



The Auditor General for Scotland's Section 23 report "New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802"

RESPONSE ON BEHALF OF CMAL TO THE PUBLIC AUDIT COMMITTEE

i) Introduction

In light of the Committee's recent discussions and investigations following the Audit Scotland report '*New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802*', published on 23 March 2022 (the "**Report**") CMAL sets out here some additional information and with supporting appendices that the Committee may find to be informative.

These relate to items raised by the Report and by the Committee during their hearings of evidence including:

- general remarks on the Report
- the procurement and operation of the contracts each dated 16 October 2015 (the "**Contracts**") for construction of hulls 801 and 802 (the "**Vessels**")
- the requirement for Ferguson Marine Engineering Limited ("**FMEL**") to provide refund guarantees in security for their due performance of the Contracts
- the decisions taken, and reassurances given, at the time of contract award
- the payment structure of the Contracts
- the planned fabrication sequence of the Vessels
- the claim made against CMAL by FMEL
- alternative dispute resolution attempts made by the parties, and
- the steps taken by CMAL in response to the Audit Scotland recommendations.

Specifically, it is intended to provide a summary of essential background to the procurement of the Vessels and explanation to what followed.

It is presumed for the purpose of this submission that the Committee will have access to and an awareness of the relevant information already released to the public domain by the Scottish Government in December 2019.¹

¹ <https://www.gov.scot/collections/ferguson-marine-documents/>

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1. General Remarks

- 1.1. CMAL broadly agrees with the findings of the Report and believes that the Report accurately records the key issues in all material respects.
- 1.2. CMAL consider that the primary cause of the Vessels' delay and associated cost over-run is a catastrophic contractor failure between October 2015 and August 2019.
- 1.3. While there are risk mitigation and documentary precautions that a buyer can take when ordering a newbuild vessel, the responsibility to design and build that vessel lies wholly with the builder.
- 1.4. In 2015, with the assistance of a third party specialist, FMEL submitted a strong tender response to CMAL in their bid for the award of the Contracts.
- 1.5. Between 2015 and 2019 CMAL, Transport Scotland, the Scottish Ministers and others involved provided FMEL with timely payment of the contract price then payable, additional financial support and various technical support and resources to enable the yard to advance the building of the Vessels. In the event, FMEL was unable to fulfil the Contracts, leading to the ultimate Administration of the business. As is well known, the Vessels remain undelivered.
- 1.6. CMAL considered that the financial guarantees proposed by FMEL for mitigation of the financial risk of non-delivery of the Vessels fell short of market standard. CMAL made all relevant stakeholders expressly aware of this in advance of the contract award and sought written authorisation from Scottish Ministers, as sole shareholder of CMAL, to proceed.

2. The BIMCO "NEWBUILDCON" and the Invitation to Tender

- 2.1. A timeline of the procurement process is at [Appendix 1](#).
- 2.2. The Vessels were procured on a standard and internationally recognised BIMCO New Build Contract known as "NEWBUILDCON", of which the key provisions – such as the guarantees typically required – are further described in [Appendix 2](#).
- 2.3. Use of the BIMCO template contract was specified in the Invitation to Tender ("ITT") and a lightly modified draft was supplied to each of the bidders.
- 2.4. The outline of the Buyer's proposal for the type and design of the Vessels, as contained in the ITT, was a Calmac Ferries Limited ship specification entitled "Specification of Operational and Technical Requirements" for the project then known as 'Super ECO 1000 Ro Pax Ferry'. This document is commonly referred to as the Statement of Requirements ("**SoR**"). It was an express requirement of the SoR that the vessels would be dual-fuel LNG.
- 2.5. In their detailed quality submission forming part of their tender bid, FMEL made clear that they understood what their responsibilities were under the fixed price BIMCO contract in the overview received with the Specification:

"Following a successful tender and contract award this Specification, Classification and other Approved Design Documents, Makers and Buyers information will be fully developed by the Builder into a full set of detailed design and production data, drawings and documents

taking into consideration Buyer's comments and preferences as well as all Classification, Flag State, Makers and other regulations and requirements... ..It is understood that anything not mentioned in this specification, but required by the regulations will be supplied and installed by the Builder, at the Builders expense." (our emphasis)

- 2.6. The ITT required bidders to make known any exceptions or qualifications to the proposed shipbuilding contract. In their tender bid, FMEL proposed no changes or amendments to the BIMCO contract.
- 2.7. While the former management of FMEL continues to insist that the issues with the Vessels arose variously from the Tender Specification being under developed and/or 'changes to design' made by CMAL during the build phase –FMEL made no comment or complaint about the Specification (including the critical deliverables of the speed, deadweight and draught) at the ITT stage.
- 2.8. FMEL were fully aware of the Specification requirements at the signing of the Contracts, and had expert legal representation at the time of negotiating. Thereafter, the parties are bound to the obligations of the Contracts, obligations which FMEL failed to meet and seemingly failed to understand.

3. Provision of Refund Guarantees

- 3.1. In their tender bid, FMEL made no objection to the requirement of the draft contract included in the ITT that the builder must provide full coverage refund guarantees for the value of pre-delivery instalments to be made by CMAL as buyer.
- 3.2. The other bidders, in their tender submissions (as was expressly permitted, using a form referred to as Document 16) made comments and proposed changes to the draft contract contained in the ITT. In their Document 16 submission, FMEL wrote: "*Ferguson Marine Engineering has no comment to make on the BIMCO New Build Contract at this time*".
- 3.3. Specifically, the draft contract within the ITT required the provision of refund guarantees on behalf of the Builder by "*a first class international bank*"². The FMEL bid was unqualified in this respect and no indication was given that this conventional form of security was unavailable.
- 3.4. In evidence to the Committee, one witness spoke of the difficulty of providing "cash refund guarantees"³, namely that the shipyard was required to fund with cash collateral the value of the instalments of the price to be paid. The BIMCO template contract, and the ITT, required in the normal way a financial instrument – a guarantee or bond of some kind – not a cash deposit of any kind. There is no evidence to support what was said in this respect.
- 3.5. In addition, that witness explained that, anticipating difficulties in the provision of the appropriate financial security – which suggests that FMEL understood the requirements of the ITT – FMEL took an email from Derek Mackay MSP to Stuart McMillan MSP

² at Part II, clause 14(b), line 241

³ Official Report, 16 June 2022, at columns 5 and 16

(believed to be on or around 2 February 2015) as a "green light"⁴ that refund guarantees would not be required and alternatives might be accommodated.

- 3.6. CMAL had no awareness of, or involvement in, these exchanges. To have done so would have been entirely inappropriate in the context of a live procurement exercise. In the event, FMEL nonetheless submitted an unqualified bid rather than offering any such alternatives in their Document 16 proposal.
- 3.7. Further, upon questioning by the Committee, this witness contended that the fact that no full-coverage refund guarantees could be provided was acknowledged and *agreed by CMAL prior to the announcement of FMEL as the preferred bidder by the First Minister on 31 August 2015*. This is simply untrue and, as noted by the Convener, bears no comparison to the extensive contemporary documentation from this time.
- 3.8. Solicitors for CMAL wrote to the solicitors for FMEL on 27 August 2015 as follows: "*I am requested specifically to ask why FMEL has not offered independent refund guarantees, standing the requirements of the BIMCO proforma in the ITT*". The CMAL board minutes of 25 August 2015⁵ and 25 September 2015⁶ show that this issue was still live and unresolved at that time.
- 3.9. The absence of full-coverage refund guarantees was the major commercial difficulty that CMAL had with the contract award, as Erik Østergaard's subsequent email to Transport Scotland dated 26 September 2015⁷ makes very clear.

4. Announcement of Preferred Bidder

- 4.1. Following receipt of the bids from the various shipyards, CMAL engaged a consultancy known as OSD-IMT to support their evaluation of the tenders. This evaluation was conducted 'blind' to the identity of the yards concerned.
- 4.2. The anonymised results of the tender evaluation were made available to CMAL Board on 10 August 2015. At this stage, as discussed above, FMEL had not indicated that refund guarantees would not be available. Had FMEL done so at the time of presenting their bid, that would have materially affected their scoring in the evaluation or led to the rejection of their tender as non-compliant.
- 4.3. During the period 10 August to 31 August 2015, CMAL continued to discuss technical and commercial elements with FMEL and to discuss with Transport Scotland the financial aspects for the voted loan that would be used to purchase of the Vessels.
- 4.4. While it was recognised by CMAL that due to their relatively recent establishment FMEL may independently have had difficulty providing suitable counter-security to a provider of the guarantees, it was expected that the ultimate parent entity of FMEL (Clyde Blowers Capital, "**CBC**") would provide appropriate support to meet the requirements of the ITT on behalf of their subsidiary.
- 4.5. FMEL made clear, through their lawyers on 21 August 2015, that CBC could not provide a guarantee and instead offered a guarantee from its immediate holding company

⁴ Official Report, 16 June 2022, at columns 5 and 16

⁵ Appendix 5

⁶ Appendix 7

Ferguson Marine Engineering (Holdings) Limited. CMAL requested that FMEL should obtain guarantees from a third party financial institution such as a bank.

- 4.6. This was of significant concern to the CMAL Board of Directors. The CMAL Board met on 25 August 2015, with Transport Scotland in attendance and discussed the risk of insufficient financial guarantees offered by FMEL. The minutes show: "*The Chair requested that TS provide CMAL with a letter of comfort if required. JN agreed that a letter of comfort would be provided to CMAL.*"⁸
- 4.7. CMAL were informed by Transport Scotland on 21 August 2015 that the public announcement of FMEL as the preferred bidder would take place on 31 August 2015.
- 4.8. The CMAL Board members were concerned that an announcement of the preferred bidder on that date, amid significant publicity at the Ferguson's yard, would materially reduce their negotiating hand and at a time when negotiations were far from concluded.
- 4.9. Further, CMAL was also concerned about potential challenge under the procurement rules. The 'standstill period' had by 31 August 2015 not yet expired.
- 4.10. CMAL were obligated to contract with the preferred bidder substantially on the basis of the published tender requirements. If CMAL and FMEL were unable to reach agreement of technical or commercial details consistent with the tendered requirements, the contracts could ultimately have required to be awarded elsewhere. For this reason, reaching preferred bidder status may often be treated more discreetly and without fanfare.
- 4.11. CMAL made Transport Scotland aware of these concerns, including at the CMAL Board meeting held at Victoria Quay on 25 August 2015. None of the non-executive CMAL Board members attended the public announcement of the preferred bidder on 31 August 2015. The CMAL Board had not taken the decision to award the Contracts to FMEL at that stage.

