecasts of FME for the years to December 2017 and 2018, including analysis of the profit and loss, balance sheet and cash flow projections, summarised below (*see Appendix 1 for detailed overview*).

- The P&L  
FME is forecasting revenue of [Redacted-182] with a gross profit of [Redacted-183]. Losses at EBITDA level are forecast at [Redacted-184] respectively before and after exceptional items and finance costs, with financing costs of [Redacted-185] attributable to fees and expenses paid to CBC. In 2018, FME is forecasting a [Redacted-186] on an improved gross profit of [Redacted-187]. Profit at EBITDA level is forecast at [Redacted-188] before exceptionals and financing costs [Redacted-189] of fees and expenses to CBC.
- The Balance Sheet  
The balance sheet as at 30 April 2017 confirms total cash held of [Redacted-190]. Total net assets were [Redacted-191] of invested capital.
- The Cash Flow  
[Redacted-192]. The business is forecasting [Redacted-193] in July 2017, [Redacted-194]. At the end of 2017 and 2018, FME is forecasting [Redacted-195]. The cashflow forecasts assumes [Redacted-196].

### Overview of Investment Risks

- The Scale of Funding Required: [Redacted-197]
- Timing Risk: any funder will require to undertake extensive commercial and financial due diligence prior to agreeing to provide any funds. [Redacted-198].
- Support from Existing Investors: [Redacted-199].
- Assumptions Underpinning Forecasts: the cashflow is contingent on a number of assumptions, none of which are guaranteed. [Redacted-200].
- [Redacted-201].
- [Redacted-202].

### **Partnership Approach – Wider Package of Support**

We have outlined below potential measures that could be explored and hopefully agreed as part of a wider package of support to help FME. This list is not exhaustive and it is recognised that some may be easier to achieve than others, if at all.

- [\[Redacted-203\]](#).
- [\[Redacted-204\]](#).
- [\[Redacted-205\]](#).
- [\[Redacted-206\]](#).
- [\[Redacted-207\]](#).
- [\[Redacted-208\]](#).

### **Potential Financing Options**

[\[Redacted-209\]](#). This should not be taken as a view as to the appropriateness of one form of support over another or indeed whether any of these options are achievable in practice. These options should be read in the context of a wider package of support discussed above.

- [\[Redacted-210\]](#).
- [\[Redacted-211\]](#).
- [\[Redacted-212\]](#).
- [\[Redacted-213\]](#).

### **Conclusions**

[\[Redacted-214\]](#). SE stands ready to commission detailed commercial and financial due diligence to help build the case for investment if significant progress can be made on these issues.

## Appendix 1

### FERGUSON MARINE ENGINEERING LIMITED

#### Trading performance

FME has supplied management accounts covering the 4 months ended 30<sup>th</sup> April 2017 and a detailed trading forecast covering the period to 31 December 2018 which are set out below:

Item	30/04/17 – [Redacted-215]	31/12/17	31/12/18
	£'000	£'000	£'000
Turnover	[Redacted-215]	[Redacted-215]	[Redacted-215]
Gross Profit/(Loss)	[Redacted-215]	[Redacted-215]	[Redacted-215]
Gross Margin	[Redacted-215]	[Redacted-215]	[Redacted-215]
Overheads	[Redacted-215]	[Redacted-215]	[Redacted-215]
Exceptional costs	[Redacted-215]	[Redacted-215]	[Redacted-215]
CBC Fee	[Redacted-215]	[Redacted-215]	[Redacted-215]
Net (Loss)/Profit	[Redacted-215]	[Redacted-215]	[Redacted-215]

Turnover in the first 4 months of this year relates to the 2 ferries currently being constructed for CMAL known as 801 and 802. Exceptional costs relate to apprentices and relocation. The CBC (Clyde Blowers Capital) fee is a recharge to cover management time and central costs. [Redacted-216].

The forecast trading performance for the full year ending 31 December 2017 appears realistic as it is based on known income and expenditure relating to existing contracts only. No sensitivity analysis is therefore deemed necessary. [Redacted-217]:

	31/12/2017	31/12/2018
	£m	£m
CMAL vessels 801/802	[Redacted-218]	[Redacted-218]
[Redacted-218]	[Redacted-218]	[Redacted-218]
Other Fabrication	[Redacted-218]	[Redacted-218]
Total	[Redacted-218]	[Redacted-218]

The revenue for CMAL vessels 801 and 802 include an assumed payment of [Redacted-219].

