From: [Redacted]
Sent: 08 October 2015 18:24
To: Minister for Transport and Islands <transportminister@gov.scot>
Cc: Cabinet Secretary for Infrastructure, Investment and Cities <CSIIC@gov.scot>; DG Enterprise, Environment & Innovation <DGEEI@gov.scot>; PS/Transport Scotland <chiefexecutive@transportscotland.gsi.gov.uk>; Middleton DF (David) [Redacted]; Transport Scotland Directors <DL_ECON_P_TSD@gov.scot>; Fairweather S (Sharon) [Redacted]@gov.scot>; [Redacted]@gov.scot; [Redacted]@gov.scot; [Redacted]@transportscotland.gsi.gov.uk>; [Redacted]@transportscotland.gsi.gov.uk>; [Redacted]@gov.scot>; [Redacted]@transportscotland.gsi.gov.uk>; [Redacted]@transportscotland.gsi.gov.uk>; Press Transport Scotland <Press_Transport_Scotland@gov.scot>; [Redacted]@transportscotland.gsi.gov.uk>; [Redacted]@transportscotland.gsi.gov.uk>; [Redacted]@transportscotland.gsi.gov.uk>; Anderson A (Alexander) [Redacted]@gov.scot>; [Redacted]@transportscotland.gsi.gov.uk>
Subject: CMAL contract award to Ferguson shipyard - request for Ministerial approval

[Redacted]

(sent on behalf of [Redacted]– and apologies for the late delivery)

This email seeks the Minister's agreement for CMAL to proceed to contract award with FMEL in respect of the two 100m vessels.

DFM approved the financial implications of the contract award prior to the announcement by FM on 31 August that FMEL were "preferred bidder".

CMAL have concluded contract negotiations with FMEL, having secured some improvements in the terms of the refund guarantees to be provided by the shipyard. CMAL's assessment is that this is the best deal that can be negotiated given FMEL's financing structure. However, it is clear that the Board of CMAL are still concerned at the risks this contract basis presents in placing orders at FMEL without the full refund guarantees in place that were specified in the original tender documents. They are concerned in respect of the position this could leave the company if the ship failed to perform or the shipyard went into liquidation.

We have been in discussion with CMAL on how best to address those concerns. Following that further engagement, I enclose the following for the Minister's consideration:

- A note from CMAL setting out details of the contract award and the associated risks (**ANNEX A**). Linked to that I also attach Erik Ostergaard's e-mail of 26 September referred to in that note (**ANNEX B**). Erik's note was drafted prior to the latest round of negotiations between CMAL and FMEL.

In response to those concerns I attach for the Minister's consideration two draft pieces of correspondence from Transport Scotland:

- Firstly, a draft voted loan letter from Transport Scotland setting out our agreement to fund the two new 100m vessels to be built at FMEL (**ANNEX C**); and

- Secondly, a draft letter from John Nicholls to CMAL Chair, Erik Ostergaard (**ANNEX D**).

The "voted loan letter" is an enhanced version of our standard voted loan letter giving greater assurance to CMAL that Scottish Ministers:

  - have been sighted on the CMAL note (referenced above)
  - are aware of the potential risks associated with this contract; and
  - are content to give approval to CMAL to proceed.

The other letter provides more general assurance to the CMAL Chair and Board of Scottish Ministers', and Transport Scotland's, commitment to CMAL in respect of the contract for the construction of the two new 100m vessels. SGLD and SG Finance have been consulted on this letter and are content.

In addition to the financial risks, absence of a full refund guarantee in the final contract could represent a considerable departure from the advertised contract terms and may raise significant procurement risks. Procurement risk can rarely be removed entirely in complex contracts and CMAL have addressed this, taking their own legal advice, and in particular by agreeing contractual terms with FMEL which are broadly comparable with the tender specification.

The impact of a successful legal challenge could be high – in the worst case the contract could be declared ineffective – and a challenge could be brought at any time as the contract terms are not being made public. The risk of a challenge materialising depends on the likelihood of any of the 5 other shipyards receiving confidential information and on the appetite of those competitors for a challenge. That is difficult to assess with confidence however there are some pointers:

- a challenge during the Alcatel period in September did not arise despite more than one of the yards reportedly being "unhappy";

- one of the yards (Remontowa) is likely to be well versed in procurement law and the avenues for challenge open to unsuccessful bidders;

- there was no challenge to the award of the third hybrid contract to FMEL last year, against the expectation of many of those involved, and despite the legality of this being openly questioned in the media.