5. Payment profile

- 5.1. As the attached timeline⁹ shows, following the announcement of FMEL as preferred bidder, there were seven iterations of the draft milestone and payments schedule negotiated between the parties.
- 5.2. This was unusually protracted but is a normal discussion between parties at this stage, prior to contract award. This dialogue provides both builder and buyer with an understanding and opportunity to discuss when funds will be required during the construction phase and allows both project management and cash-flow management accordingly.
- 5.3. The number of milestone events proposed by FMEL was more than typically seen, with fifteen in total as opposed to the five or six conventionally agreed. CMAL attributed this relatively unusual feature of the payment profile to the yard's need for more frequent injections of funding, as a relatively newly established business without a track record of credit from major suppliers.

⁸ Appendix 5

⁹ Appendix 1

- 5.4. The first version of the milestone and payments schedule, referred to by FMEL at that time as a 'Proposed Billings' was dated 21 August 2015¹⁰. This shows a final payment to the shipyard, upon delivery of the Vessel, of only £247,500 representing 0.494% of the purchase price. That is very unusual, and was not acceptable to CMAL because typically the buyer seeks to incentivise the builder to complete the project with a final instalment as large as possible.
- 5.5. On 28 August 2015, FMEL proposed an increase of the delivery instalment to 15% of the purchase price. The final version of the milestone and payments schedule, as eventually agreed, is shown at Appendix 4 of the Report and shows a 25% payment due upon completion and successful delivery of each Vessel.
- 5.6. As described in the Report, the payment profile of the Contracts was later amended in 2017, as discussed further below.

6. The award of the Contracts

- 6.1. CMAL maintained that there were significant concerns around the award of the contract to FMEL, in particular regarding the absence of a market standard builder's refund guarantee. It was clear to the CMAL Board that Transport Scotland and the Ministers wished the award of the Contracts to be made to FMEL and for the Vessels to be built in Scotland.
- 6.2. Negotiations between CMAL and FMEL continued, in correspondence and in meetings, with successive drafts of the proposed contracts and billings schedules prepared and discussed between the parties and their lawyers, as shown in the timeline at [Appendix 1](#).
- 6.3. The CMAL Board met on 25 September 2015 and the minutes¹¹ show "*TD [Tom Docherty, then CMAL Chief Executive] advised it was made clear by the FMEL lawyer that no other funds were available to offer any increase to the refund guarantee*".
- 6.4. These minutes also show that the CMAL Board took the view that there were "*too many risks involved around the refund guarantee matter which are still to be resolved and to that end the Board are not in a position to award the contract to FMEL at this stage*".
- 6.5. An official from Transport Scotland, in attendance as representative of CMAL's sponsor directorate, joined the 25 September 2015 board meeting and the minutes mention that "*JN requested that a detailed note of the risks, including how risks will be mitigated should be sent to TS for onward briefing to the Minister*".
- 6.6. The Board also resolved to speak to CBC. CBC joined the negotiations and this was at a meeting held between CMAL, FMEL and CBC in Glasgow on 28 September 2015. CBC made clear that no improvement to the security offered, with guarantee coverage at only 25%, could be made available.
- 6.7. The following day, FMEL increased the propose final milestone instalment from 15% to 25%, leaving CMAL broadly with 50% of the pre-delivery payments at risk.

¹⁰ Appendix 4

¹¹ Appendix 7

- 6.8. As requested, the CMAL Director of Vessels prepared a paper 'Contract award to FMEL and the associated risks' that set out the numerous risks giving rise to the concerns of the Board, which was circulated on 7 October 2015 to Transport Scotland for the consideration of the Ministers.
- 6.9. CMAL were told that they should not seek a Ministerial direction by the Ministers in relation to contract award of the Vessels to FMEL. However, the Board were sufficiently concerned about the Contracts in all the circumstances instead to seek a letter from the Ministers holding CMAL harmless in the event that the Contracts encountered the financial and technical issues identified in the risks paper. As mentioned above, this had been raised by the Chairman of CMAL and agreed in principle by the Transport Scotland official at the August 2015 board meeting.
- 6.10. The CMAL Directors were also concerned in respect of their duties always to act in the best interests of the company, and always in a position of solvency, and such a letter of comfort was considered an appropriate mitigation. In particular, the Board members sought and received a shareholder authorisation¹² from Ministers, as CMAL's sole shareholder, to proceed with the award; and an express and unconditional financial undertaking and reassurance that "*[F]unds 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.*"¹³ This wording was negotiated in correspondence and discussions with Transport Scotland representatives.
- 6.11. On 7 October 2015 the CMAL Board received papers including a briefing note from the Chief Executive, a draft of the letter of comfort, a draft of the voted loan letter, a draft briefing note to the Minister, and the risk paper – seeking approval in circulation that CMAL should proceed to award and sign the Contracts with FMEL.
- 6.12. The response of the Board was to authorise the signature of the contracts with FMEL expressly subject to (i) the recognition and acceptance by the Ministers of the risks identified in the risk paper; (ii) the express authorisation by the Ministers of the award, in their capacity as CMAL's sole shareholder; and (iii) the issuance by Transport Scotland of the letter in the terms as negotiated.
- 6.13. The letter from Transport Scotland to CMAL dated 9 October 2015¹⁴ shows "*The Scottish Ministers have also seen and understood that [the Director of Vessels'] 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*".
- 6.14. Also on 9 October 2015 the Head of the Ferries Unit at Transport Scotland wrote to CMAL: "*The Scottish Ministers have seen [the Director of Vessels'] 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).*"¹⁵

¹² as permitted under the 'Shareholders Reserve Power' contained in the CMAL Articles of Association.



- 6.15. In this way, CMAL was effectively instructed to proceed with the purchase from FMEL despite the concerns raised. In the event, refund guarantees were provided from two Investec entities for a reduced coverage of £12,125,000 per vessel.
- 6.16. The letter from Transport Scotland duly provided authorisation from the Ministers, expressly *'in their capacity as CMAL's sole shareholder and more generally'* of CMAL, for the Contracts and gave the financial undertaking sought in respect of CMAL's future financial position. CMAL therefore proceeded to sign the Contracts.
- 6.17. As explained in the risk paper, CMAL were not content with the final draft contracts. In these circumstances, the Ministerial approval process was not normal. CMAL made no recommendation to Transport Scotland or to the Minister.

7. The Contracts as signed

- 7.1. With the exception of the value of the refund guarantees as compared to the value of the intended pre-delivery instalments, in all other respects, it should be emphasised that the Contracts for the Vessels were broadly market standard.
- 7.2. A notable example of the commercial amendments that were negotiated is that title in the Vessels would be vested in CMAL from the stage 2 milestone payment.¹⁶
- 7.3. Such vesting of property in the Vessel with the buyer, is commonly seen as a safeguard against the insolvency of a builder in circumstances where full coverage refund guarantees are unavailable. Using this method, CMAL as buyer took ownership of all equipment, machinery and materials as they passed inwards to shipyard and all items were clearly individually marked as property of CMAL. For all items, a full inventory was to be prepared and a record of their location kept, countersigned by FMEL in recognition of CMAL's right of ownership.
- 7.4. Save as to a pre-contractual discussion during the preferred bidder phase about a currency fluctuation clause (requested by FMEL, not agreed by CMAL and not forming part of the Contracts) the form of the Contracts as executed and the negotiation of the various amendments to the template BIMCO contracts did not form the basis of any later contention between the parties.

8. Variations to Contract

- 8.1. Aspects of the template "NEWBUILDCON" provisions, as relevant for present purposes – the variation to contract or "VTC" mechanism – are explained in [Appendix 2](#).
- 8.2. The Contracts contained the standard BIMCO clause 24 wording of the VTC mechanism as described in [Appendix 2](#). Therefore, the Contracts specifically guard against the Builder being out of time or money for design changes that are instructed by the Buyer. FMEL were aware of the purpose and operation of this critical clause 24 and indeed used it, as mentioned below.

¹⁶ Clause 31

- 8.3. On numerous well-documented occasions, FMEL and its former management have suggested that design changes to the Vessels made by CMAL were the cause of the delay to the Vessels.
- 8.4. It must be remembered that the responsibility for the design, under these design and build contracts, rested wholly with FMEL. While CMAL could request and propose design changes, these would need to be agreed with FMEL before implementation and the VTC mechanism engaged to allow for the delivery date and value to be amended, as appropriate.
- 8.5. At the point of FMEL entering Administration in August 2019 there had been 111 validly proposed changes made to the specification of the Vessels pursuant to clause 24 of the Contracts. Of these, 30 were cancelled, declined or not progressed. Of the 81 remaining VTCs, 35 were requested by CMAL and 46 were initiated by FMEL.
- 8.6. The combined effect of these changes upon the price payable to the builder, across both Vessels, was £1.55 million or 1.6% of the intended build cost. This is comfortably within CMAL's allocated contingency budget which is 3% and which CMAL consider standard for this type of contract.
- 8.7. However, claims by FMEL for the cost of re-work do not constitute a valid VTC under clause 24. Work that has to be done again due to any non-compliance of the work performed is a risk for the Builder under the Contracts.
- 8.8. FMEL on many occasions commenced fabrication and construction prior to CMAL approval or Class or Flag State approval of the design drawings. This means that the cost of any re-work resulting from Buyer's or Class or Flag comments or amendments to the design were attributable to the yard's build strategy and not for CMAL's account.
- 8.9. This type of strategy is referred to as "fabricating at risk" or "chasing steel", which is intended to maximise income to the yard by the attainment of milestone events.

