Further written submission from Jim McColl, Former Director, Ferguson Marine Engineering Limited, by email, 11 November 2022

Response to the First Minister's evidence to the Public Audit Committee on 4 November 2022

Why FMEL did not go to court against CMAL

The contract for 801 and 802 was a standard newbuild Baltic and International Maritime Council (BIMCO) contract. The contract allowed for the price to be adjusted in accordance with the terms of the contract in section 2 - Financial, paragraph 7.

Paragraph 15(b) covers payment for modifications and changes.

Section 5 - Legal, paragraph 42(b) covers expert determination.

This was not a fixed price contract as has been adamantly vocalized repeatedly by the CMAL CEO and parroted by the First Minister, the Deputy First Minister and various Cabinet Ministers and SNP MSPs. The Auditor General also used the term "fixed price" in his report.

The Deputy First Minister, John Swinney was asked by reporter Mark Daly why, when Scottish ministers owned CMAL, did they not sort out the issue of mediation and get everyone, CMAL, FMEL, and Transport Scotland around the table to resolve the growing conflict?
Swinney said: "The basis of what was being aired was essentially a departure from a fixed price contract and once that had been settled there was no legal basis for that to be explored and that was the issue that prevented dispute resolution being taken forward in that context." The Government used the false claim of a fixed price contract to prevent dispute resolution being taken forward.

This false claim has originated and been used by CMAL to suppress any serious discussion about price increases, to frustrate mediation and to block an expert determination process.

Early in the contract to build the two LNG dual fuelled ferries, variations to the original contract were resulting in significant changes and cost increases. These went well beyond what would normally be expected in a standard new build contract. CMAL refused to discuss these despite numerous attempts by FMEL to engage with them, claiming that the contract is a fixed price design and build contract.

The Court of Session Practice Note 1 of 2017, under Pre-action Communication states in paragraph 11:

For their part, solicitors acting for the defender are expected to respond to pre-litigation communication by setting out the defender's position in substantial terms; and by disclosing any document or expert's report relating to liability upon which they rely. To

that response the solicitors for the pursuer are expected to give a considered and reasoned reply. **Both parties should consider carefully and discuss whether all or some of the dispute may be amenable to some form of alternative dispute resolution**.
Paragraph 12:

"Saving cases involving an element of urgency, action should not be raised using the commercial procedure until the nature and extent of the dispute between the parties has been the subject of careful discussion between the parties and /or their representatives and the action can be said to be truly necessary."
Before bringing a commercial case before the Court of Session, both parties are expected to have exhausted all other means of resolving the dispute.

The Founding Principles of the Arbitration (Scotland) Act 2010 state that **"The object of arbitration is to resolve disputes, fairly, impartially, and without unnecessary delay or expense."**

"Arbitration is also private, which is another major advantage to commercial parties who may not wish the nature of their dispute or sensitive commercial information debated openly in the courts. The parties can choose their arbitrator, which is not possible in the Courts. **By way of example if a technical expert is appointed as an arbitrator, this may reduce the need to lead technical evidence so that arbitration may be quick, cost effective and efficient.** The process can provide flexible procedures (as it is privately funded and initiated) and because it is within the parties' control, the location, timing and other arrangements can be planned to suit their particular needs."

The contracts for 801 and 802 Included a section on dispute resolution which allowed for an Expert Determination process. The dispute between the parties was of a complex technical nature which unquestionably required Independent Expert involvement. The Expert appointed in such a process acts as an Arbitrator. **Refusing to take part in Expert determination prevented all other means of resolving the dispute from being exhausted**.

Ferguson needed the process to be quick, cost effective and efficient. The business had been put under financial pressure by CMAL and the Scottish Government and could not fund a long drawn out and extremely expensive legal action through the Courts. Also, suing CMAL would have resulted in an immediate cessation of work on both vessels and paying off several hundred workers. CMAL would have claimed breach of contract leading to a long and expensive legal action which was in neither party's interest. Such an option would have been extremely reckless and irresponsible.