In the case of a challenge, CMAL would robustly defend their position on the basis of the legal advice they have received and the steps they have taken to bring the final contract clauses into broad comparability with the tender specification.

More generally, and in discussions between Transport Scotland officials and CMAL Senior Executives on Tuesday 29 September and on Friday 2 October, the CMAL Senior Executives made clear that CMAL would likely be facing similar problems no matter who the preferred tenderer was. Their Senior Executives also made the point that despite receiving stronger financial assurances in previous shipbuilding contracts they still subsequently faced problems, and in once instance significant challenges, during the respective construction phase.

We would welcome the Minister's confirmation that he has/ is:

- considered the CMAL note,
- aware of the potential procurement and financial risks associated with this contract;
- content with both the “voted loan letter” and the letter from John Nicholls to Erik Ostergaard; and
- content to give approval to CMAL to proceed.

If the Minister wanted to speak to a representative of the CMAL Board to offer his further confirmation of the above then that could be arranged.

Thanks

[Redacted]

ANNEX A - note from CMAL setting out details of the contract award and the associated risks

Contract award to FMEL and the associated risks.

Ferguson Marine Engineering Limited (FMEL) became the preferred tenderer to build the new vessels following a restricted procedure procurement exercise. Tenders were received on 31st March from 6 yards in total (Turkey, Germany, Poland, England & Scotland). The bids were evaluated on price (50%) and quality (50%).

The FMEL cost for each vessel was £50,247,500.00, later reduced to £48,500,000.00, after post tender negotiations, and is to be paid over 15 milestones or staged payments reflecting somewhat the outlays the shipyard will have to make to suppliers, staff and overheads.

The shipbuilding contract is an amended BIMCO standard newbuilding contract and the area of greatest debate regarding this contract has been the Builder’s Refund Guarantee.

The Builder’s Refund Guarantee requires the builder to put in place a guarantee, with a bank, to refund the staged payments to the buyer should the shipyard fail or the vessel’s performance falls below set standards. A call on the guarantee is at the buyer’s discretion and cannot be blocked by the shipyard. Normally as each stage payment is made a new guarantee is issued to cover the cost of the payment.

These refund guarantees are expensive to put in place and ultimately are paid for by the buyer through the contract price. The banks will not only require a large payment to issue the refund they will require a charge over the shipyard’s assets which will be a multiple of the guarantee value. This is sometimes done through the shipyard mortgaging the vessel as it is being constructed.

This procedure protects the buyers outlays to a high level, in theory losses should be restricted to time and project costs.

An alternative way the buyer can protect their payments is not to make any, or make minimal payments, until the vessel is ready for delivery. Obviously only shipyards with sufficient capital to purchase equipment and pay their staff will be in a position to do this.

The tender documents, which were sent to the shipyards, included a draft of the shipbuilding contract which included a draft of the refund guarantee. The shipyards were invited to comment on the terms of the contract, some did and some didn’t, FMEL did not. There could have been an assumption that no comment meant that the draft contract was acceptable in all areas but I doubt this would have been the reality

We are aware of a risk of procurement challenge on the basis that the contract to be awarded does not resemble the contract which was tendered. The lack of a refund guarantee for the full value has been commercially mitigated by various protections that we have negotiated as described later in this note, but a disappointed competing bidder could argue that in accepting a lesser refund amount from a financial institution the cost saving of this to FMEL makes it no longer a level playing field. The problems that can arise with the cost and the charge over the shipyard’s assets for a guarantee to be put in place can be demonstrated with the Finlaggan’s construction where the shipyard did not claim for a substantial payment, that was due from CMAL, to avoid setting up a guarantee. Another example is the Loch Seaforth Construction where the vessel under construction was mortgaged to the bank issuing the refund guarantee, the ship’s construction was late, the refund guarantee was expiring, the mortgage was expiring and there was no money left to finish the ship and the shipyard very nearly went into liquidation.