9. FMEL's 'VTC' spreadsheet and subsequent claim

- 9.1. The pursuit by FMEL of claims to recover cost over-runs was first notified among the heads of claim described in a spreadsheet presented to CMAL at a project meeting in July 2017. On 7 July 2017, FMEL issued CMAL with a spreadsheet - 'CMAL PROJECT 801 & 802 HIGH LEVEL SUMMARY' – seeking a contribution by CMAL to FMEL of some £17,500,000.
- 9.2. The spreadsheet provided almost no narrative, no vouching, no reference to the Contracts and specifically did not follow the VTC mechanism that the Contracts required. CMAL rejected the claim and requested further details.
- 9.3. On 3 August 2017, FMEL wrote to CMAL again seeking the sum in the spreadsheet. This offered some narrative but again made no reference to the contractual basis between the parties for which the money claimed was sought. Again, no vouching of the alleged costs was provided.
- 9.4. In December 2017, FMEL wrote to CMAL setting out the same request for payment and again without reference to the BIMCO contracts, described as "*cost impacts*" arising primarily from "*unforeseen complexity*". That is, unforeseen by FMEL.

- 9.5. In correspondence between the parties during January and February 2018, FMEL confirmed that their request for payment went *'beyond the terms of the contract'* (i.e. there was no contractual basis for more money).
- 9.6. In the autumn of 2018, FMEL employed a firm known as HKA to prepare a claim against CMAL. HKA is not a law firm or a naval architect, it is a claims consultancy. FMEL (or perhaps CBC) spent £650,000 on the preparation of a claim document. At this time, the only source of funding to FMEL was through the second loan from Scottish Ministers.
- 9.7. On 20 December 2018, a letter of claim and report and appendices were delivered to CMAL, seeking payment of over £65,000,000 (the "**HKA Claim**"). The HKA Claim and its value were expressly time limited to 31 August 2018 inclusive only, and forms the basis of what FMEL referred to in the Administration and elsewhere as their 'claim'.
- 9.8. The fundamental legal basis of the HKA Claim was not those terms of the Contracts relating to allowance of additional time or money to the contractor. Instead, the HKA Claim hinged on an alleged breach of an "implied term" of *'non-hindrance'* by CMAL during the build process.
- 9.9. 'Implied terms' are rarely accepted in a commercial context in which a signed written contract has been negotiated between professional parties. The 'hindrance' or interference alleged by FMEL was unfounded – in terms of the BIMCO contracts the Buyer has the right to a site supervision team in attendance at the yard facility and for the purpose of verification and observation of the construction in progress. This is ordinary ship-building practice.
- 9.10. The HKA Claim was considered in detail by leading specialist lawyers and by Senior Counsel on behalf of three interested participants (CMAL, Scottish Government and the Administrators) and found entirely baseless.
- 9.11. Nonetheless, dealing with the HKA Claim took up considerable time and resources for all parties. This was another example of FMEL refusing to focus on the key task of building the Vessels.
- 9.12. Finally, at the point of FMEL entering Administration in December 2019, the Administrators were obliged under the Insolvency Act to consider whether a claim should be pursued. After taking the advice of Scottish Senior Counsel, the Administrators considered the value of the HKA Claim to be nil.

10. Alleged disruption to the fabrication sequence

- 10.1. In his testimony to the Committee on 16 June 2022, one witness clearly and repeatedly¹⁷ referenced the project delay and associated cost over-run as attributable to a change in the build strategy forced on FMEL because of various faults alleged by CMAL. That witness claimed that the Vessels were originally planned to be built from the stern first of all¹⁸.

¹⁷ Official Report, 16 June 2022 – at column 20: *"we had to build sections that were not the sections that we had intended to start with and not in the sequence that we had intended"*, and *"We did the fabrication in a different order from the one that we had intended to do it in"*.

¹⁸ Official Report, 16 June 2022 – at column 14: *"The way that we did it was out of the sequence that we wanted, because we wanted to build two ships side by side on the slipway, starting with the sternmost"*

- 10.2. This was also the essential technical basis of the legally baseless HKA Claim, that the yard suffered significant disruption in the intended sequence of fabrication of the Vessels, due to delays by CMAL including their choice of main engines and propellers.
- 10.3. We suggest that this alleged disruption to the intended block sequence is one of the most critical issues to be understood by the Committee. CMAL believes that this issue clearly demonstrates contractor failure and is also an example of the creation by FMEL of a subsequent narrative that is entirely unfounded in reality.
- 10.4. HKA state that CMAL "*caused such delay and disruption that FMEL had to make two radical changes to the sequence of its works...*". The two alleged 'radical changes' are (i) that the Vessels would be built from the mid-ships (rather than stern-first); and (ii) that the Vessels would be built prior to their launch in sequence i.e. 801, then 802 (rather than simultaneously). CMAL believe that most of the value of the HKA Claim, and blame for what followed, rests on this theory.
- 10.5. It can be demonstrated that no such changes occurred, attributable to any fault by CMAL, with reference to the earliest versions of the Cardinal Date Programme (a GANTT chart form of project planning document, "**CDP**") that were produced by FMEL in late 2015.
- 10.6. The two CDPs dated 14 December 2015, one for each Vessel¹⁹ – prior to any of the delays or interference which are alleged – show for both Vessels a sequence of building from the mid-ships and not, as the witness contends, from the stern.
- 10.7. To assist the understanding of the Committee, this sequence is explained in detail and with diagrams in Appendix 3.
- 10.8. Entirely contrary to the purported methodology which the witness and the HKA Claim describe, we see from the CDP that in fact from the very beginning some 50% fabrication was intended to have been reached before the yard would turn its attention to the stern-most blocks. It seems inescapable that the original intention was always to begin construction at mid-ships.
- 10.9. In relation to the second alleged radical change, to build the Vessels in sequence rather than in tandem, no such change occurred in August 2016. A later version of the CDP issued by FMEL on 7 July 2017 (revision 4) shows no significant delay to the delivery of Hull no.802. Only in the CDP issued on 27 June 2018 (revision 5) is a delay of 593 days to delivery of Hull 802 indicated.
- 10.10. In summary, the suggestion that the Vessels should have been built stern-first appears more a theory applied in retrospect than a description of anything that ever happened.

11. Attempted Dispute Resolution

Mediation

- 11.1. CMAL supports, encourages and pursues alternative dispute resolution wherever possible. Arbitration is a standard feature of shipbuilding contracts and CMAL

blocks and building them out"; and at column 28 "because we could not build from block 1 up, we could not build both vessels side by side."

¹⁹ An extract of the December 2015 CDP for hull 801 is shown at Appendix 3. Full copies can be provided to the Committee.

considers that mediation and similar alternative dispute resolution processes are in general highly preferable to court procedure.

- 11.2. Several contributors to the Report and submissions to the Committee have focussed on the role of mediation and have even gone so far as to suggest that had the parties to the Contracts mediated on the matter, it is possible that the Vessels would now be delivered. In the circumstances, this is mistaken for the following reasons.
- 11.3. In order to be effective, the usual process for mediation is for the parties to agree beforehand those items or areas of dispute to be mediated upon. These will be narrowed as far as possible in advance, in order that the Mediator might guide the parties through these areas of dispute and on to resolution during the course of the mediation.
- 11.4. The nature of the relationship between the Builder (in this case FMEL) and the Buyer (in this case CMAL) under a signed NEWBUILDCON, is a contractual relationship in which one party agrees to build a ship and the other agrees to pay for it for a fixed price.
- 11.5. In this case, Mediation could not take place because FMEL could not show what area of the Contracts entitled them to the payments they demanded. Without this justification, any payment by CMAL to FMEL would have been *ex gratia* and outside CMAL's competence.
- 11.6. CMAL are responsible for public funds and accountable for their expenditure to the Scottish Ministers. CMAL could *only* hand over money to FMEL because the Contracts for the Vessels required it. Otherwise, CMAL has no ability to give away public funds to FMEL, however constrained the builder's situation. Any money given by CMAL to FMEL *must* be justifiable pursuant to the Contracts.
- 11.7. CMAL repeatedly noted in correspondence with FMEL²⁰ that unless any outcome of the mediation fell under the parties Contractual obligations, CMAL would not be able to sanction any payment at the levels demanded. Put simply, FMEL seemed to want to rip up the Contracts and start again.
- 11.8. Given the demand subsequently made for a further £66 million up to 31 August 2018 only, it is hard to imagine the future additional cost from that date forwards, for which FMEL would have claimed additional compensation.
- 11.9. As the Report documents, CMAL were willing to attend mediation with FMEL, and dates and venues were discussed and suitable Mediators and their availability were canvassed. However, FMEL were not able to point to a clause or clauses in the Contracts which would – in their view – entitle them to additional payments from CMAL.
- 11.10. On 25 January 2018, FMEL accepted in writing that their claim was non-contractual in nature.²¹ It is for this reason that mediation did not proceed.

Expert Determination

- 11.11. In response to a request by FMEL for expert determination of the VTC claims, CMAL sought legal advice from Stephenson Harwood LLP, a London-based international law

²¹ Appendix 11

firm with expertise in shipbuilding contracts, and which had no prior involvement in the Vessels project.

11.12. Stephenson Harwood reviewed the matter, and on 23 March 2018 concluded: *"In summary, our opinion is as follows: CMAL is not obliged to refer any dispute to expert determination"* and went on to say, *"and in any event, the present dispute is not of a type which can or should be determined by reference to expert determination"*.

11.13. The expert view was that FMEL VTC claim was inappropriate for expert determination:

'13.1 In the context of shipbuilding contracts, expert determination is usually reserved for matters of a technical nature, where the parties disagree on technical, engineering or construction matters, such as whether or not a particular specification has been met, or whether a particular cost has been incurred reasonably. For these types of dispute, the purpose of the expert determination clause is to allow the parties to rely upon the independent and qualified expertise of an industry specialist, such expertise pertaining to the factual subject matter in dispute. Expert determination usually, therefore, pertains to a factual enquiry, rather than a legal enquiry.

13.2 In the present case, FMEL have until now failed to explain, let alone prove, their legal entitlement to the sums demanded. That being the case, the first and most important dispute between the parties is a legal one. For all practical purposes, such questions are properly to be dealt with by the Court, not an industry expert.'

11.14. There was further concern that FMEL may increase their claim (as did indeed happen) and that any determination should therefore anticipate that: *"where CMAL is concerned that yet more unexplained and unsubstantiated requests for further payment may be forthcoming, CMAL may quite fairly prefer these matters, as a whole, to be in the hands of the Court, rather than in the hands of an expert, whose expertise and authority is necessarily limited"*.