#### Financial Position

FME's balance sheet as at 30 April 2017 per management accounts shows that [Redacted-220].

#### Cash Flow Forecast

The detailed cash flow forecast covering the period to 31 December 2018 shows [Redacted-221].

Expenditure in y/e 31 December 2017 includes [Redacted-222]. FME can supply the detail behind this figure which it will be discussing shortly with CMAL and we have no reason to believe that it is not realistic. [Redacted-223].

#### Forecast Trading

In terms of future viability, FME has supplied high level figures for the 3 years ending 31 December 2021 which are set out below:

	<b>31/12/19</b>	<b>31/12/20</b>	<b>31/12/21</b>
	£'000	£'000	£'000
Revenue	[Redacted-224]	[Redacted-224]	[Redacted-224]
Gross Margin	[Redacted-224]	[Redacted-224]	[Redacted-224]
GM%	[Redacted-224]	[Redacted-224]	[Redacted-224]
SG&A Costs	[Redacted-224]	[Redacted-224]	[Redacted-224]
EBIT	[Redacted-224]	[Redacted-224]	[Redacted-224]
EBITDA	[Redacted-224]	[Redacted-224]	[Redacted-224]
EBITDA %	[Redacted-224]	[Redacted-224]	[Redacted-224]

[Redacted-225]

## MINISTERIAL ENGAGEMENT BRIEFING: DEREK MACKAY

<i>Engagement Title</i>	Meeting with Jim McColl of Clyde Blowers Capital, owner of Ferguson Marine Engineering Ltd.
<i>Timing</i>	Normal
<i>Organisation/Venue and full address including postcode</i>	7 <sup>th</sup> floor, AQ
<i>Date and Time of Engagement</i>	Date(s): Wednesday 17 July 2017 Time(s): 12.30 – 13.15
<i>Background/Purpose</i>	Please see outline Agenda and Key issues at <b>Annex A</b> .
<i>Relevance to Core Script</i>	Investment in Transport Infrastructure to support sustainable economic growth.
<i>Greeting Party and specific meeting point on arrival (if event is at a non SG Building)</i>	N/A
<i>Specific entrance for Ministerial Car/parking arrangements</i>	None
<i>Venue contact Number</i>	
<i>Special Dress Requirements</i>	No
<i>Event Programme</i>	<b>Annex A</b> Agenda and attendees.
<i>Key Points</i>	Included in <b>Annex A</b>
<i>Guest List or Meeting Attendees</i>	Included in <b>Annex A</b>
<i>Background</i>	<b>Annex B</b> – FMEL – current issues <b>Annex C</b> – Note of meeting 2 March 2017 <b>Annex D</b> – Note of meeting 7 June 2017 <b>Annex E</b> – [Out of Scope] <b>Annex F</b> - [Out of Scope]
<i>Supplementary Info:</i>	N/A

<p><i>Directions including map(s)</i></p> <p><i>Media Handling</i></p> <p><i>Official Support</i></p>	<p>N/A</p> <p>Non Media Event</p> <p>Officials</p> <p><b>Names:</b></p> <p>Richard Rollison, Deputy Director Innovation, Industries and Investment Division [Redacted]</p> <p>[Redacted]</p>
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Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness
Cabinet Secretary for Rural Economy and Connectivity Cabinet Secretary for Economy, Jobs and Fair Work Minister for Transport & Islands			X X X		
DG Economy DG Finance Roy Brannen, CE TS PS Transport Scotland Gordon Wales, Chief Financial Officer TS Directors [Redacted] Richard Rollison, Innovation, Industries and Investment Mary McAllan, Directorate For Economic Development [Redacted] Liz Lloyd, Special Adviser John McFarlane, Special Adviser Kate Higgins, Special Adviser Stewart Maxwell, Special Adviser					

## ANNEX A

### Attendees

Derek Mackay  
Jim McColl  
Richard Rollison, Deputy Director, Innovation, Industries and Investment Division  
[Redacted]

### Agenda

Mr McColl has suggested the following agenda:-

1. Ferguson Marine Engineering Ltd
2. [Out of Scope]

## Key issues

1. Jim McColl's concerns around FMEL's future cashflow and the impact this could have on their ability to deliver the 2 CalMac vessels commissioned by CMAL.