At the all-parties meeting held that Victoria Quay in Edinburgh on the 10th of April 2018, attended by representatives from the Scottish Government, Transport Scotland, CMAL, FMEL and Clyde Blowers, **Transport Scotland proposed an Expert Determination process**. This was opposed by the chairman of CMAL, who said that his board had taken the staggering decision not to allow an independent expert.

When the First Minister was asked by Colin Beattie when she appeared before the Public Audit Committee: "What did ministers talk about in terms of resolving the

dispute - because it was a major issue?" Her answer was: "we were at all stages seeking to discharge that wider responsibility to try to keep the yard open and operational, to protect employment and to get the vessels finished. All along you will see evidence in the public documents of Government seeking to do that. Ministers were seeking to try to keep the relationship where it needed to be to improve the relationship. To use their best offices where they could, to resolve the issues between the parties. There was a view on the part of the government that they wanted to encourage mediation. There was a period when mediation was agreed by both parties, it didn't happen, the chosen mediator wasn't available in the time scale that was necessary. **Expert determination was deemed by CMAL not to be appropriate, rightly in my view, because of the scale of the claim."**

A notice of mediation was served on CMAL on 31st August 2017, three potential mediation candidates were identified by FMEL and CMAL. The preferred candidate was agreed by both parties, but when approached was not available until April 2018. Given the urgency of the deteriorating situation, FMEL wished to approach one of the other candidates, but CMAL refused and insisted on waiting for the first-choice candidate to become available. Preparation of the scope of the mediation followed, but it became very clear that CMAL would not agree to the proposed scope for the mediation. They claimed that this was a fixed price contract, and that mediation could not consider any increase in price.

The First Minister stated that "at all stages we were seeking to discharge that wider responsibility to try to keep the yard open and operational, to protect employment and to get the vessels finished." **The Government also had a responsibility "to resolve the dispute, fairly, impartially, and without unnecessary delay and expense**," in accordance with the Founding Principles of their own Arbitration (Scotland) Act 2010. Expert Determination was not only the best way to achieve this, it was the only way. The FM said that ministers were seeking to try to keep the relationship where it needed to be to improve the relationship. To use their best offices where they could, to resolve the issues between the parties. Their best offices should have been applied to ensuring an independent Dispute Resolution process.

"The public audit committee was established in June 2021. It mainly focuses on reports published by the Auditor General for Scotland **to ensure that public money is spent efficiently and effectively by:**

- **the Scottish Government, and**
- **other public bodies**

Independent Expert Determination was the appropriate way to resolve the dispute to ensure that the Government discharged its wider responsibility to ensure that public money was spent efficiently and effectively and to keep the yard open and operational, to protect employment and to get the vessels finished.
For the First Minister to say that, rightly in her view, "Expert Determination was deemed by CMAL not to be appropriate, because of the scale of the claim." was a nonsense, spoken words that have no meaning or make no sense. There is no restriction on the scale of a claim in an Expert Determination process.
Before bringing a commercial case before the court of session, both parties are expected to have exhausted all other means of resolving the dispute.

The Scottish Government's decision to reject Transport Scotland's proposal in early April 2018, and repeated requests from FMEL, for an Expert Determination process, unthinkingly defending CMAL, has resulted in public money being squandered on a reckless and foolish scale. It also forced FMEL into administration, a business that was well invested, with a healthy pipeline of work diversifying the business away from a dependence on Scottish Government ferry work.

Meeting with the First Minister on 31st May 2017

In an attempt to resolve the standoff between FMEL and CMAL I met with the First Minister at Bute house to request her intervention to facilitate meaningful discussions around the significant changes and cost increases being experienced in the two ferry contracts.

She said that the discussion at the meeting was around me raising concerns about cashflow, money being tied up unfairly in a security bond. "These are the concerns that he was expressing to me."

It was not until the 31st August 2017 that I approached the Government about the £15 million that FMEL had tied up in escrow. This was Ferguson's money which I felt was unnecessarily tied up in a security bond. The Government felt that this would be construed as a breach of EU procurement rules and facilitated a government loan of £15 million instead. None of this was discussed at the May 31st meeting with the FM as represented by her to the Public Audit Committee.