11.15. In addition, expert determination is a private process without external scrutiny. FMEL's original VTC claim of £17,535,950 then amounted to an uplift of nearly 20% of the Contracts' value. Stephenson Harwood considered that given the sums of public money involved the matter may be better settled in public view to avoid any inference of mishandling of funds.

11.16. Given all of the risk factors, the potentially substantial amendment of the contract price, and CMAL's obligations towards the public purse, Stephenson Harwood concluded: *"...we consider expert determination to be completely inappropriate for the disputes presently under consideration"*.

Conduct of the dispute resolution methods available

11.17. In testimony to the Committee, one witness characterises CMAL as at every turn refusing or 'blocking' attempts to resolve the dispute²². It has been stated by the former management of FMEL that the Ministers should have 'insisted' that CMAL take part in expert determination, and has suggested *'the Scottish Government were afraid to*

²² Official Report, 16 June 2022 – at column 8, on three occasions

confront CMAL and insist on them taking part in a dispute resolution process'.²³ There is no basis for this. Indeed, the Scottish Ministers put significant pressure on CMAL to mediate.

- 11.18. It should also be recognised that the 'back-channel' that evidently existed between CBC and certain MSPs confused what should have been a contractual dispute between CMAL and FMEL.
- 11.19. As noted, CMAL has a positive view of alternative dispute resolution. In this case, the decisions not to participate in mediation or expert determination were taken by CMAL for the reasons set out above. These decisions were made on the basis of contractual review, internal discussion, legal advice and the constraints of the Public Finance Manual. At all times CMAL's decision makers acted professionally and without prejudice, and sought and acted on appropriate advice.
- 11.20. As FMEL appeared so convinced of the merits of their claim, it is true that at times CMAL struggled to reason with them. At all times however it remained open to FMEL to pursue their HKA claim in the Scottish Courts, as they had repeatedly and publicly threatened in the press.
- 11.21. In the absence of a clear contractual entitlement, a judicial mandate for payment from CMAL to FMEL could have allowed CMAL to pay FMEL additional sums. Therefore, if FMEL had taken the dispute to Court and won, CMAL would have required to make payment of any sums awarded.
- 11.22. No response was ever given by FMEL in reply to the CMAL letter dated 4 March 2019 that denied liability for the HKA Claim.

12. The limits of the Contracts, and efforts by CMAL to help FMEL deliver

Project management

- 12.1. As observed by the Report, FMEL appeared fundamentally unable to manage the project and their own resources to successful completion, leading to the chaos on the project and the ultimate Administration of the FMEL business.
- 12.2. As early as December 2015, CMAL were raising concerns about the project management. By that time, CMAL's Director of Vessels had been obliged to refuse the first iteration of FMEL's second milestone payment request for lack of vouching and FMEL's failure to correctly use the payment processes contained in the Contracts.²⁴
- 12.3. In addition, at this time the yard had yet to recruit the appropriate design staff for the Vessels. CMAL were concerned that FMEL were already ordering components for the Vessels, despite lacking design staff to finalise the vessel design, leading to a high likelihood of purchasing mistakes by the yard²⁵.

²³ Written submission to the Committee by the Former Senior Management Team of FMEL, page 2

- 12.4. FMEL created further problems for themselves by pursuing the overhaul and complete re-development of the yard concurrent with the Contracts. Old buildings were torn down and new buildings erected, and significant work was done on the hardstanding at the yard during 2016. While the redevelopment was positive for the yard, these were management choices and that work was pursued to the detriment of the progress in fabrication of the Vessels.
- 12.5. This created substantial issues both for the yard's cashflow, and for the physical impact on the available space at the yard in which to construct two sizeable ferries.
- 12.6. In turn, this led to FMEL's decision-making for the Vessels becoming driven by factors other than appropriate project management, dictated by FMEL's limited space and increasingly limited financial position.
- 12.7. CMAL considered the decision to launch hull 801 in November 2017 to be premature and entirely motivated by the FMEL need for space and for working capital from funds to be released upon the achievement of that milestone, rather than with any concern for economy or good practice²⁶.
- 12.8. The Contracts allowed for termination by the buyer and (albeit limited) reimbursement under the refund guarantees in the event of significant lateness in delivery. However, the Contracts could not and did not account for the wider considerations and political context in which the Vessels were procured and built in which the consequences of termination were uniquely undesirable.
- 12.9. For CMAL, Transport Scotland and the island communities, the key priority was and is to secure the delivery of these critical Vessels. With that, CMAL accept that when faced with repeated project management failures by FMEL, there was also a political consideration of the future of the Ferguson Marine yard and its workforce.

Change of Refund Guarantor

- 12.10. At the request of CBC and FMEL and with the involvement of Transport Scotland and the Ministers, in November 2016 CMAL agreed to the replacement of the nature and provider of the refund security from the bank guarantees from Investec to surety bonds from an insurance company called HCCI.
- 12.11. Addendum No.1 to the Contracts, which gave effect to that replacement, served FMEL only.

These suppliers are not charities and I think it is inevitable that if orders are placed on these contractors, that subsequently are found to be incorrect, they will want to be paid for any changes or additions that may be required. Approval of these purchase orders from CMAL will leave us vulnerable.

It is a difficult situation that to my mind is the result of the yard not have the experienced (or any?) engineering design staff employed at present to evaluate and compare the suppliers offers against other offers or the contract and/or specifications. It would appear this is being undertaken by a purchasing manager with no experience in shipbuilding.'

²⁶ The CMAL Director of Vessels report to the Board in November 2017 shows: "FMEL's main priority is putting the ship in the water on 21st November 2017, regardless of the problems that will be encountered later. Given that so much work internally is way behind schedule and work is being rushed to achieve the launch date, this will result in significant levels of re-work and additional time will be required, mainly down to poor planning and co-ordination of the work and the need for the yard to get the vessel in the water to free up space for 802."

Amendment to Milestone structure

- 12.12. Following representations by CBC to Derek Mackay MSP, at the request of FMEL and with the involvement of Transport Scotland and the Ministers, in May 2017 CMAL were instructed to amend the milestone payments structure of the Contracts to ease cash-flow for the yard.
- 12.13. The Board of CMAL were very reluctant to make any acceleration of payments to the yard, amid faltering progress in the construction of the Vessels. However, CMAL were also aware that many suppliers both internationally and locally had not been paid for several months. CMAL was concerned that a court petition by any creditor to wind up FMEL could be presented at any time. In fact, when CMAL saw the invoices that were not paid it became apparent that this amounted to over £9m of debts that were overdue from the beginning of the year.
- 12.14. Acceleration of the payments was agreed to by CMAL only on the condition that the funds would be used for specific Vessel equipment (which would vest in CMAL) and related suppliers.
- 12.15. Addendum No.2 to the Contracts is the allowance by CMAL of accelerated payments to FMEL expressly to enable them to pay their suppliers, without which the progress of the fabrication would have simply have ground to a halt.
- 12.16. This acceleration (which did not increase the Contract price) necessitated a restructuring of the remaining future milestone events and their values, reducing the final instalment payable upon delivery of the Vessels from 25% to 10%.
- 12.17. A letter from Transport Scotland to CMAL was prepared, confirming approval of these arrangements and making the necessary change to the drawdown profile of the voted loan for the Vessels.²⁷

Grace period despite lateness

- 12.18. At the request of FMEL, and with the involvement of Transport Scotland, CMAL further granted a significant indulgence to the yard by allowing it to complete the Vessels by the revised CDP issued by the yard on 27 June 2018, extending the delivery dates to 21 June 2019 (for "GLEN SANNOX") and 10 March 2020 (for Hull 802).
- 12.19. This non-contractual and voluntary grace period, during which CMAL agreed not to cancel the Contracts for lateness, allowed HCCI to extend the validity of the surety bonds issued for both Vessels beyond their original given expiry date of 31 December 2019.

Other concessions made

- 12.20. CMAL agreed to material reductions in the technical specification of the Vessels. These include a reduction in the deadweight or carrying capacity by 77 tons; an increase in length of Hull 802 by over 2 metres (reducing manoeuvrability and interchangeability of the Vessels between routes); and removal of the portside mid-ships passenger lift.
- 12.21. Such decisions were taken to do whatever could reasonably be done by CMAL and others to get the Vessels delivered for the island communities.

²⁷ Appendix 13

- 12.22. The contractual arrangements, in the industry-standard form, do not provide for the Buyer to intervene in the yard in any way, even once it becomes apparent that the Builder cannot deliver the Vessels. The Buyer, as customer, is required to be at arm's length from the shipyard.
- 12.23. In all the circumstances CMAL offered an extraordinary level of co-operation, concessions, support to and engagement with the yard.

13. Government loans

- 13.1. CMAL had no awareness of the £15,000,000 first loan made by the Scottish Ministers to FMEL in September 2017 nor the £30,000,000 second loan made by the Scottish Ministers to the parent entity of FMEL in February 2018, at the time they were made.
- 13.2. CMAL understood that a naval procurement professional was appointed by the Ministers to approve a draw-down of the second loan to the shipyard, measured against progress in certain steps of the fabrication of the Vessels.
- 13.3. In his testimony to the Rural Economy and Connectivity Committee, that individual confirmed that he has no experience of building ferries or any other kind of ships in a civilian context.
- 13.4. CMAL was not sighted on the reports that this individual was providing to Directorate General Economy. He was appointed by DG Economy, not by CMAL or Transport Scotland.
- 13.5. It appears to CMAL that this individual personally sanctioned the draw-down of £30 million of public funds against designated progress events that had in fact not been fulfilled by the shipyard at the time payments were approved.
- 13.6. That individual met with CMAL representatives only twice. The first was an informal introduction; at the second meeting the individual was pressed to explain why drawdown payments from the second Government loan were continuing to be made when no progress was evident in the construction of the two Vessels.
- 13.7. At that second meeting, on 24 January 2019, this individual advised Scottish Government officials and CMAL that all activities in the most recent cardinal date programme issued by Ferguson on 27 June 2018 had been completed successfully on time. These major activities and their planned completion dates are given in the table below:

<i>Activity</i>	<i>Planned achievement date</i>
Shore Power Supply Tests	30 July 2018
First Run Auxiliary Engines	9 November 2018
Commission Systems	9 November 2018
First Run Main Engines	21 November 2018
Generator Load Tests	7 December 2018
Engine and Generator Power Management Tests	3 January 2019

- 13.8. None of the activities in the above table had in reality been achieved at that time despite the individual advising at the meeting they were completed and that the yard was on track. CMAL asked if he had himself witnessed these events as being completed – he did not answer.