2. [Out of Scope]

## Background to meeting

The meeting has been set up at Jim McColl's request.

Mr McColl continues to have concerns about future cashflow which appear credible on the basis of Scottish Enterprise reports. However recent engagement indicates that neither the company nor the shipbuilding contracts with CMAL are at currently at risk.

[Out of Scope] **See Annex E**

Engagement with Mr McColl has been ongoing since he met Mr Mackay, Mr Brown and Mr Yousaf on 2 March 2017. A note of that meeting is attached as **Annex C**. Subsequent to that meeting:

- Mr McColl introduced a new project manager, Gerry Marshall, who set up a "war room" at the yard. CMAL noted an immediate improvement. On 3 July we were informed that Gerry Marshall has replaced Liam Campbell as MD at FMEL.
- [Redacted-226].
- Liz Ditchburn (DG Economy), John Nicholls (TS) and Kevin Hobbs (CMAL) met Jim McColl and Keith Mitchell (Clyde Blowers Capital) on 7 June. See note of meeting at **Annex D**. Following detailed discussions, [Redacted-227].
- [Redacted-228].
- In parallel, and following the 2 March meeting, Ministers asked Scottish Enterprise to see what other forms of support could be offered to FMEL as a business.
- Scottish Enterprise have engaged with FMEL to fully understand the financial situation of the company and develop potential options for SE financial support. SE delivered their report to SG on 11 July. This is being considered by SG officials. SE's analysis showed that FMEL's cash forecast remained poor with cash gap peaks of [Redacted-229] and [Redacted-230].

Most recently Mr McColl met Liz Ditchburn on 12 July with Roy Brannen and [Redacted]

- (TS) in attendance. Mr McColl noted that FMEL were going to delay the launch of the first vessel from August to September as this would enable a more efficient use of the yard's resources. This would not affect the final delivery date.
- Mr McColl may raise questions about whether or not [Redacted-231].
- Notwithstanding the challenges, the quality of work by FMEL remains high and the investment made at the shipyard is now very visible in terms of improved and expanded buildings, plant and machinery.

- SG remains committed to supporting the development of a successful shipbuilding sector in Scotland.

[Out of Scope]

## ANNEX B

### Ferguson Marine Engineering Ltd (FMEL) – Current Issues

#### Background

In November 2015, CMAL placed orders at FMEL for the construction of two 100m Dual Fuel Ferries (LNG and Marine Gas Oil), currently referred to as Vessels 801 and 802.

The delivery dates of the vessels at contract signing were:

- Vessel 801 – 25 May 2018 – for subsequent deployment on the Arran service to Brodick.
- Vessel 802 – 26 July 2018 – for subsequent deployment on the Uig Triangle service, serving Tarbert, Harris and Lochmaddy, North Uist service.

The value of the core contract is £97m: , £48.5m per vessel. In addition to the FMEL contract costs there are other costs associated with these vessels – design, construction supervision and mobilisation relating to the CMAL supervision team and the secondment of vessel based personnel from CalMac. The total cost Scottish Ministers is forecast at [Redacted-232].

There have been a number of challenges that are recognised throughout CMAL’s experience with FMEL and these are outlined in more detail below under the following headings:-

- Progress of build and delivery prospects
- Quality of Built
- Payments
- Contract variations
- Contract terms and conditions including Surety Bonds
- Challenges
- Future Progress
- Broader issues and future opportunities for FMEL

#### Progress of build and delivery prospects

The assessment of CMAL, supported by CalMac, is that there is a high probability that the vessels will be delivered later than that indicated above.

- [Redacted-233].
- Most recently, the scheduled launch of the first vessel, the MV Glen Sannox, has just been put back from 24 August to late September.
- [Redacted-234].

There are a total of [Redacted-235] “allowable days” within the contract for delays without penalties. CMAL’s working assumption is that these “allowable days” will be used and potentially exceeded. That means that the “best case” scenario that CMAL can foresee is as follows:

- the delivery of Vessel 801 will be in August 2018 (compared to 25 May 2018 envisaged at contract signing), and
- the delivery of Vessel 802 will be in October 2018 (compared to 26 July 2018 envisaged at contract signing).