On May 31st I explained to her the seriousness of the situation and that CMAL were refusing to discuss the claims with FMEL. I had been asked by FMEL to intervene to try and resolve what was becoming a very serious situation. Following this meeting the First Minister asked the Director General for Economy to lead a government task force to work with both parties to try and resolve matters. The First Minister also requested FMEL submit the current cost overruns, which were running around £16.5m, to CMAL.

The First Minister said she did not go into it thinking it was a great crisis meeting nor did she come out of it thinking it was. The fact that I had to appeal to the First Minister directly was an indication that it was a very serious situation. I communicated that clearly to her at the meeting. She could have been in no doubt about the urgency of the situation and that if we did not do something it would become a crisis.

The minutes of the meeting will reveal the seriousness of the discussion. There must also be correspondence - a briefing note to the FM on the purpose of the meeting and to Liz Ditchburn (the then Director-General Economy), briefing her on the situation which will verify the true nature of our discussion.

Other observations on the FM's evidence to committee.

During her evidence on Friday to the public audit committee, Nicola Sturgeon accused Clyde Blowers Capital which owned the Ferguson shipyard of breaching the conditions of a government loan to the yard because it had failed to invest further equity into the business. The £30 million loan was brokered to help cover cost overruns on the project which Ferguson claimed were caused by design changes to the vessels imposed by the Scottish government's procurement vehicle CMAL and was very much viewed as a short-term bridging loan.

When the government provided a loan of £30 million to the yard in 2018 it insisted that we put money in as well. Clyde Blowers committed £3 million as a bridging loan. We made it very clear at the time that we were not going to put in equity to subsidise a government contract and it's a total misrepresentation by the first minister to suggest bad faith by Clyde Blowers. We had committed to invest a further £5.5 million in the yard for expansion but only after a dispute resolution had been agreed through an Expert Determination process.

The First Minister also said that prior to going into administration FMEL had announced redundancies at the yard. This is false. During CBC's ownership of the yard there have never been any redundancies.

She also said that in consideration of the proposal put forward by Jim McColl before nationalisation "you can see from all the documentation, that was rigorously assessed and considered by the government and for a range of state aid and legal procurement issues" could not be considered. I am not aware of "all the documentation" that she referred to which the committee has. I was very concerned at the time at the lack of serious consideration given to the proposal. We received a response to the proposal from Derek Mackay stating that the Governments 'view was that the CBC proposal falls short of compliance with the Market Economy Operator Principle and there are a number of serious legal risks including that entering into the proposal would be unlawful. In an email back to him I said:

"We have received no explanation or feedback from the Scottish Government to support its view other than the bland statement that our proposal is illegal.
In light of Counsel's Opinion, can I ask you to revisit the FMEL proposal. This results in FMEH and ultimately CBC taking half of the pain for the increase in the price of the vessels and results in halving the cost to the Scottish Government."

It also resulted in the additional cost to the Government being capped at £50 million.
Derek Mackay's response was: "We have reviewed the legal opinions that you provide to us. Scottish ministers remain of the view that the CBC proposal falls short of compliance with the Market Economy Operator Principle, (MEOP) and that a number of significant risks remained"

It does not appear that the government "rigorously assessed" the proposal. There is one day between my appeal to reassess the proposal and this response. Given Senior Counsel's unequivocal opinion that the offer was legal I would have expected the Government to take their own QC's opinion. There is no evidence that they did.

If the Government had received an independent opinion confirming it was legal, and accepted the proposal it would have saved at least £200 million of taxpayers money. The claim by the FM that the proposal was "rigorously assessed needs to be probed and evidenced.

A letter from the Director General, Economy was sent to the CEO of FMEL on the 25th April 2019. The letter acknowledged the Scottish government's awareness of the challenges surrounding the build of the CMAL vessels and the stalemate with respect to the claim, also noting the meeting between the contracting parties had been unproductive. The letter also stated," to better illuminate matters the Scottish Government will now seek an independent view of the claim. We expect this process to last around one month and be conducted by a Senior QC. The individual conducting this work on our behalf will need access to relevant documentation. We would welcome FMEL support with this process."