14. The BIMCO contracts at Administration and since

- 14.1. When it became apparent that the delays in delivery of the Vessels would extend beyond the validity of the HCCI surety bonds, CMAL required to explore the options available to them under the Contracts including their termination.
- 14.2. At a similar time, the Scottish Ministers were exploring the potential ways in which the yard and its workforce could be prevented from collapse. Those processes were known as Project Kildonan – as the Committee is aware, ultimately involving the Administration of FMEL and the eventual public ownership of the shipyard.
- 14.3. As part of that process, CMAL agreed not to terminate the Contracts but to novate them to a Scottish Ministers' wholly-owned 'newco' entity.
- 14.4. At no time during the currency of the Contracts with FMEL, nor with the 'newco' entity named Ferguson Marine (801-802) Limited, did the headline price payable by CMAL increase.

15. Audit Scotland recommendations and steps taken by CMAL

- 15.1. CMAL has noted the Auditor General's recommendations contained within the Report.
- 15.2. CMAL has taken every opportunity to learn from the challenges that have come with this experience of the Vessels' procurement, and we are continuously seeking to redefine best practice.
- 15.3. In the context of new-build projects, and the Audit Scotland recommendation to CMAL:
- *in addition to insisting on a full refund guarantee, review its contract management arrangements and consider how to encourage shipbuilders to meet its expected quality standards over the duration of new vessel projects. This may include making a clearer link between quality standards and milestone payments.*

CMAL has implemented the addition of further robust quality controls at the point of contract award. This can be seen on the vessels recently procured by CMAL for the Islay route (the '**Islay Vessels**') from Cemre Shipyard in Turkey ('**Cemre**').

- 15.4. As with the Contracts, the Islay Vessels are also contracted for on a BIMCO NEWBUILDCON with minor amendments. Full-coverage builders refund guarantees were sought and duly provided by Cemre.
- 15.5. For the Islay Vessels, the milestone payment certificate are now tripartite: as well as payments being signed off by both CMAL and the Builder, CMAL also requires to be signed by the attending surveyor of the vessel's Classification Society.
- 15.6. In addition, for the Islay Vessels the mere achievement of the milestone event (such as reaching a % of steel fabricated) is alone insufficient to trigger the payment for that

work, but Cemre must also have obtained the necessary Class approval of all the design drawings up to that stage²⁸. This acts as a third party confirmation of work completed, and relevant plan approvals obtained, for compliance with the minimum expected quality standards of Class and to eliminate the risk that plan approvals do not lag the fabrication process.

- 15.7. Further details about the Islay Vessels procurement journey can be shared with the Committee. This may be useful as a comparator with the experience in 2015 and shows a timeline of stakeholder engagement, decision-making challenges, adopted changes to the process as well as the progress of negotiation between the parties and the ultimate approval and award of the Islay Vessels' contracts earlier this year.

²⁸ NEWBUILDCON new building contracts between CMAL and Cemre, in respect of hull 1092 and 1093, both dated 28 March 2022, clause 50(c).

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APPENDIX 1 – TIMELINE OF CONTRACT AWARD

17 October 2014	Pre-Qualifying Questionnaire issued
10 December 2014	Invitation to Tender CMAL0060 issued, including draft build contract
31 March 2015	Tender bid received by CMAL from FMEL. The tender bid contains no indication that full coverage refund guarantees (RGs) are unavailable.
April 2015 - August 2015	Tender Evaluation phase
10 August 2015	CMAL Director of Vessels seeks Board approval to initiate technical and commercial discussions with leading candidate bidder
21 August 2015 (17:35)	FMEL provide first draft milestone schedule (0.5% final instalment, upon delivery) and notify proposed amendments to the draft contract removing the provision of RGs
25 August 2015	CMAL Board Meeting, concerns expressed; CMAL reiterates requirement of full coverage RGs from a first-class international bank
27 August 2015 (9:03)	CMAL solicitor issues second draft shipbuilding contract
27 August 2015	Letters issued to successful and unsuccessful bidders
28 August 2015 (11:45)	FMEL solicitor provides second draft milestone schedule (15% final instalment)
31 August 2015	FMEL announced as preferred bidder by the First Minister
4 September 2015 (11:07)	FMEL solicitor provides third draft milestone schedule (15% final instalment)
9 September 2015 (16:25)	FMEL solicitor proposes RGs provided by Investec Bank plc, at 25% of the price; and a vesting of title clause
10 September 2015 (12:03)	CMAL solicitor issues third draft shipbuilding contract
11 September 2015	Standstill period ends
16 September 2015 (11:57)	FMEL provide fourth draft milestone schedule (15% final instalment)
16 September 2015 (14:46)	CMAL solicitor issues fourth draft shipbuilding contract, including vesting of property clause
18 September 2015	Contract meeting CMAL / FMEL at Brodies, Edinburgh
25 September 2015	CMAL Board Meeting, concerns expressed
28 September 2015	Contract meeting CMAL / FMEL / CBC at Brodies, Glasgow – CMAL informed that FMEL security offered is at their limit, proposing two Investec guarantor entities
30 September 2015	Director of Vessels' Risk Paper issued to the Board and to TS
29 September 2015 (10:46)	FMEL provide fifth draft milestone schedule (25% final instalment)
2 October 2015 (12:03)	CMAL solicitor issues fifth draft shipbuilding contract, including two Investec entities as several guarantors

6 October 2015 (15:39)	FMEL solicitor provides sixth draft milestone schedule (25% final instalment)
7 October 2015	CMAL Board papers circulated for approval
9 October 2015	CMAL Board confirm approval subject to assurances being given
9 October 2015	Voted Loan letter – Transport Scotland to Tom Docherty
9 October 2015	Letter of comfort – Transport Scotland to Erik Ostergaard
10 October 2015	CMAL CEO confirms assurances received acceptable and CMAL board approval passed
13 October 2015 (16:46)	CMAL solicitor issues sixth draft shipbuilding contract
14 October 2015 (20:46)	CMAL solicitor issues seventh draft shipbuilding contract
16 October 2015	Contracts signed between CMAL and FMEL

APPENDIX 2 – BIMCO "NEWBUILDCON" – OVERVIEW

BASIS OF CONTRACT

- (a) This is a 'design and build' basis of contracting in which, as its name implies, the shipyard undertakes both to design and then to build a vessel, in accordance with the tendered outline specifications of the buyer.
- (b) This contract is typically used to ensure that all risk for the design of the vessel and for the build of the vessel remains with the builder throughout the construction process. For this, the buyer entrusts the project to the capability and competence of the shipyard.
- (c) The price to be paid for the vessel is fixed at the outset of the contract. The builder undertakes at the outset to deliver to the vessel specification at that price. The buyer pays only for those stages of fabrication (often referred to as milestone events) as each are completed by the builder.
- (d) In entering into the contract, the builder holds itself out as technically competent to design, fabricate and deliver the vessel in question; and also as having sufficient financial resources and support to do so within the price offered.
- (e) There is no ability for a buyer to withhold payment to a builder for achieved milestone events, although delivery may be expected to be significantly late. It is only after an agreed longstop date after delivery should have occurred, that cancellation is permitted.
- (f) In the event that the builder fails to deliver in accordance with the contract, the contract may be terminated and the already-paid instalments are to be returned to the buyer.

BUILDER'S GUARANTEES

- (g) In order to give comfort to the buyer (both against the risk of insolvency of the builder and concerns about the as-built technical compliance of the completed vessel) the refund of instalment payments can be secured by a refund guarantee purchased by the builder from a third party, ensuring that funds will be available to return such payments should the builder fail to perform.
- (h) The obtaining of refund guarantees is a commercial process undertaken by the builder, and forms a separate contract or bond between the buyer and the third party guarantor.
- (i) The un-amended template contract requires the builder to provide full coverage security in this way, using third party refund guarantees, equivalent to the value of the pre-delivery instalments that are payable by the buyer.

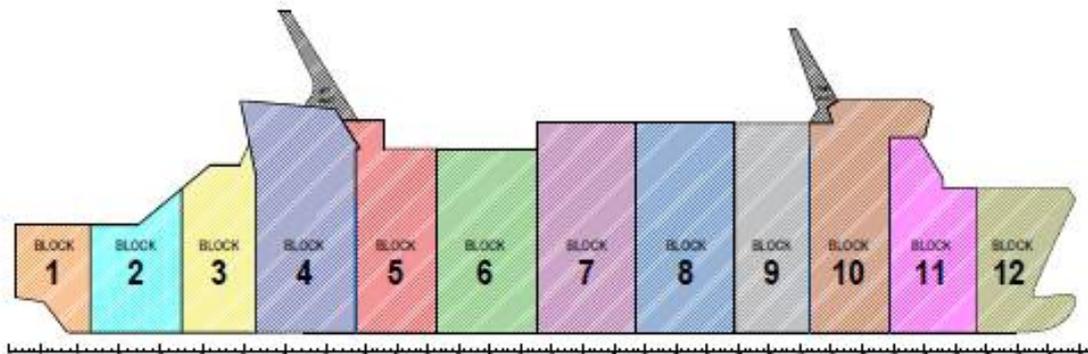
VARIATIONS TO CONTRACT

- (j) The contract sets out the process by which variations to the design or vessel specification that may arise during the build phase are to be agreed between the parties. This is based on a detailed mechanism in the contract to capture the effect of any such changes on the delivery date and the price.

- (k) In this way the actual cost of the vessel may fluctuate from the initial fixed price, but only in so far as the process for variations is followed.
- (l) The VTC mechanisms provide for changes to delivery dates or technical amendments that arise during the construction phase, as would be anticipated on shipbuilding projects of this nature, and regulate the process by which those changes are agreed and paid for. They can be requested either by the Builder or the Buyer.
- (m) Any claim for additional payment or additional time, or for a reduction to the cost, can therefore be properly captured and vouched by the parties using the mechanism described in clause 24 of the Contracts.
- (n) It is possible for the Buyer or Builder to reject requests for such changes. Importantly, these VTC items are required to be expressly agreed in advance of any change to the design, price or delivery date becoming effective.