[Redacted-236]:

- [Redacted-237]
- [Redacted-238]

[Redacted-239].

[Redacted-240].

[Redacted-241].

### **Quality of build**

It should be noted that the quality of the workmanship that CMAL has witnessed at FMEL to date is very good. This is seen as a significant positive indication, particularly for the subsequent reliability and longevity of the vessels.

### **Milestones and payments**

Within CMAL’s contract with FMEL, there are various milestone payments that are required to be made at certain stages of the construction. To date the milestones reached have been up to and including:

- Milestone 10 (75% of the Hull fabrication) in respect of vessel 801, and
- Milestone 8 (50% of the Hull fabrication) in respect of vessel 802.
- [Redacted-242].

The total payments made up to and including the respective milestones as above is £61.235m. That leaves a balance of £35.765m.

Further scheduled payments linked to the completion of fabrication and launch of the 2 vessels will take the total paid to FMEL to [Redacted-243] of the contract price, [Redacted-244] for each vessel to be paid by CMAL to FMEL over the remainder of the construction period.

### **Contract Variations**

[Redacted-245].

It is not unusual for shipbuilding contracts to be subject to such variations due to e.g. design changes made at the request of the shipowner during the course of the project. These are usually reconciled and agreed towards the end of the contract and finalised before ship delivery and contract closure. Provision has been included in the TS capital budget submission for 2018-19 some variations – [Redacted-246].

[Redacted-247].

### **Shipbuilding contracts – terms and conditions**

[Redacted-248].

[Redacted-249].

Following a meeting with Mr McColl on 2 March 2017, Ministers undertook to explore further potential remedies with CMAL.

[Redacted-250].

The indication from Liz Ditchburn's meeting with Mr McColl of 7 June is that Mr McColl acknowledges that [Redacted-251] Actions from that meeting (see **Annex D** for the full note) were:

1. [Redacted-252].
2. [Redacted-253].
3. [Redacted-254].

The following advice was put by DG Economy to FM on 2 June 2017 following a meeting with Jim McColl on 31 May:

Following the meeting on 31 May with Jim McColl, we understand FM asked for further information. I have set this out here on behalf of DG Economy, it is the result of various input and consideration by officials in Transport Scotland, Finance and SGLD.

- 1. The surety bond, including how it was detailed in the tender information, how it was accounted for at the point of contract award and how it has evolved since.**

[Redacted-255].

[Redacted-256].

[Redacted-257]

[Redacted-258]

[Redacted-259].

[Redacted-260].

[Redacted-261].

[Redacted-262].

[Redacted-263].

[Redacted-264].

[Redacted-265]

## 2. [Redacted-8].

[Redacted-9].

[Redacted-10].

[Redacted-11]

[Redacted-12]

[Redacted-13]

[Redacted-14]

[Redacted-15]

[Redacted-16]

### **Challenges**

There have been a number of challenges that are recognised throughout CMAL's experience with FMEL as outlined below.

- The ship yard has a new owner as it was effectively in administration prior to Clyde Blowers Capital (CBC) stepping in.
- Whilst CBC are well versed in the manufacturing environment the ship building business was not known to them previously.
- The ship yard has a new management team and Board of Directors.
- There has been significant investment in the yard in terms of new build facilities, machinery, processes and IT of circa £25 million.
- There have been delays in vessel construction as various areas of the yard have been in refit and therefore unable to be fully utilised for ship building.
- The vessels are technically complex and planning has proved a difficulty for the yard.
- Fifteen months into the contract: FMEL has yet to issue a detailed plan for fabrication, equipment installation, outfitting and commissioning.

### **Future Progress**

CMAL will continue to meet regularly with FMEL, to look closely at the planning and address any issues that are expected to arise. The situation in relation to the delivery dates for Vessels 801 and 802 is an evolving one, and Ministers will be kept informed.

Transport Scotland officials are also monitoring progress with a particular emphasis on financial planning and profiling and the interactions with associated planned pier and harbour infrastructure works for the Arran service and on the Uig Triangle. Transport Scotland officials will liaise closely with CMAL on this matter.