The dispute covered many highly technical issues and was not a purely legal dispute. The proper way to deal with it was through an Expert Determination Process which was allowed for in the contract and would have given both parties the opportunity to state their case. FMEL were denied this opportunity. The opinion of Senior Counsel was received on the 21st of June 2019. He had not contacted FMEL for any input nor had he sought independent technical assistance, in my opinion, a critical omission.

The QC was asked first whether the parties are bound by the contract entered into or if there is a reasonable legal basis for the contracts to be set aside and for FMEL to be paid on a cost-plus basis.

This question set by the government was irrelevant as FMEL were not asking for the contract to be set aside or to be paid on a cost plus basis, they were asking for the Independent Expert Determination process as provided for in the contract. So the first part of the QC's opinion is not relevant to the dispute.

On the second question,

Senior counsel was asked to opine on the legal merits of FMEL's claim. His opinion was that he could not give a view on the disputed factual issues.
Importantly, he did not say that there was no legal basis for CMAL to pay more than the £97M contract price.

He was also asked for his views on FMEL's claim as presented by HKA. Again he said that he could not express a view.

Despite this inconclusive opinion the Scottish Government claimed that it was conclusive and manipulating it in an unscrupulous way, used it as evidence that FMEL did not have a justifiable claim, closed off any opportunity for an independent dispute resolution process and used it to justify nationalising the Yard against the advice of its own Independent Expert, Commodore Luc van Beek.

- The First Minister was alerted to the serious issues with the two vessels almost five and a half years ago.

- She was issued with a report by BCTQ, highly qualified Naval Architects and Marine Engineers, on the 2nd April 2018, detailing serious issues with CMAL and their original specification. HKA and Commadore Luke van Beek confirmed their findings. Three Expert opinions and CMAL were never seriously challenged.

- The Government strongly resisted confronting CMAL and supported their refusal to engage in a meaningful dispute resolution process.

- The CMAL board misled the government by repeatedly claiming that the contract was a fixed price contract. A simple review of the contract would have exposed this claim to be false.

- The Government have misled Parliament, the Auditor General and the public by claiming that the contract was a fixed price contract.

- The Scottish Government appointed a QC for an independent review of the claim when an Expert Determination Process was the appropriate way to legally resolve the dispute under the terms of the contract.

- The Auditor General stated in his report “In May 2019, the Scottish Government commissioned an independent view. It concluded in June 2019, that there was no legal basis for CMAL to pay more than the £97 million price paid for the contract.”

- The QC’s answer to the question on the legal merits of the case being advanced by FMEL, answered in his opinion. “I consider that this is an important restriction on the scope of the views that I express in this opinion. I do not consider that I usefully give a view on these disputed factual issues”.

- The Government’s conclusion that there was no legal basis for CMAL to pay more than the £97 million price paid for the contract was not supported by the QC opinion. This was another instance where the Government misled Parliament. The Auditor General should have checked this before quoting it in his report.

- Having read the QC Opinion, the Government should have instructed CMAL to engage in a Dispute Resolution Process. They did not, instead following through with the false statement that there was no legal basis for CMAL to pay more than the £97 million.

- In a final bid to resolve the dispute, Clyde Blowers made a proposal to the Government which would limit the additional costs borne by them, to £50 million. The Government claimed that the proposal breached EU rules. Clyde Blowers shared a Senior QC’s opinion (see **Annexe**) confirming that the proposal did not breach any EU or State aid rules and was perfectly legal. Derek Mackay dismissed it saying that was not the Governments’ view.

- The Government have incurred over £200 million of costs since nationalising the yard and they are not finished yet. This need not have happened if the Government had heeded the early warning given to the First Minister over five years ago, or if she had reacted properly to the damning BCTQ report, or if they had taken the HKA claim seriously and insisted on an expert determination process, or if they had taken the time to read the BIMCO contract and find out that it was not a fixed price contract, or if they had not rode roughshod over their QC Opinion and Clyde Blowers' on the proposal to cap the Governments' costs.