APPENDIX 3 – NO CHANGE TO BLOCK SEQUENCE

- (a) The location of the fabrication blocks from which the Vessels are built, and their numbering as used by FMEL, are shown in the diagram below:



- (b) Block 1 is at the rear or stern; block 12 is at the front or bow of the Vessel.
- (c) It should be recognised that the alleged change in the entire method of fabrication of the Vessels, discussed in section 10 of the attached written submission, was first revealed to CMAL more than two years after it was said to have taken place. This alleged change to the block sequence, said by FMEL to have occurred in August 2016, was notified to CMAL for the first time on 20 December 2018 when presented with the HKA Claim.
- (d) The HKA Claim makes numerous references to a proposed fabrication scheme commencing from the stern. For example: "*provided that they were built from the stern forwards*"; "*hence the need to consolidate starting with the stern blocks*"; "*provided both vessels were consolidated from the stern*"; "*needed to build both vessels from the stern forwards if it was to meet the Contractual Dates...*"; and "*without the design of the stern block, fabrication could not start*".
- (e) Almost the entire premise of the HKA Claim (and expressly affecting both hulls and influencing perhaps everything that followed) depends upon the allegation that there was an enforced change in the block sequence, essentially from concurrent to consecutive fabrication of the two vessels.
- (f) The HKA Claim explains that in order to deliver the Vessels two months apart, for both vessels the rear-most blocks 1, 2 and 3 would require to be consolidated first of all, and so forth. One witness before the Committee suggested that the commencement of consolidation at mid-ships, which FMEL attributed to delays and interference by CMAL, has in effect ruined their plans. In fact, that was the yard's plan all along.
- (g) As can be seen on the following page, this December 2015 version of the CDP shows (at line 17) the fabrication of blocks 5 and 6 first of all; then (at line 19) blocks 7 and 8; and then (at line 21) blocks 4 and 9. This sequence also founds the milestone events described in the Contracts as establishing 25%, 35% and 50% fabrication respectively.

(h) The December 2015 CDP shows:

ID		Task Mode	Task Name	Duration	Start	Finish	C
1			801 CMAL 100m				
2			DESIGN	15 mons	Mon 02/11/15	Fri 23/12/16	
3			Hull Midship	3.75 mons	Mon 02/11/15	Fri 12/02/16	
4			Hull Aft Ship	3 mons	Mon 04/04/16	Fri 24/06/16	
5			Hull Foreship	3.2 mons	Tue 03/05/16	Fri 29/07/16	
6			Hull Open Deck	1.75 mons	Mon 06/06/16	Fri 22/07/16	
7			Hull Superstructure	3 mons	Mon 06/06/16	Fri 26/08/16	
8			Outfitting 3D model	9.5 mons	Mon 04/04/16	Fri 23/12/16	
9			Outfit Midship zones	3 mons	Mon 04/04/16	Fri 24/06/16	
10			Outfit Aftship zones	3.2 mons	Tue 03/05/16	Fri 29/07/16	
11			Outfit Foreship zones	3 mons	Mon 06/06/16	Fri 26/08/16	
12			Outfit Open deck	0.5 mons	Mon 06/06/16	Fri 17/06/16	
13			Outfit Superstructure zones	3 mons	Mon 06/06/16	Fri 26/08/16	
14			FABRICATION	16.85 mons	Mon 30/11/15	Tue 14/03/17	
15			Cutting of Steel	0.05 mons	Tue 15/12/15	Tue 15/12/15	
16			10 % Fabrication	0.05 mons	Mon 18/04/16	Mon 18/04/16	
17			Blocks 5,6	2.35 mons	Fri 12/02/16	Mon 18/04/16	
18			25 % Fabrication	0.05 mons	Tue 14/06/16	Tue 14/06/16	
19			7 & 8	2.85 mons	Mon 28/03/16	Tue 14/06/16	
20			35 % Fabrication	0.05 mons	Mon 15/08/16	Mon 15/08/16	
21			4 & 9	2.25 mons	Tue 14/06/16	Mon 15/08/16	
22			50 % Fabrication	0.05 mons	Fri 14/10/16	Fri 14/10/16	
23			1, 2 & 3	2.25 mons	Mon 15/08/16	Fri 14/10/16	
24			75 % Fabrication	0.05 mons	Thu 15/12/16	Thu 15/12/16	
25			10, 11, 12 & 13	2.25 mons	Fri 14/10/16	Thu 15/12/16	
26			100 % Fabrication	0.05 mons	Mon 16/01/17	Mon 16/01/17	
27			14, 15, 16, 17 , 18 & 19	6.3 mons	Mon 25/07/16	Mon 16/01/17	
28			Berth Join Ups	9.35 mons	Mon 27/06/16	Tue 14/03/17	

(i) It is ironic in this context that a report on naval ship-building prepared for the United States Congress (known as the GAO Report²⁹) was annexed to the HKA Claim, which comments "*Ships are typically built from the centre - bottom up*" – which is entirely consistent with CMAL understanding of the originally intended and the actual sequence for the Vessels.

²⁹ United States Government Accountability Office – Report to Congressional Committees GAO-09-322, 13 May 2009 "High Levels of Knowledge at Key Points Differentiate Commercial Shipbuilding from Navy Shipbuilding".

APPENDIX 4 – FMEL PROPOSED BILLINGS SEQUENCE

21 AUGUST 2015



CMAL PROPOSED BILLINGS SCHEDULE – 100M FERRY VESSEL 1

Stage	Date	Milestone	Proposed Amount	Percentage
1	15 Sept 2015	On Order	£2,500,000	4.975%
2	15 Oct 2015	Procurement Deposits Long Lead Items (1)	£3,750,000	7.464%
3	15 Nov 2015	Cutting of Steel	£5,000,000	9.951%
4	15 Dec 2015	Procurement Deposits Long Lead Items (2)	£6,250,000	12.438%
5	15 Mar 2016	10% Fabrication	£2,500,000	4.975%
6	15 May 2016	25% Fabrication	£6,250,000	12.438%
7	15 Jul 2016	35% Fabrication	£6,250,000	12.438%
8	15 Sep 2016	50% Fabrication	£6,250,000	12.438%
9	15 Oct 2016	Major Equipment and Lock Out Items Installations	£2,500,000	4.975%
10	15 Nov 2016	75% Fabrication	£2,500,000	4.975%
11	15 Dec 2016	100% Fabrication	£2,500,000	4.975%
12	15 Feb 2017	Berth Join Up	£1,250,000	2.488%
13	15 Mar 2017	Hull Inspection Prior to Paint	£1,250,000	2.488%
14	15 Jun 2017	Launch	£1,250,000	2.488%
15	15 Jan 2018	Delivery	£247,500	0.494%
		TOTAL	£50,247,500	100.0
00%				

August 21, 2015



CMAL PROPOSED BILLINGS SCHEDULE – 100M FERRY VESSEL 2

Stage	Date	Milestone	Proposed Amount	Percentage
1	15 Sept 2015	On Order	£2,500,000	4.975%
2	15 Oct 2015	Procurement Deposits Long Lead Items (1)	£3,750,000	7.464%
3	15 Nov 2015	Cutting of Steel	£5,000,000	9.951%
4	15 Dec 2015	Procurement Deposits Long Lead Items (2)	£6,250,000	12.438%
5	15 Mar 2016	10% Fabrication	£2,500,000	4.975%
6	15 May 2016	25% Fabrication	£6,250,000	12.438%
7	15 Jul 2016	35% Fabrication	£6,250,000	12.438%
8	15 Sep 2016	50% Fabrication	£6,250,000	12.438%
9	15 Oct 2016	Major Equipment and Lock Out Items Installations	£2,500,000	4.975%
10	15 Nov 2016	75% Fabrication	£2,500,000	4.975%
11	15 Dec 2016	100% Fabrication	£2,500,000	4.975%
12	15 Feb 2017	Berth Join Up	£1,250,000	2.488%
13	15 Mar 2017	Hull Inspection Prior to Paint	£1,250,000	2.488%
14	15 Aug 2017	Launch	£1,250,000	2.488%
15	15 Mar 2018	Delivery	£247,500	0.494%
		TOTAL	£50,247,500	100.000%

August 21, 2015

APPENDIX 5 – CMAL BOARD MINUTES

25 AUGUST 2015



MINUTE OF THE CALEDONIAN MARITIME ASSETS LTD BOARD MEETING

Meeting	Caledonian Maritime Assets Ltd August Board Meeting	Date/Venue	25 August 2015 Scottish Government Offices Victoria Quay
Meeting Chair	Erik Østergaard	Start Time	1000Hrs
		End Time	1230Hrs

Members Present		In Attendance	
Name	Title	Name	Title
Erik Østergaard	Chairman	Chris Wilcock	Transport Scotland
Mark Forrest	Non-Executive Director	John Nicholls	Transport Scotland
Morag McNeill	Non-Executive Director	Graham Laidlaw	Transport Scotland
Tom Docherty	Chief Executive	Ramsay Muirhead	Head of Engineering
Lorna Spencer	Director of Harbours	Jim Anderson	Technical Superintendent – Vessels
Andrew Duncan	Director of Harbours	Norman Thomson	Financial Controller
Gillian Bruton	Director of Finance	Susan Williams	Board Secretariat

1. MEETING OPENS – WELCOME AND APOLOGIES

The Chair welcomed those present to the meeting and noted apologies from Alistair Whyte.

The Chair welcomed Ramsay Muirhead, Jim Anderson and Norman Thomson to the meeting who were present to assist in discussions around various projects.

The Chair advised that Grenville Johnston and Shahbaz Hamid from AON would join the meeting at Item 15 – Pensions – to deliver presentation regarding the Calmac Pension Scheme.

2. APPROVAL OF PREVIOUS MINUTES

The Chair enquired if Members had any comments on the previous minutes from 16th June. GB requested removal of paragraph 2 under the CHFS 2 section due to inaccuracy.

Following the above amendment being made approval was given to publish the redacted minutes on the CMAL Website.