We have come a long way with in our discussions with FMEL and the issue of a refund guarantee. Initially there was to be no guarantee, the first stage payment on contract order

(5% of contract price) was to be deferred to delivery and the delivery payment was to be 0.5% of the contract price. This was a theoretical worst case risk of £47.5Mper ship

The current situation is that a full guarantee for all payments is not being offered, due to the structure of the financing, but a part guarantee will be put in place before first payment is made of 25% of the contract price and that the final payment will be 25% of the contract price, a theoretical maximum risk of £24,250,000.00 per ship. Also due to the structure of the financing the guarantees expire at the end of 2018 rather than the standard 300 days or after any contractual dispute has been resolved. There is a provision in the shipbuilding contract for these to be renewed, if the vessels have not, or will not be delivered prior to the end of 2018 though these guarantees are normally issued independently of the contract.

A parent company guarantee has not been made available

In addition CMAL will have title to all of the part finished vessel as it is being constructed. This protects CMAL from insolvency but not from the risk of lateness or performance (though this is thought to be low). I

t is felt that the current deal, that has been negotiated with FMEL, is the best deal that can be achieved, given the financing restrictions the yard is operating under, as explained to us by Clyde Blowers Capital

This maximum risk occurs after the vessel is launched, the last but one payment is made and the shipyard goes into liquidation. This will be 9 months before scheduled delivery but I believe the part finished vessel will have a very real value at this stage that I have estimated at £22.5M. The vessel will be afloat, all the major equipment will be installed, or if not, at the shipyard, and CMAL will have title over it. I have estimated that at this stage the total cost to CMAL of taking over the part finished ship and having it completed and including the payments already made will be £60,625,000.00, this is reduced to £48,500,000.00 after receiving the guarantee payment.

A different risk occurs earlier in the project when the vessel has reached the 50% fabrication stage and there is little equipment in the yard to take title over. It probably would not be viable to finish the vessel due to the high cost of this and I have estimated this would be a loss to CMAL of £11,875,000.00.

In summary CMAL are theoretically at risk for 50% of the cost of the vessel but in practice this reduces to an estimate of 25%.

These figures and risks assume we have a cast iron guarantee in place and this is under preparation. The guarantee will be issued by two Investec Bank entities, one in England and the other in South Africa, who, it would seem, are closely associated with Clyde Blowers Capital.

The guarantee does not just protect the buyer from shipyard liquidation but also from lack of performance of the vessel e.g. if the vessel fails to meet its contract speed it can be rejected and a claim made on the guarantee. Without guarantees for all payments made there is a substantial risk.

A further risk reduction measure will be put in place in that FMEL will require major suppliers to provide refund guarantees for payments made. These refund guarantees will have CMAL as payee if the supplier entered into liquidation hence protecting these payments.

The main areas of technical risk are:-

The vessel is heavier than estimated and hence cannot carry the specified weight of cargo (deadweight). This risk is thought to be low as the weight, compared to other tenderers estimates, is similar and they have a good correlation with other existing vessels in the fleet. The shipyard has also included margins in their estimates as have CMAL in their requirements.

The vessel cannot meet its contract speed and hence cannot meet its timetable requirements. This is thought to be a very low risk, before finally selecting the main engine rating a model will be tested to ascertain the required power. The currently specified engine can meet the speed at 65% of rated power and this is with a 17% margin.

There are various other areas of risk including passenger, car and freight numbers, ability to carry dangerous goods, meeting stability requirements etc. These requirements are all included in the technical specifications and in the shipbuilding contract and will have to be managed by CMAL and FMEL design and supervision staff.

In general it is thought that the vessels' failing technically to perform as require is unlikely and if it was to occur would have a medium to low impact on the routes they are to serve (the vessels as specified have a greater capacity in practically all respects than the vessels currently operating on the routes).The Board of CMAL are very concerned at the risks this contract basis presents in placing orders at FMEL without full refund guarantees in place and the position this could leave the company in if the ship failed to perform or the shipyard went into liquidation. It would be unlikely to be able to repay the loans, and the interest on the loans, it had taken out to pay the shipyard. Under normal circumstances it is probably unlikely that a company of the size of CMAL would take on this risk.