- A fear of confronting CMAL seems to have prevented the Government from acting effectively to prevent this catastrophic mess. Don't be distracted by the Bank Refund Guarantee which would have been for the £97 million contract price. An equivalent to a cash refund guarantee was in place. The current cost is running at £340 million and rising. The real issues here are the problems with the original specification issued by CMAL, their subsequent handling of the contract and the Governments' handling of the dispute.

OPINION of SENIOR COUNSEL

For

CLYDE BLOWERS CAPITAL & FERGUSON MARINE ENGINEERING LIMITED ("CBC" & "FMEL")

Re

LAWFULNESS OF PROPOSAL MADE TO SCOTTISH GOVERNMENT

INTRODUCTION & SUMMARY

1. I refer to Agents' letter of instruction dated 26th July 2019 and note that I have been instructed to advise on the following issues. For ease of reference, a summary of my advice is provided in bold type.

   a. Can the proposal which has been made to the Scottish Government by CBC and FMEL, relating to an equity investment, be implemented without engaging or breaching procurement law? **Yes. The proposal does not engage procurement law.**

   b. Is this proposal capable of being implemented consistently with the market economy operator principle ("MEOP") for State aid purposes? **Yes. The proposal is not unlawful State aid.**

   c. Is the fact that a business is publicly-owned relevant to the question of whether or not public funding provided to it is State aid. **No. The rules governing State aid apply equally to privately and publicly owned companies.**

2. This Opinion will now consider each of these issues in detail after first setting out the main features of the proposal which has been made to the Scottish Government.

THE PROPOSAL

3. The aim of the proposal which has been made to the Scottish Government ("the Proposal") is to find an efficient and cost-effective way of completing the contract for the construction of the vessels. In order to achieve this a new corporate structure is required and the Proposal involves the following steps being taken:
   - FME(H) sets up a Newco (Ferguson Marine Engineering Technology Company Limited).
   - FMEL transfers all of its assets and liabilities (other than the contracts for 801 and 802) to NEWCO.
   - With the consent of CMAL, FMEL enters into a subcontract with NEWCO to complete the vessels.
   - The Scottish Government converts £10m of its loan in FMEL into equity in FMEL and FMEL assigns the balance of the £5m of the existing £15m loan to FME(H). Interest would cease to accrue on the loan and warrants would be issued.
   - The Scottish Government then invests a further £50m into FMEL to give it 95% of the equity in FMEL. FME(H) retains the balance.
   - The bond for 801 will cease on 31st August 2019. The 802 bond would roll off 31 December 2019. Neither bond will be extended as there is no contractual obligation to do so. Once both bonds have expired, the surety is released with the £5m then being available for use in the group. The Scottish Government would then take a first ranking security for its £35m loan. NEWCO would also become part of the security package.
   - Claim proceedings would not be pursued.

4. Under the Proposal the Scottish Government would obtain delivery of the vessels 801 & 802 with an additional investment of £50m plus £10m conversion of the loan, with NEWCO having to generate sufficient cash to distribute to FME(H) to allow it to repay the £35m loan before CBC would secure any equity value from FME(H).

5. Having identified the main features of the Proposal, its lawfulness under reference to procurement law and State aid law can now be considered.

PROCUREMENT LAW

Summary

6. The Proposal does not engage procurement law and it is not necessary to carry out any procurement exercise before implementing the proposal. If the Proposal was implemented, any challenge based on procurement law would not have reasonable prospects of success.

Discussion

7. The contracts for the construction of vessels 801 & 802 were subject to procurement law and a tender process was carried out which complied with the requirements of the Public Contracts (Scotland) Regulations 2015. However, the proposal does not engage procurement law because it does not involve any modification to the terms of the contracts between CMAL and FMEL as procured. No new contractual obligations are created and no existing contractual obligations are modified. The Proposal is an equity investment. It does not place any new obligations upon FMEL to produce any works, services or supplies.