DECISION

Approval was given to publish *redacted* minutes on the CMAL Website.

3. REVIEW OF ACTION REGISTER

Action 1 - Was marked as on-going. GL stated that this would be discussed at 2 x 100 metre vessel meeting with CFL, CMAL and TS on the 27th August.

Action 2 - Was marked as on-going. GL stated that this would be discussed at 2 x 100 metre vessel meeting with CFL, CMAL and TS on the 27th August.

Actions 3 to 11 were marked as complete.

4. CHAIRMANS UPDATE

The Chair advised he would provide relevant comments/updates under each agenda item.

5. PUBLIC SERVICES REFORM (Scotland) Act

Members noted the PSR(S) Act Disclosures. No queries were raised.

6. FINANCE

GB advised that information requested from CMAL has now been submitted to Transport Scotland. The ITT was published on the 31st of July.

GB requested approval of the Annual Accounts 2014/2015 which have been previously approved by the Audit Committee on the 25th August.

DECISION

Members **Approved** the 2014/2015 Annual Accounts.

MM queried the reference to TS being a Shadow Director in the previous versions of the annual accounts and stated that she did not believe that was accurate. A discussion ensued around the legal definition of Shadow Director. CW agreed to seek further clarity from the Public Bodies Unit and feedback to the Board.

ACTION 1: CW to seek clarity from the Public Bodies Unit on the definition of Shadow Director.

7. VESSELS

The monthly vessels business area update was agreed as noted as read.

8. HARBOURS

The monthly Harbours business area update was agreed as noted as read.

9. BUSINESS DEVELOPMENT

The monthly Business Development Business Area update was agreed as noted as read.

10. CORPORATE SERVICES

The Corporate Services was noted as read.

With reference to the Records Management Plan submission MM stated that CCTV data capture should be included in the Data Protection Policy. LS advised that D McHardie has prepared a CCTV section to be included in the Data Protection Policy and agreed to forward to SW.

ACTION 2 – LS to forward CCTV sections to SW for incorporation into the Data Protection Policy and subsequently in the Records Management Plan.

DECISION

Board Members **Approved** the extension of use of the free staff ferry travel benefit to include immediate family.

11. HUMAN RESOURCES

The monthly vessels business area update was agreed as noted as read.

12. HEALTH AND SAFETY UPDATE

The monthly Health & Safety business area update was agreed and noted as read.

13. ADOPTION AND APPROVAL OF 2X 100 METRE DUAL FUELLED FERRIES

AD advised that shipyard B had been identified as the leading shipyard and that post tender negotiations had commenced with the yard on the 13th of August.

The Chair enquired when the unsuccessful yards would be notified. AD advised 5pm on Thursday 27th August. AD added that the preferred tenderer would be notified at 3pm on Friday the 28th August.

AD advised next steps would be involve discussions with the CMAL lawyers to discuss risks associated and contractual matters.

A discussion ensued around the matter of the refund guarantees.

The Chair requested that TS provide CMAL with a letter of comfort if required. JN agreed that a letter of comfort would be provided to CMAL. JN added that the Ministers were clear on the position and progress that must be made in order to proceed with the contract award.

The Chair enquired about press/media arrangements in place. TD advised a draft press release has been prepared in co-ordination with CMAL and TS and would be circulated to the board prior to release.

ACTION 3: SW to circulate the final press releases to all Board Members.

The Chair stated it was of upmost importance that the RACI process is being followed with regards to CFL, TS and CMAL involvement at key stages.

TD requested approval from all Board members to proceed with the issue of the Alcatel letters to the unsuccessful yards and also the letter to successful yard informing them of preferred bidder status.

DECISION

Approval was given by the Board to proceed with issue of the Alcatel and Preferred Tenderer letters.

14. BRODICK PROJECT UPDATE

Members agreed the previously circulated report had been read and noted.

RM stated that 7 tender submissions have been received (6 tenderers plus an alternative tender) and assessed and the costs received vary between £22m and £38m.

RM stated that whilst the value engineering phase has identified efficiencies it unlikely that there will be cost reduction from the £22m tenderer price.

RM presented the board with 3 options to proceed: -

1. Agree to the above costs, allowing work to proceed in autumn 2015 and complete by early 2017.
2. Remove some items from the current scheme to reduce costs. This would involve some re-design costs, tender re-assessment costs and could potentially take a number of months, and may in fact lead to a full re-tender (ref 3rd option).

3. Re-tender the project to enable phased construction. This would take at least 8 months to redesign and re-tender. Overall costs for entire development would be higher.

RM added that funding had been secured from North Ayrshire Council (£1.2M) and Strathclyde Partnership (£1m) but this was only secured if the project was completed in one phase.

RM recommended that George Leslie is awarded preferred tenderer status.

MM requested that before the Board proceed with any of the above options that a cash flow analysis is prepared for the next 3 years. Board members agreed with this approach.

Action 4 - GB to prepare Cash Flow forecast of the next 3 years and distribute to board members.

15. PENSION PRESENTATION

S Hamid and G Johnston joined the meeting to deliver a presentation on the CalMac Pension Fund.

16. AOB

J Nicholls advised members that David Middleton, Chief Executive of Transport Scotland will be leaving his role in early November and an internal recruitment process will shortly commence.

J Nicholls also wished to thank TD, LS and RM for welcoming the TS Board to Oban and for arranging a tour around the facilities.

The Chair requested the SW commence planning of the 2016 Board Meetings.

Action 5: SW to commence planning of the 2016 Board Meetings.

Meeting Closed

APPENDIX 7 – CMAL BOARD MINUTES

25 SEPTEMBER 2015



CALEDONIAN MARITIME ASSETS LIMITED BOARD MEETING

Meeting	Caledonian Maritime Assets Ltd September Board Meeting	Date/Venue	25 th September 2015 CMAL Offices Port Glasgow
Meeting Chair	Erik Østergaard	Start Time	0930Hrs
		End Time	1230Hrs

Members Present		In Attendance	
Name	Title	Name	Title
Erik Østergaard	Chairman	Chris Wilcock	Transport Scotland
Mark Forrest	Non-Executive Director	Susan Williams	Executive Assistant
Morag McNeill	Non-Executive Director		
Tom Docherty	Chief Executive		
Lorna Spencer	Director of Harbours	John Nicholls (by audio)	Transport Scotland
Andrew Duncan	Director of Vessels	Richard Hadfield (by audio)	Transport Scotland
Gillian Bruton	Director of Finance		

1. MEETING OPENS – WELCOME AND APOLOGIES

The Chair welcomed those present to the meeting and noted apologies from Alistair Whyte.

The Chair advised that J Nicholls and R Hadfield would join the meeting by audio for agenda item number 6.

2. APPROVAL OF PREVIOUS MINUTES

Members agreed Minute for meeting on 25th August was an accurate record of discussions. Approval was given to publish the redacted minutes.

DECISION

Approval was given to publish *redacted* minutes on the CMAL Website.

3. REVIEW OF ACTION REGISTER

Action 1,6 & 7 - Was marked as complete.

4. CHAIRMANS UPDATE

The Chair advised he would provide relevant comments/updates under each agenda item.

5. PUBLIC SERVICES REFORM (Scotland) Act

Members **noted** the PSR(S) Act Disclosures. No queries were raised.

6. Update on 2 x 100 Duel Fuelled Ferries

AD advised that there was an on-going matter to resolve around the refund guarantee. AD advised that the currently guarantee offered is 25% for the

contract duration and increased final payment to 15% of the contract price but advised this still leaves large gaps. AD advised that bank offering the refund guarantee would be provided by two separate banks Investec UK and Investec South Africa.

John Nicholls and Richard Hadfield joined the discussions via audio at 1030Hrs.

The Chair welcomed John Nicholls and Richard Hadfield to the meeting. The Chair informed JN and RH that the general consensus of the Board was that there are too many risks involved around the refund guarantee matter which are still to be resolved and to that end the Board are not in a position to award the contract to FMEL at this stage. JN requested that a detailed note of the risks, including how risks will be mitigated should be sent to TS for onward briefing to the Minister.

ACTION 1 – AD to prepare risks paper and circulate to the Board and TS.

JN stated that CMAL should continue to pursue the refund guarantee matter with FMEL. TD advised it was made clear by the FMEL lawyer that no other funds were available to offer any increase to the refund guarantee.

JN requested that AD send risks and mitigating actions to JN and RH who would in turn brief the Minister and advise way forward.

7. BRODICK CONTRACT AWARD

LS advised that the Grant in Aid letter was with R Hadfield at TS awaiting approval and sign off. CW advised it would go to Ministers next week.

8. PENSION UPDATE (N Thomson joined the meeting)

Calmac Pension Scheme

GB advised there has been no progress in terms of the Calmac Pension Scheme since the last meeting attended in August. However GB advised that TS had received an options paper from CFL but did not have sight of it as yet. GB advised she would source letter and circulate to the Board.

Action 2 : GB to circulate CFL pension options paper to CMAL Board.

MNRPF

NT referred to the previously circulated correspondence from MNRFP outlining payment options for the CMAL to address the deficit. NT recommended that option 1 is progressed paying the deficit over the 2 year period. The board approved this option provided that GB was comfortable that it could be accounted for in the cash flow for 2015/16.

MNOPF

GB stated that CMAL have 1 active member of the MNOPF and advised of the risk of triggering a section 75 if that employee was to leave. GB advised the AON were currently preparing a report and expects that will propose to close the scheme to future accrual. GB advised there was a meeting arranged for the 9th of October to progress discussions.

9. FINANCE UPDATE

The monthly finance business area update was noted as read.

GB advised finances were tracking close to budget. GB informed that the operating costs were slightly behind due to a slowdown of harbour activity over summer months however meetings have been arranged to discuss anticipated spend to year end.

GB advised the cash flow review had been complete with Brodick and the 2 x dual fuel ferries included. The chair enquired who would be responsible for the LNG liabilities. TD confirmed the operator.

The Chair requested that a monthly cash flow update is provided at all Board meetings going forward. GB noted.

10. VESSEL UPDATE

AD advised the Loch Seaforth would dry dock at Cammel Laird on the 29th of October for 3 weeks and advised there were guarantee items to undertake. AD advised that works to increase the width of the stern ramp would also be carried out to enable dual way traffic and that JA and AC would be present at the yard to assist and oversee works.