### **Broader issues and future opportunities for FMEL**

The global ship building market is very weak. Worldwide, new build orders in 2016 are only at a level of 5% of the equivalent position in 2006. Shipyards are closing all over the globe due to lack of orders. Those shipyards that remain are aggressively chasing what little works remains – both in terms of the low prices being offered to buyers and acceding to the buyers’ demands in relation to the terms and conditions associated with the contracts. It is undoubtedly a very competitive and difficult market place.

FMEL want to secure global contracts so it is likely that they will have to accept the normal practice of offering Bank Guarantees or Surety Bonds to secure such business. [Redacted-266]

[Redacted-267]:

- [Redacted-268]
- [Redacted-269].

Scottish Enterprise have been engaging with FMEL to fully understand the financial situation of the company. SE delivered their report on 11 July. This is being considered by SG officials.

SG officials will then consider the options proposed by SE and whether beyond this there are any options for SG support (using the analysis provided by SE to inform). Gordon Wales and Liz Ditchburn will consider the conclusions and recommendations of this work. Liz and relevant colleagues will then meet with Jim McColl to discuss, in mid-July if the work is suitably progressed and if diaries allow.

[Out of Scope]

**ANNEX C**

[See Document 3: Note of meeting between Cab Sec EJFW, Transport Minister and Jim McColl on March 2nd 2017]

**ANNEX D**

[See Document 14: E-mail from DG Economy to Ministers containing a note of a meeting on 7th June]

**ANNEX E**

[Out of Scope]

**ANNEX F**

[Out of Scope]

**From:** Ditchburn L (Liz)

**Sent:** Tuesday, 18 July 2017 18:11

**To:** Rollison R (Richard) [Redacted] Gillespie G (Gary) Anson S (Sam) [Redacted]

**Cc:** DG Economy Brannen R (Roy) [Redacted] Chief Financial Officer DG Finance Mailbox McAllan M (Mary)

**Subject:** Note of meeting with Jm McColl - Commercially sensitive - protect

All

I met Jim McColl last week on Wednesday with Roy Brannen and [Redacted]. The substantive business of the meeting was on the contract with CMAL, however, in that conversation and following the main meeting, there were a number of issues that are of broader interest. This note captures those other issues, [Redacted] are actioning the other aspects of the discussion wrt the contract.

[Redacted-270], in the context of ship building, but much broader as well in terms of strategic industries, [Out of Scope]

Liz

**Liz Ditchburn**

Director General Economy  
Scottish Government

**From:** Nicholls J (John) (TRANS)  
**Sent:** 25 July 2017 19:01  
**To:** DG Economy  
**Cc:** Brannen R (Roy) Transport Scotland Secretariat [Redacted]  
**Subject:** FMEL

Liz

[Redacted] passed on your message that Jim McColl had phoned you to express his continuing concern about CMAL's attitude to FMEL's claims. Kevin Hobbs had been trying to contact me this afternoon on the same subject, and I have now discussed this with him- he had been approached separately today by FMEL senior management on the same subject.

CMAL's position is as follows:

- the contract sets out processes for submission and consideration of claims, which follow industry norms
- FMEL's earlier "claim" submitted last week did not follow that process, which requires more detailed explanation and justification
- CMAL remain ready to consider properly-submitted claims, [Redacted-271]
- CMAL have already conveyed the above to FMEL in writing and orally again (today)
- agreed claims normally become payable at the end of the [Redacted-272]
- [Redacted-273]

Kevin would be happy to discuss this with you on the phone or in person if that would be helpful..

Going forward, I think we need to encourage FMEL to engage properly with the contractual process for claims. TS would be happy to facilitate that if necessary.

John

**From:** Brannen R (Roy)  
**Sent:** 27 July 2017 16:55  
**To:** DG Economy PS/Transport Scotland  
**Subject:** RE: Call with Jim McColl  
**Importance:** High

Quick read out from call.

JMcC requested a call to discuss ferry contract. RB called him today at lunchtime.  
Main points:

- [Redacted-275].
- [Redacted-276].
- [Redacted-277].
- [Redacted-278].
- [Redacted-279].
- RB reiterated what was conveyed during previous call that he understands the contract has mechanism for dealing with variations and any dispute of resolving same. This is how TS would approach a similar issue if it were the contracting authority and this should be the approach here between FMEL and CMAL. As in most contracts this process normally runs in parallel with progressing the original delivery of the contract scope. [Redacted-280].
- JMcC understood position but would be seeking a further call with Liz.