The Board would wish the Minister to be appraised of these risks and to acknowledge to the Board that he fully understood the potential risk of assigning a contract to FMEL under these circumstances. The Board feel it is their absolute duty to point out the risks to their shareholder and in that respect would expect approval, should SG wish this project to proceed, and to receive direction to that effect.

For clarification the stage payment refund guarantees are to cover for three possible eventualities.

1. The vessels are late being delivered and the buyer wishes to cancel the contract and have their payments refunded.

   This is always a possibility but unless it became ridiculous would CMAL wish to do this? Procedures will be in place to allow monitoring of progress against plan from an early stage. Liquidated damages are payable for late delivery.

2. The vessels fail to perform and the buyer wishes to cancel the contract and have their payments refunded.

   Again this is a possibility but there are built in margins for speed and deadweight. There will be model tests undertaken at a very early stage, it will be a requirement that early submissions are made to MCA regarding stability, carriage of dangerous goods and passenger evacuation. The FMEL tender submission on these areas shows a good correlation with other tenderers' submissions and the existing vessels. Liquidated damages are payable for lack of performance.

3. The shipyard is declared bankrupt and the buyer wishes to have their payments refunded.

   Stage payments are being made to the shipyard for the purchase of items of equipment that should ensure they do not have cash flow problems. CMAL will have title over equipment delivered into the shipyard thus protecting it from a liquidator. Down payments on major items of equipment will have refund guarantees in place with CMAL as payee. If cash flow problems should occur in the latter stages of construction CMAL will have title to the part completed vessel and all items delivered into the yard. 25% of the cost of the vessel is not payable until the vessels are successfully delivered.

Please also reference Erik Ostergaard's email of 26th September sent at 14.41

Please also note all the figures mentioned are for one vessel and should be increased two fold for both vessels.

ANNEX B - Erik Ostergaard's e-mail of 26 September referred to in that note

From: Erik Østergaard [Redacted]
Sent: 26 September 2015 14:42
To: Tom Docherty; [Redacted] [Redacted]; John Nicholls; [Redacted]
Subject: SV: Follow up to this morning

Tom,
Thanks for the note.

Reading it it seems to me that FMEL don't get the point. Where we are at present is not a matter of "words to overcome the drop dead feature". The issue is that the level of refund guarantee is not sufficient. At present, the bulk of the possible engagement with a newly established shipyard with no track record at all of building ferries of this size, is an unsecured risk of (100% less guarantee of 25% less final payment of 15%) equal to about £ 60 million which is totally off the track of what is normal practice for the shipping industry in respect of contracting for newbuildings - i.e. https://www.bimco.org/~/media/Chartering/Document_Samples/Sundry_Other_Forms/Sample_Copy_NEWBUILDCON.ashx and especially clauses 14(b), 15 and Annexes A. There is no way that the board can recommend the SG through CMAL to take this level of unsecured risk on its shoulders.

If FMEL don't get back with substantially improved conditions in this respect the board of CMAL have no other option than once again reject the deal. This will imply

a) Shelving the project until further
b) Re-opening the contract negotiations with Remontowa (with whom we have a track record of doing business) or even a second yard in parallel while continuing negotiations with FMEL

You will recall that we had a meeting with our Minister at the time, Mr. Keith Brown, on the 5th. of August 2014 in respect of the delays of the Loch Seaforth where the Minister highlighted our obligations - also in respect of future newbuilding contracts - to thoroughly exercise due diligence to safeguard part that future vessels were delivered on time, on spec and at the stipulated costs and with proper penalties and guarantees. [Redacted]

Unless of course, that SG have substantially changed their view in this respect and can accept this level of unsecured risk (which we would need to have confirmed in writing) the message to FMEL on Monday is not doing legal word exercises on the wording on the 25% guarantee but to come back with something that meets our original requirements i.e. a refund guarantee that safeguards all our installments should the yard fail to deliver (on time and spec). In my opinion the best option would be to bin the present result and start from scratch on the basis of our initial requirements based on the Bimco terms.