AD advised that a meeting had been set up with the Environmental Officer regarding the on-going matter of the Loch Seaforth's excessive noise caused by the engine, HGV's loading and various other attributes.

11. HARBOUR UPDATE

The monthly harbour and project status report was noted as read.

LS advised Weymss Bay will be shut down next week to commence the refurbishment works.

LS advised the CCTV tenders have now been evaluated and preferred tendered had been identified. LS requested Board approval to award the contract to the Scottish Communications Group.

DECISION: Approval was given to progress with the CCTV contract award.

12. BUSINESS DEVELOPMENT UPDATE

The monthly business development update was noted as read.

13. CORPORATE SERVICES UPDATE

The monthly corporate services update was noted as read.

14. HUMAN RESOURCES UPDATE

The monthly HR update was noted as read.

GB advised the pay remit process was on-going and she would feedback to the Board in due course.

15. HEALTH & SAFETY UPDATE

The monthly Health and Safety update was noted as read.

16. AOB

The Chair advised that October Board meeting would be cancelled as it was expected to have an extraordinary board meeting to discuss the 2 x 100 Metre dual fuel vessel contract award within this period. Members agreed with the next meeting taking place on the 16th of November.

Date of Next Meeting

0830Hrs – Monday 16th November 2015

Meeting Closed

APPENDIX 11 – CMAL BOARD RESOLUTION

13 OCTOBER 2015

CMAL Board Resolution re 2x 100m ro-pax

At the meeting of the Board on 25th September 2015 a number of reservations were expressed 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). It was resolved at that meeting that the Board should receive a note from the Director of Vessels on the subject (the Risks Paper).

The Board considered the Risks Paper which was provided to the Board, and to Transport Scotland, on 30 September 2015 and also the recent progress in the detailed and ongoing discussions and negotiations between the Company and FMEL. The commercial risks to the Company include:

- a) The provision of refund guarantees by FMEL in respect of only 25% of the contract price;
- b) The provision of those guarantees on a several basis by two Investec Bank entities, one in England and the other in South Africa;
- c) The expiry of those guarantees earlier than the conventional period of 300 days following the contractual delivery date, and which do not extend to the duration of any possible dispute arising between CMAL and FMEL;
- d) The personal, rather than independent, obligation on FMEL to renew the refund guarantees should such a dispute arise;
- e) The unavailability of a substantial parent company guarantee from FMEL; and
- f) The passing of title to the Vessels while under construction, although in general terms considered to be protective of an insolvency event affecting FMEL, does not constitute security in relation to as-built performance deficiencies of the Vessels, or significant lateness in their delivery.

It was noted that a meeting was held on 28 September 2015 between the Company and FMEL and Clyde Blowers Capital IM LLP and their legal advisors in relation to the risks that have been identified, with the Company seeking a substantial improvement in the protections available in all the circumstances. Certain amendments to the commercial proposal that was before the Board on 25 September 2015 have been negotiated, including:

- a) the increase of the final instalment payable by the Company to FMEL upon delivery, from 15% to 25% of the price of the Vessels;
- b) the appointment by Investec Bank Limited of an English process agent;
- c) an irrevocable warranty and undertaking by FMEL waiving any possible remedy of retention or withholding performance in respect of their obligation to procure a replacement refund guarantee;
- d) an express early termination right, in the event that any replacement refund guarantee is not timeously provided; and
- e) the proposed assignment by FMEL to the Company of such refund guarantees as FMEL receives from the Original Equipment Manufacturer of major items of machinery for the Vessels, and for which substantial down-payments shall be placed.

It was noted that the Company has also sought reassurance from the Scottish Ministers on how the risks arising as a consequence of the proposed award of the Contracts to FMEL will be managed. In reply, in the voted loan letter received from Transport Scotland relating to the financing of the Vessels it is confirmed that the Scottish Ministers have (i) considered the Risks Paper; (ii) noted the risks identified; and (iii) following due consideration, approved the award of this Contracts to FMEL.

A further letter dated 9th October 2015 was provided by Transport Scotland to the Chairman confirming all matters raised by the Board had been fully discussed and understood by the Minister for Transport and Islands.

Subsequent to the Ministers acknowledgement of the risks as set out by the CMAL Board it was confirmed that CMAL were granted clearance by Scottish Ministers to proceed to contract award.

The Board duly confirmed their acceptance of the assurances given by the Minister and agreed to authorise TD/AD or GB to agree and award contract to Fergusons Marine Engineering Limited for the procurement of the two 100m dual fuel vessels.

APPENDIX 13 – LETTER FROM TRANSPORT SCOTLAND TO CMAL

15 MAY 2017

Director
Aviation, Maritime, Freight & Canals

Victoria Quay, Edinburgh EH6 6QQ
T: [REDACTED]



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

Your ref:

Our ref:

Date:
15 May 2017

Dear Erik

Contracts for the construction of two 100m dual fuel passenger ferries

The purpose of this letter is to set out Scottish Ministers' position in relation to recent developments in respect of the above contracts between CMAL and Ferguson Marine Engineering Ltd (FMEL).

Scottish Ministers are aware that FMEL has requested acceleration of some of the contracted milestone payments to address cash flow issues so that construction of the vessels is not unduly delayed. Scottish Ministers are the sole shareholders of CMAL and responsible for CMAL's funding through voted loans. The acceleration of cash flow is thus a matter in which Scottish Ministers have an interest.

Transport Scotland has worked closely with CMAL over recent weeks in order to identify measures to address the cash flow issues being faced by FMEL whilst at the same time ensuring that Scottish Ministers' interests are protected. In this regard, we note that FMEL had originally requested that the delivery payments payable under the contract in May and July 2018 should be brought forward to launch dates (August and November 2017), and that the Surety Bond should be replaced by a Scottish Government guarantee. On advice from CMAL, Scottish Ministers could not agree to either element of the original FMEL proposal on the basis that to do so would have changed the economic balance of the contract.

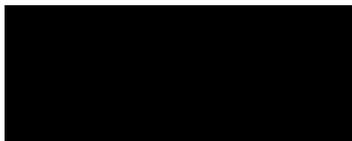
In consultation with CMAL, Scottish Ministers have instead agreed that the final delivery payment may be reduced from 25% (£24.25m) to 10% (£9.70m), allowing for the bringing forward of payments up to £14.55m from financial year 2018/19 to 2017/18, and that the Surety Bond should remain in place. Following careful consideration of the legal, procurement and financial issues, Scottish Ministers are satisfied that under this arrangement the economic balance of the contract is not altered to the extent that the risk of challenge is heightened. We note that CMAL has put in place with FMEL measures to ensure that there is full transparency on how FMEL will use the accelerated payments, so that this will relate only to incurred cost directly attributable to the vessel construction.

Accordingly, additional loan support of up to £14.55m will be made available to CMAL to enable payment to FMEL of contractual sums due, subject to the conclusion of a detailed contract variation between CMAL and FMEL. We will issue a revised funding letter to CMAL for this purpose.

In parallel with the above arrangements, the Scottish Government is considering whether it may be possible to provide support to FMEL in other ways outwith the contracts for the construction of the vessels. Those considerations involve colleagues across Scottish Government and are unlikely to impact directly on CMAL's relationship with FMEL.

I can confirm that the contents of this letter do not change the contents of my letter of 9 October 2015 in relation to the contracts (letter enclosed for ease of reference).

Regards



John Nicholls

APPENDIX 14 – LETTER FROM CMAL TO FMEL

12 JANUARY 2018



Caledonian Maritime Assets Ltd
Municipal Buildings
Fore St
Port Glasgow PA14 5EQ

Tel: [REDACTED]
Fax: [REDACTED]

Mr Gerry Marshall
Ferguson Marine Engineering Limited
Orbital House
3 Redwood Crescent
East Kilbride
G74 5PA

12 January 2018

Dear Gerry

(1) NEWBUILDCON between Ferguson Marine Engineering Limited ("FMEL") and Caledonian Maritime Assets Limited ("CMAL") dated 16 October 2015, as amended, in relation to FMEL hull no. 801

(2) NEWBUILDCON between FMEL and CMAL dated 16 October 2015, as amended, in relation to FMEL hull no. 802 (together, the "Contracts")

Thank you for your letter dated 8 January 2018.

Since July 2017 we have been seeking to understand the reasons why, legally, the claims that you have made are justified. We asked you this in open correspondence on 17 August 2017, 21 September 2017, 13 December 2017 and 24 December 2017.

You respond on each occasion to describe circumstances of one kind or another where you seek to justify these very significant extra payments, from public funds, perhaps on the grounds of fairness or foreseeability but without reference to the Contracts themselves.

You are aware of the entire agreement provisions of the Contracts. You are also aware that FMEL expressly tendered its competence to the task at hand and contracted to do so on the basis of an internationally recognised template form of agreement which contains detailed mechanisms for claims of additional time and/or money.

Your suggested definition of 'Disputes' for the purpose of the Mediation Agreement to be as described in your letter of 11 December 2017 is not in itself unreasonable but we cannot escape the glaring omission of any contractual references in that letter. The terms of the Contracts are almost wholly ignored.

We do agree that if a resolution were to be reached, that the mediation should aim to capture the commercial headlines of an addendum to each of the Contracts – for example to vary the terms of Clause 15(b)(i) if considered appropriate.





Caledonian Maritime Assets Ltd
Municipal Buildings
Fore St
Port Glasgow PA14 5EQ

Tel: [REDACTED]
Fax: [REDACTED]

We ask again: do you contend that the claims fall within Clause 24 of the Contracts or are they something else?

If the mediation is to be constructive we must understand clearly in advance whether and how the claims are legally justified such as to fulfil the proper obligations of CMAL under the Contracts – which discussions we would welcome – but we will not receive board authority to attend a mediation that seeks essentially non-contractual compensation of some sort.

Having declined our suggestion of the key dates for inclusion in the Mediation Agreement, please advise the timetable to which you are working.

We have no difficulty with the meeting being at a hotel in Glasgow.

Yours sincerely



Kevin Hobbs
Chief Executive Officer

for and on behalf of
Caledonian Maritime Assets Limited

