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PROJECT POSEIDON: LOAN DRAWDOWN ASSURANCE REPORT

Reference: Project Poseidon VATIS

Background

The Scottish Government has provided a commercial loan facility to Ferguson Marine Engineering Limited (FMEL) – the Project Poseidon Commercial Loan – and has identified the need for independent operational expert advice relating to the Loan. This is to monitor FMEL's performance against its vessel delivery programme and resourcing plan and provide assurance that Loan conditions and expectations are being met.

The Loan Agreement states that FMEL will provide the following information for review:

> "a build update report on the build out of vessels 801 and 802 plus cost overruns and other issues, details of cost estimations in connection therewith and any such other information as relevant to the delivery of the vessels and to the running of the business"

One condition precedent to drawing the Loan is:

> "satisfactory assurance from the Scottish Ministers' independent operational expert that progress of the build of the vessels known as 801 and 802 is proceeding in accordance with the overall resource program presented by FMEL on 28 and 29 May 2018 at Port Glasgow, taking account of factors that are outside FMEL's control."

Report

The report below is the fifth independent drawdown report (complemented by several other reports) on the progress of the build of the vessels known as 801 and 802. The review was undertaken on 05 and 06 March 2019 on site in Port Glasgow.

LOAN DRAWDOWN ASSURANCE REPORT

Drawdown Number: 6 Date of Drawdown Request: 6 March 2019

Reference A: Meeting Transport for Scotland, Economic Development Scotland, CMAL on 24 Jan 19 (Present Frances Pacitti, Kevin Hobbs, Jim Anderson, [redacted] Luke van Beek, [redacted]

Reference B: Loan Drawdown Assurance Report Project POSEIDON dated 23 Jan 19

Reference C: FMEL letter of 14 Feb 19

Reference D: CMAL letter of 15 Feb 19

Reference E: CMAL letter of 20 Feb 19

Current Position

My last visit to FMEL was in late January. The period leading up this last report was characterised by a period of uncertainty for FMEL resulting from a shortage of cash. I recommended a number of actions to address this uncertainty however there appears to have been no progress on any of them.

The situation appears to be at an impasse. According to FMEL, CMAL, despite assurances to the contrary (Reference A) have continued to demand changes and to interfere in the design process. A number of mitigation measures (to ease programme pressure) were tabled at this meeting and Transport Scotland appeared to direct that these should be discussed. To my knowledge this has yet to occur.

At Reference B I highlighted, as a minimum, a 3 month slip to the programme. Also in Reference B I highlighted a deteriorating relationship between CMAL and FMEL. This continues to worsen as evidenced by exchanges of letters between CEO FMEL and CEO CMAL reinforced by accusations from CMAL (References C, D, and E). The alleged anticipatory breach of contract (Reference E) was refuted in a solicitor's letter from Brodies (FMEL solicitor) to CEO CMAL which I have seen at FMEL.

Work is continuing on both 801 and 802 albeit at a slower pace than is desirable. Both key sub-contractors remain engaged so outfitting and electrical work are well in hand. Shore power (a key milestone) is expected onboard 801 within the next 2 weeks. FMEL are being cautious in employing their limited cash and this situation is likely to continue until there is a clear way forward. In the light of the above there is no revised programme against which an assessment can be made of a delivery date. I assess that my earlier forecast is optimistic and slip is now heading towards 6 months.

FMEL have stated that they will not stop work but they are planning to mobilise the media and Trade Unions to explain their case. It seems likely that they will move their legal claim to the next level.

To ensure the best chance of delivering 801 and 802 at minimum increased cost and with minimum delay I suggest the following should be considered:

- Confirm that all change (both new and design) is frozen for 801;
- The discussion on the programme and risk register (Reference A) occurs quickly;
- Simplify the build (both process and delivered capability) through an open discussion;
- Use arbitration to examine the claims and counter claims from FMEL and CMAL;
- Work quickly to resolve the medium term cash issue.

Alternative Options

I meetings with PWC and Transport Scotland I was made aware of 3 possible options for the way forward:

- Re-tender the contract
- Nationalisation
- Arbitration

Each of these options would incur additional cost and time. None resolve the relatively short term cash challenge facing FMEL. In the options of Nationalisation and Arbitration work could continue on the ferries. In the re-tender option it is likely work would have to stop. Nationalisation will be strongly resisted by FMEL, Arbitration strongly resisted by CMAL.

I my opinion (with experience of all 3 of these options) Arbitration offers the lowest price increase and shortest time delay to ferry delivery. It also avoids any long term Government involvement in the shipyard whilst allowing work to continue.

Recommendation

Against my original remit (a deliverable programme) I see challenges since no programme exists. I believe the factors which have led to this position were outside FMEL's control. I repeat that I believe FMEL have the managerial and technical capability to deliver both ships. On this basis I believe that, to maintain FMEL as an ongoing entity, draw down should be approved.

Luke van Beek CBE
VATIS Ltd
Independent Expert