RB confirmed with John Nicholls following the call that CMAL were clear on the professional approach expected with contract administration and treatment of variations. He confirmed they were but would be speaking with Erik and Kevin tomorrow to reiterate.

**From:** James A. McColl  
**Sent:** 28 July 2017 09:47  
**To:** Cabinet Secretary for Finance and the Constitution DG Economy  
**Subject:** FMEL / CMAL  
**Importance:** High

Dear Derek & Liz,

As you know, we are attempting to work through the cost impact areas with CMAL, however as I have outlined to you, we appear to be coming at this from different mind-sets. I have also outlined to you the urgency of dealing with the working capital requirement for Fergusons. I appreciate that you have asked SE to look at funding solutions but to date, nothing appears to have been forthcoming [Redacted-281].

[Redacted-282].

[Redacted-283]:

- [Redacted-284].
- [Redacted-285]:
  - (i) [Redacted-286],
  - (ii) [Redacted-287]
  - (iii) [Redacted-288]

[Redacted-289].

- [Redacted-290].
- [Redacted-291].
- [Redacted-292].

[Redacted-293]

[Redacted-294]

[Redacted-295].

[Redacted-296].

To date we have been focused on specific individual cost impact areas but if we take a step back and look at the whole project and where all interested parties are now, the circumstances that have occurred during the design and build go way beyond those which could have been foreseen by CMAL at the bid phase. At the time of the bid and indeed the contract execution, CMAL had a concept design for the build of two LNG ferries which would be the first of a kind in Scotland and indeed in the UK. [Redacted-297]:

- (i) [Redacted-298]
- (ii) [Redacted-299].
- (iii) [Redacted-300]

[Redacted-301].

It is extremely important, and in the interests of all parties, that these matters are urgently resolved. I would be grateful therefore if we can have a discussion later today once you have had a chance to consider the forgoing, so that we can finally agree an acceptable solution.

Jim

**Jim McColl**  
Founder, Chairman & CEO

**From:** Ditchburn L (Liz) **On Behalf Of** DG Economy

**Sent:** 28 July 2017 12:54

**To:** Cabinet Secretary for Finance and the Constitution DG Economy Chief Financial Officer

**Cc:** DG Finance Mailbox Chief Financial Officer [Redacted] Lloyd E (Elizabeth) McFarlane J (John)

McCaig C (Callum) Minister for Transport and the Islands Maxwell S (Stewart) (Special Adviser)

McAllan M (Mary) PS/Transport Scotland Cabinet Secretary for Economy, Jobs and Fair Work

Cabinet Secretary for the Rural Economy and Connectivity [Redacted] Rollison R (Richard)

[Redacted] Brannen R (Roy) [Redacted]

**Subject:** RE: FMEL / CMAL

All

Readout from my call with Jim last night:

On the contract: Jim confirmed that he had now had a response from Kevin Hobbs and that Kevin had proposed a process on the contract variations. [Redacted-302].

He said he had two proposals to make to us:

1. He would be asking us to review again his original proposal to [Redacted-303].
2. He believed the build had been more difficult than either he or CMAL could reasonably have foreseen and that this was increasing costs. [Redacted-304].

On our discussions with SE: I updated him on some of the headlines from our discussion with SE earlier in the week. [Redacted-305].

I confirmed that, if the SG / SE were to consider investing in any way, it could only be on the basis of co-investment and therefore CBC / Jim would need to put resources in. [Redacted-306].

[Redacted-307] He indicated that he would, but we should follow up in writing to nail this down – including any role or sharing of information with CMAL. Richard's team to action.

[Redacted-308].

That was the call. In terms of next steps and actions for us:

1. [Redacted-309]
2. [Redacted-310].
3. Ec Dev to confirm with TS and Finance the appropriate route to the further diligence work – who should contract / info sharing etc. And write to Jim today if possible confirming our proposal and timeframes on this and seeking his agreement. (I flagged to him that we thought it would be in the order of 3 weeks work).

In terms of timeframes for 1 and 2 – can we have initial views by cop Tuesday with an estimate of further work required if appropriate?

Liz