

Mary McAllan  
Directorate for Economic Development  
5 May 2017

Cabinet Secretary for Finance and the Constitution

## UPDATE ON DISCUSSIONS ON FMEL


### Purpose

1. To provide an update on the meetings you asked to take place yesterday.

### Priority

2. Urgent

### Background

3. Mr McColl expressed concern about the lack of a state sponsored bond scheme for non-defence shipbuilding and indeed manufacturing industries more generally, in Scotland and the UK. He cited various European examples in the ship building context, which he claimed made for an uneven playing field. He has raised with the UK in context of their Industrial Strategy and thought Scotland also needed its own scheme.
4. He was upbeat about the prospects for domestic shipbuilding refit and repair in Scotland but explained that the current ferry contract was having a significant adverse effect on company cash flow. He had now utilised to the full all of the collateral in the company to deal with the cash flow impact of staged payments and the performance bond.
5. 
6. He raised questions about the ability to revisit the payment terms to the contract given that in his understanding these were agreed post the initial procurement exercise. He was aware of the separate discussions also taking place yesterday between Transport Scotland, Fergusons and CMAL to look at the scope to stage payments differently releasing £14.55m subject to appropriate diligence to assist the cash flow

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situation. While this was helpful it would in his view be insufficient leaving a £10 million gap.

7. Transport Scotland have subsequently confirmed that an agreement in principle on rescheduling payments was reached separately yesterday (subject to checks that payments will be spent solely on salaries and equipment for the contract and that finance legal and procurement are content).
8. We agreed to look at two areas .
  - To explore Mr McColl's points on the procurement process and in particular the arrangements for agreeing the payment schedule and assurance bonds conditions underpinning the contract.
  - To look at different ways outside of the current contract to consider how we might work with Fergusons to address the cash flow gap of £10 million. And to respond to Mr McColl on both issues by close Monday 8 May

### **Conclusion**

9. We agreed the following actions. Only the last of these - i.e. arrangements for a future bond scheme - was covered in any detail with Mr McColl.
  - SE to consider models for lending and/or co-investment (e.g. short term equity stake in the yard) that could sit outside of the contract to provide £10m of additional working capital. Likely basis a 50:50 shared risk model.
  - TS to ensure they have tested the limits on payment profile in terms of timing of purchase/ownership of materials to accelerate cashflow to the earliest feasible point
  - TS to update legal advice to determine 1) whether the current legal advice might be reconsidered in (say) three months' time following further completion/risk reduction 2) what the legal tests would be that would allow Ministers to safely change the contracting basis if a 'walkaway' scenario emerged
  - SG to consider (over longer term) 1) restructuring basis on which retention and bond arrangements are established in vessel procurement 2) introducing an industrial guarantee regime (likely under the banner of the Scottish Growth Scheme).

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Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness

Permanent Secretary  
DG Economy  
DG Finance Mailbox  
Roy Brannen  
PS / Transport Scotland  
Director of Financial Management

**NOTE OF MEETING – 4 MAY 2017**

1. The purpose of the meeting was to continue previous discussions between CMAL and FMEL on how the contracted milestone payments might be accelerated to assist with FMEL's cashflow issues. This followed the telephone call between Mr Mackay and Mr McColl earlier in the week.
2. Meeting attendees were:
  - Tom Cousins, FMEL
  - Gerry Marshall, FMEL
  - Kevin Hobbs, CMAL
  - Gillian Bruton, CMAL
  - Jim Anderson, CMAL
  - John Nicholls, Transport Scotland.
3. FMEL/CBC restated their requirement for accelerated payment of the remaining contracted funds – i.e both the £14.55m offered by CMAL on Monday plus the £9.7m final retention payment. It was explained that this was not possible because of the procurement and delivery risks. FMEL/CBC indicated that, whilst the £14.55m would allow them to continue with construction of the vessels during 2017, the £9.7m funding gap would cause problems thereafter. FMEL were bidding for a number of other (non-SG) contracts which, if successful, could ease their cashflow issues but that could not be assumed.
4. It was noted that parallel discussions were taking place on possible alternative support which SG might offer, and it was agreed to focus on how the £14.55m might be accelerated. CMAL indicated that this would require transparency on equipment purchase, wage payments etc to ensure that the accelerated payments were being used appropriately. There had been previous discussions between CMAL and FMEL on this point, and CMAL indicated that they were broadly satisfied that accelerated payments could be properly accounted for but that they would need to complete that assessment in the light of further papers submitted to them by FMEL in advance of the meeting.
5. In conclusion, CMAL undertook to complete their assessment of the position and submit a paper to SG for consideration by close today (Friday 5 May). It was noted that SG procurement, legal and finance colleagues would need to consider this before any offer to FMEL could be made. FMEL indicated that they would require some of the £14.55m to be advanced soon [Jim McColl's letter of Monday indicated that they would need something by the end of this week], and that the total £14.55 would be needed by the end of June. CMAL/TS indicated that this issue was a priority for Ministers, but did not commit to a particular timescale.

**John Nicholls, Transport Scotland** [REDACTED]