You are welcome to convey this message to FMEL and their lawyers on Monday. If the message fails to penetrate I would be happy to speak to the relevant representative to make sure the message gets through.
Best regards
Erik

-----Oprindelig meddelelse-----
Fra: Tom Docherty [Redacted]
Sendt: 25. september 2015 18:38
Til: Erik Østergaard; [Redacted] [Redacted] John Nicholls; [Redacted]
Emne: Follow up to this morning

After a fairly brisk afternoon of calls from [Redacted] and [Redacted] of Clyde blowers and the respective lawyers on why the current proposals on refund guarantee have been rejected by the Board, we have all agreed to meet face to face on Monday at Brodie's office in Glasgow to further discussions.

[Redacted] has reiterated that there are no more funds available to improve on the quantum of the guarantee but she is confidant words can be found to overcome the drop dead feature of the current offer come 31/12/18.

Not discussed this afternoon as an issue but we will also need to clear up the arrangements being offered by Investec bank as following further scrutiny this afternoon it still seems to be a combination of UK and South African branches that we have to deal with. We clearly do not wish to deal with two banks- we need a lead facility through preferably Investec UK. What happens after that must be down to them.

We'll update you after the meeting on Monday and [Redacted] will provide a risk matrix of whatever we end up with.

Regards
Tom

ANNEX C - draft voted loan letter from Transport Scotland setting out our agreement to fund the two new 100m vessels to be built at FMEL

Ferries Unit

Aviation, Maritime, Freight & Canals

Victoria Quay, Edinburgh EH6 6QQ

T: [Redacted]

[Redacted]

Your ref:

Our ref:

Tom Docherty

Chief Executive

Caledonian Maritime Assets Ltd

Municipal Buildings

Fore Street

Port Glasgow

Inverclyde

PA14 5EQ

Date: October 2015

Dear Tom

VOTED LOAN - PROCUREMENT OF TWO 100M VESSELS

I refer to [Redacted] email of 8 September 2015 requesting loan funding for the construction of two 100m vessels, his email of 30 September 2015 setting out the agreed funding profile and [Redacted] paper entitled “Contract award to FMEL and the associated risks” emailed to Transport Scotland, and the CMAL Board, on 30 September 2015.

The Scottish Ministers have seen this paper and have noted the risks identified by CMAL. **I confirm that following due consideration, the Scottish Ministers have approved the award of this contract by Caledonian Maritime Assets Limited (CMAL) to Ferguson Marine Engineering Ltd (FMEL)**.

The Scottish Ministers are empowered by the Transport (Scotland) Act 2001 to award advances by way of voted loans to CMAL for the purpose of improving sea transport. I can confirm that the Scottish Ministers are willing to offer the company a voted loan towards the construction of two 100m vessels. Payment of the loan will be phased over the construction period of four years. The loan draw-down profile for the vessels have been agreed as detailed in [Redacted] email of 30 September 2015. See Appendix A.

2015/16	£33.8m
2016/17	£34.150m
2017/18	£6.3m (This includes £1.5m for CMAL Project Management costs)
2018/19	£31.750m (This includes £7.5m for CMA Project Management costs)
Total -	£106m

The loan profile includes allowance for CMAL's project management costs up to a maximum of £9m. Included in these project management costs are CMAL direct costs, CalMac project and crew familiarisation costs, and variations to contracts. These costs are detailed in Norman Thomson's email of 30 September 2015 payable over the years of 2017/18 and 2018/19.

The main milestones of construction are indicated in the draw-down profile detailed in Appendix A with delivery of the two vessels due in April and June 2018 respectively. Any revisions to these timelines must be notified immediately supplying reasons why they are not achievable. In this event, revised timelines and associated payment and drawdown profiles should be submitted promptly.

Interest at Public Works Loan Board rates (25 year rate) will be charged on the outstanding loan and I shall inform you of the applicable interest rate as each loan tranche is drawn down. Following the final loan drawdown the instalments will be consolidated into a single term loan for the vessel. **Loan repayments will commence on the first scheduled repayment date after the date of entry into service of the vessels.** Interest accrued up until the first scheduled repayment date shall be added to the capital amount due.

The term loan plus accrued interest will be repayable over 25 years. The loan plus accrued interest will be repaid on an annuity basis in 50 instalments payable twice yearly together with applied interest on 31 March and 30 September. We shall send you a schedule detailing both principal and interest payments when the term loans are finalised.

