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PROJECT POSEIDON: QUARTERLY REVIEW

Reference: Project Poseidon VATIS/3/Dec18

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"

and will allow:

> "an independent operational expert nominated by the Scottish Ministers to meet with the Chief Executive Officer of the Group (whether by telephone conference or otherwise) and provide such independent expert with information as may be reasonably requested by him, provided that (i) such meeting/call or information is in connection with the vessel build progress for the vessels known as 801 and 802, and (ii) such meeting/call is for no longer than one working day in duration."

Luke van Beek CBE is employed as an independent expert who has the remit to review the information provided by FMEL and prepare:

i. A brief assurance report relating to the condition precedent for each subsequent drawdown notice prepared by FMEL (last completed on 06 Nov 18);

ii. A quarterly review to monitor build progress against the declared plan;

iii. Assistance as required to the Scottish Government to support and improve the future commercial strategy of the FMEL shipyard.

Quarterly review

This review was specifically commissioned following a briefing to DGE and CEO Transport Scotland delivered by Luke. The report below is an independent review of the build progress against the plan declared by FMEL. It concentrates on 2 particular concerns: the commissioning programme for Ship 801 and the impact on this programme of the cash flow challenge resulting from delayed payment of the loan drawdown (requested on 28 Sep 18). The review was undertaken on 11 December on site.

QUARTERLY REVIEW REPORT

<u>Summary:</u>

My last visit was early November to produce a drawdown report. This Quarterly report is based on a visit to FMEL on 11 Dec 18. This visit included a tour of Ship 801 and it was encouraging to see significant progress since my previous tour (in September). A recurring theme of this visit was the evident frustration with the inability of the yard to progress in accordance with the programme because of the cash flow challenge.

The rationale and impact of the lack of cash are listed later however the reduction in workforce numbers, slowing down of sub-contractor work, inability to order key materiel and loss of the allocated dry dock booking are serious and result in impact well beyond a simple day on day delay. It is assessed that the minimum delay is 3 months, however this assumes loan payment before 21 December, speed and ability to re-employ personnel and re-engaging of [redacted] almost immediately. A further significant impact is the cash situation that will arise in April resulting from the delay in the milestone payment associated with handing over Ship 801.

Possible mitigation to some of the risk does exist and this is outlined.

Given the current uncertainty surrounding a number of interlinked factors it is not possible to either firm up a new programme nor declare a new date for 801 handover now. Once the loan drawdown is made, negotiations entered into with the supply chain and employment agencies, a new programme can be produced. This programme should be reviewed, hopefully in late January.

Conclusions

1. The impact of late loan drawdown is significant and will impose, at least, 3 months delay to the Ship 801 programme.

2. It is not possible to produce a definitive programme for completing 801 now. Once the situation becomes clearer a new programme can be produced.

3. The impact on 802 programme, with the exception of launch date, is significantly less.

4. The ongoing cash situation will require careful monitoring.

Recommendations

1. The new programme should be reviewed and a further report be produced on its viability and associated risk.

2. Work should start now to resolve the further cash flow issue that will arise in April

3. The relationship with CMAL should be addressed.

Programme Impact (Ship 801)

As has been previously reported the programme activity for 801 from now until handover is mostly on the critical path. The necessary sequencing of activity has been severely disrupted by the lack of cash. The relationship between installing pipes and valves, running cables and completing compartments is complex and relies on careful sequencing of activity. This sequence is currently broken and will take time to restore. This has led to a situation where the programme delay is significantly more than the delay in completing loan drawdown. The uncertainty surrounding the re-starting of numerous activities means that it is not possible to produce a definitive programme now. It is clear, however, that a delay of at least 3 months is inevitable. A more realistic figure is 4 to 5 months. Further explanation is provided below.

Supply Chain. Vital items of equipment have not been purchased. This includes pipes and valves. The LNG piping is very specialist and re-ordering will not be straightforward. The lack of these items has stopped work in numerous compartments.

Sub-contractor Engagement. [redacted] It appears likely that they will stop all work next week unless they are provided with more cash. When this occurred previously (June/July) it required 6 weeks of negotiation to return to the necessary level of work. One of the first elements in the commissioning programme is a power management trial and load test. A revised date for achieving these is key to producing a stable programme to handover.

Dry Dock. Dry docking of 801 was planned for 4 weeks starting on 18 Feb 19. Because this booked date cannot be met the dock is no longer available and a new slot in a very busy dry-dock schedule will need to be re-negotiated. Alternative docking facilities [redacted] are being considered but the programme needs to be certain before any new slot can be agreed.

Impact Ship 802

The impact on Ship 802 programme is small although if the reduced manpower situation is not resolved quickly this may change. The LNG tank is installed (to programme) and fabrication is progressing well. The knock on effect of a delay to 801 will be an inevitable delay to 802 launch. There is not alongside berthing for 2 ships of this size at FMEL thus until 801 leaves (is handed over) 802 cannot be launched. A new date for 802 launch is thus dependent on the new programme for 801. Encouragingly the additional time on the slipway will allow further work to be undertaken and thus is unlikely to have any significant impact on the date 802 can be handed over.

Manpower

The lack of cash makes it essential to reduce the wage bill and with the reduction in work because of reducing material purchases there is less work to be done.. The immediate impact is on short term contractors and on the 21 December 65 personnel will not be re-employed. Another 50 are at risk. Once cash is available the re-employment of this number will be essential to maintain a re-baselined programme. Other work (not in Scotland) is known to be available for these skilled tradesmen and a consequence is that it not be straightforward to restore workforce numbers. Inevitably many of those leaving take with them familiarity and experience with this build that will be difficult to replicate (i.e. another learning curve will be necessary)

Risk Register

Following my previous advice the Risk Register has become a living document and whilst it remains “work in progress” it is emerging as a key management and planning tool. I expect revision of this set of risks as the new programme is constructed. I will review during my next visit.

Mitigation

LNG Commissioning and Subsequent Operation. I understand that, to achieve commissioning, LNG will be delivered by road tanker and piped onboard. Subsequent operation is also dependent on road tanker delivery however CALMAC do not expect to operate the ferries in dual fuel mode for at least 2 years because of infrastructure challenges. This raises the significant question of why it is essential to undertake the

LNG commissioning on 801 in 2019. With a 2 year delay on use this work is likely to have to be repeated and it may indeed be better to carry out first LNG commissioning on 802. It may be possible to save 4 weeks by this approach. If this is agreed it will need further work to quantify the time and cost implications. It could be reviewed at the same time as the overall programme (see above).

<u>CMAL Involvement</u>. The re-baselining of the programme and the development of the risk register presents an opportunity to change the relationship with CMAL by involving them in the programme and risk debate. If this is to work it must be as a willing partner rather than the adversarial situation that appears to exist currently. This would allow for some “give & take” which is essential during the commissioning phase.

<u>Ongoing Cash Situation</u>

The current loan facility only provides a facility until the end of March. In the original programme the milestone payment associated with handover of 801(June 19) would have mitigated any cash flow concerns. With, at least, a 3 month slip to this date it is difficult to see how this situation can be managed by FMEL alone. To avoid the current situation early consideration is required to examine options for managing the problem.

<u>Next Visit</u>

As stated above I would expect the revised programme to be ready for review mid to late January. This should be undertaken as a matter of urgency. Key aspects to consider will be:

- Robustness of the commissioning programme for 801
- Revised date for 802 launch and any impact on 802 handover date
- Examination and updating of the risk register

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