We will phase the payments of these loans according to the agreed draw-down profile and the company must provide invoices submitted by the shipyard and endorsed by CMAL in support of any request for a loan draw down. Any increase in construction costs must be notified to Transport Scotland before any commitment is given by the company to incur additional costs.

CMAL shall keep the Scottish Ministers fully informed of the progress of the Project in the form of quarterly update reports to Transport Scotland. Details shall include actual progress to date of the project against the schedule, actual expenditure to date compared with profiled expenditure, and the reasons for any changes or delays. The format of these reports shall be agreed between CMAL and Transport Scotland within a month of this letter. The first report should be submitted 3 months after the dated of this letter. Budget monitoring of the quarterly construction and project management costs should be reported separately. Project management costs should be reported on a monthly basis.

CMAL shall maintain a “Vessel Procurement and Construction Risk Register” to set out and rate the risks and the mitigation strategy. A suggested format can be found in Appendix B. (this format is not prescriptive). The Register will be shared Transport Scotland on a quarterly basis along with the above reports.

The frequency of reports may be updated at any time by mutual agreement. CMAL must inform Transport Scotland of any proposals to sell, transfer or otherwise dispose of any rights as it may have in the vessel to any other person and shall not proceed with such proposal without prior consent from Transport Scotland.

I confirm that the Scottish Ministers have considered and approved the contents of this letter.

I would welcome confirmation from you, on behalf of the CMAL Board, that you are content to accept the offer of loan under the conditions set out above.

Yours sincerely,

[Redacted]

Head of Ferries Unit

APPENDIX A

25 year loan - Annuity repayments		PWLB Interest Rate 31 August 2015		3.19%				
First loan repayment date 30/09/2018					No days Interest accrual to 30/09/2018	Total interest charge	VL Drawdown Financial Year	Total
Stage	Date	Milestone	Amount	Cumulative				
1	30/09/2015	On order	4,800,000	4,800,000	1096	459,779.51		
2	30/10/2015	Procurement deposits long lead time (1)	24,200,000	29,000,000	1066	2,254,604.60		
3	30/11/2015	Cutting of steel	2,800,000	31,800,000	1035	253,277.26		
4	31/12/2015	Procurement deposits long lead time (2)	2,000,000	33,800,000	1004	175,493.70	**2015/16**	33,800,000
5	04/04/2016	10% Fabrication	4,800,000	38,600,000	909	381,331.73		
6	31/05/2016	25% Fabrication	7,300,000	45,900,000	852	543,576.00		
7	30/07/2016	35% Fabrication	7,300,000	53,200,000	792	505,296.00		
8	30/09/2016	50% Fabrication	4,800,000	58,000,000	730	306,240.00		
9	31/10/2016	Major equioment & lock out items install	2,750,000	60,750,000	699	167,999.38		
10	30/11/2016	75% Fabrication	2,400,000	63,150,000	669	140,325.04		
11	30/12/2016	100% Fabrication	2,400,000	65,550,000	639	134,032.44		
12	28/02/2017	berth join up	2,400,000	67,950,000	579	121,447.23	**2016/17**	34,150,000
13	03/04/2017	Hull inspection prior to paint	2,400,000	70,350,000	545	114,315.62		4,800,000
14	31/07/2017	Launch 801	1,200,000	71,550,000	426	44,677.48		1,500,000
16	29/09/2017	Launch second vessel 802	1,200,000	72,750,000	366	38,384.88	**2017/18**	6,300,000
15	28/04/2018	delivery 801	12,125,000	84,875,000	155	164,252.23		24,250,000
17	30/06/2018	delivery second vessel 802	12,125,000	97,000,000	92	97,491.64		7,500,000
			97,000,000			5,902,524.73	**2018/19**	31,750,000
		CMAL costs vessel 1	5,000,000					
		CMAL costs vessel 2	4,000,000					
			9,000,000					
18	31/03/2018	drawdowr 1	1,500,000	98,500,000	183	23,990.55		
19	30/06/2018	drawdowr 2	7,500,000	106,000,000	92	60,304.11		
			9,000,000					
	Total Project Costs		106,000,000			5,902,524.73		106,000,000
	Gross interest accrual		5,902,525					
	Total repayable from 30 September 2018		111,902,525					

Appendix B

Risk No.	Risk Type				Risk Description	Risk Owner	Mitigating Controls	Mitigation Control Owners	Further Actions	Further Action Owners	Target Date
	Inherent, Residual	Risk Likelihood 1 - 5	Risk Impact 1 - 5	Risk H / M / L							
				Red Amber Green							
				Red Amber Green							
				Red Amber Green							

ANNEX D - draft letter from John Nicholls to CMAL Chair, Erik Ostergaard.

Aviation, Maritime, Freight & Canals

Victoria Quay, Edinburgh EH6 6QQ

T: [Redacted]

John.Nicholls@scotland.gsi.gov.uk

Erik Østergaard
Chair
Caledonian Maritime Assets Limited
Municipal Buildings
Fore Street
Port Glasgow
PA14 5EQ

Your ref:

Our ref:

Date:

<u>Contracts for the construction of two 100m dual fuel passenger ferries</u>

1. Following a Caledonian Maritime Assets Limited (CMAL) Board Meeting dated 25 September 2015 I understand that a number of concerns and reservations have been expressed by the Board members in connection with the proposed award of contracts to Ferguson Marine Engineering Limited (FMEL) for the construction and delivery of two 100m dual fuel passenger ferries (the Vessels) with a proposed contract price of £48,500,000 per vessel (the Contracts).

2. I have seen [Redacted] paper entitled “Contract award to FMEL and the associated risks” emailed to Transport Scotland, and the CMAL Board, on [6 October 2015]. The Scottish Ministers have also seen and understood that paper and have noted and accepted the various technical and commercial risks identified and assessed by CMAL and have indicated that they are content for CMAL to proceed with the award of the Contracts.

3. I note that the commercial risks set out in [Redacted] paper arise largely because the guarantees that are to be available under the Contracts are materially different in the protections offered and in their value as compared to

those sought by CMAL and offered by FMEL in the tender process in anticipation of the Contracts. I further note that these terms were arrived at after prolonged discussion and negotiations between CMAL and FMEL and their respective advisors and that these were substantively improved following the discussion I had with the CMAL Board on 25 September.

4. I note that CMAL has sought and carefully considered specialist legal advice in relation to the risks that have been identified. I further note the assessment of the likelihood of these risks arising set out in [Redacted] paper.

5. CMAL have sought confirmation from the Scottish Ministers on how the risks arising as a consequence of the award of the Contracts to FMEL will be managed.

6. In their capacity as CMAL's sole shareholder, pursuant to and in accordance with the "Management Statement / Financial Memorandum for Caledonian Maritime Assets Limited – May 2015", the Scottish Ministers hereby approve the award of the Contracts to FMEL. The Scottish Ministers, both in their capacity as CMAL's sole shareholder and more generally, also confirm that CMAL is authorised to enter into the Contracts and any associated documentation.

7. The Scottish Ministers have committed to providing loan funding to the value of £106m. This is set out in the Voted Loan letter from [Redacted] to Tom Docherty dated [6 October 2015 (attached)] which clarifies that "loan repayments will commence on the first scheduled repayment date after the date of entry into service of the vessels". Therefore, if any of the identified risks materialises prior to delivery of the vessels, CMAL will not be required to repay any loan drawn down unless or until the position is resolved to allow the vessels to be completed.

8. I note that the provisions of the Voted Loan letter do not, in themselves, mitigate the risks around in-built performance deficiencies. This particular risk can be most effectively mitigated through the robust project management arrangements that CMAL will put in place.

9. If any of the identified risks arise and, despite the best endeavours of CMAL to mitigate and manage their consequences, additional costs are incurred by CMAL then the Scottish Ministers will look favourably on requests by CMAL for additional resources. I note in this context that the Scottish Ministers intend for CMAL to receive sufficient funding for the company to continue to operate in accordance with its statutory obligations and contractual requirements and to deliver the tasks entrusted to it by the Scottish Ministers through the Management Statement / Financial Memorandum. Funds will be provided as they are required in order for CMAL to meet its debts as they fall due and maintain the company as a going concern.

10. I confirm that the Scottish Ministers have considered and approved the contents of this letter.

11. I would welcome confirmation from you, on behalf of the CMAL Board, that you are content with the assurances from the Scottish Ministers provided above.

John Nicholls

Director