8. Importantly, the proposal does not breach any of the terms of the contracts as procured. The contracts as procured expressly permit FMEL to appoint sub-contractors subject to CMAL's consent. There is no change in the identity of the counter-party to the contracts with CMAL, which will remain FMEL.

9. In order to potentially engage procurement law, there would require to be some change to the obligations of the contracts as procured. In the absence of any such changes, procurement law is not engaged. As discussed above, the existing contracts and the obligations thereunder remain unchanged. In particular, the works to be carried out by FMEL and the price to be paid by CMAL remain unaltered. In the absence of any new or varied obligation on the parties, there is no modification to the contracts to which a procurement obligation might attach.

10. I note that the solicitors acting on behalf of the Scottish Government have cited the English Court of Appeal case of ***Faraday Development Ltd v West Berkshire Council*** [2018] EWCA Civ 2532. In that case, the Court of Appeal held that although a development agreement entered into by a local authority and a property developer was not a "public works contract" as defined in Directive 2004/18, by entering into the agreement the local authority had unlawfully committed itself to entering into a public works

contract in the future without following the public procurement procedure.

11. Lindblom LJ explained why this was the case at paragraphs [62] and [63] of his judgment:

> "62. By entering into the development agreement, therefore, the council effectively agreed to act unlawfully in the future. In effect, it committed itself to acting in breach of the legislative regime for procurement. As Mr Giffin submitted, that is in itself unlawful, whether as an actual or anticipatory breach of the requirements for lawful procurement under the 2004 Directive and the 2006 regulations, or simply as public law illegality, or both. The only other possibility would be that a contracting authority is at liberty to construct a sequence of arrangements in a transaction such as this, whose combined effect is to constitute a "public works contract", without ever having to follow a public procurement procedure. That would defeat the operation of the legislative regime.
> 63. Those conclusions do not, in my view, offend any principle in the authorities. They sit well with the approach evident in the relevant decisions of the Court of Justice of the European Union, which requires the national court to look at the real substance of the transaction, and to view the several stages of a "multi-stage" process as a whole. In this case that entails not only a first stage, comprised in the development agreement itself, but also a second stage provided for in it, which is initiated when the option is exercised and land is drawn down by the developer. In that second stage the developer's obligation to execute the works is effective, and the public works performed. Inherent in this two-stage process is a public procurement. The breach of the 2004 Directive and the 2006 regulations occurs when the land is drawn down by St Modwen. At that point the council retains its contractual control over the content of the works, but has no further control over the award of the contract for their execution. Once the option is exercised, the council is obliged to enter into a long lease, and St Modwen is obliged, under both the lease and the development agreement, to bring the works to fruition."

12. The present circumstances are very different. The Proposal would not involve the Scottish Government or CMAL incurring an obligation to act unlawfully in the future. In particular, the Proposal does not impose any obligation to act in any way which would otherwise have required a procurement exercise to be carried out. There is no future breach of procurement law embedded in the proposal. This is why the Proposal can be distinguished from the case of ***Faraday***.

13. It is for these reasons that the Proposal does not engage procurement law and any challenge to it, which was based on procurement law, would not have reasonable prospects of success.

14. Finally, it should be noted that any challenge to the Proposal under procurement law could only be brought by an unsuccessful tenderer for the contracts to build the vessels. The remedy sought would be damages for the loss of the opportunity of winning the contracts. These damages would be based on the likely loss of profits duly discounted to take account of the fact that it was a lost opportunity rather than a certainty. Having regard to the difficulties encountered with the hybrid propulsion system, it is likely that any such profits would have been extremely

modest, if any. Accordingly, the scope for any damages claim would be extremely limited.

15. In addition, I do not consider it a realistic possibility that an ineffectiveness order would be pronounced by the court. To date only one ineffectiveness order has been pronounced by the Scottish courts. The statutory criteria for granting an ineffectiveness order are extremely stringent and the courts are very reluctant to grant such orders.

16. For these reasons, it is highly unlikely that there would be any challenge to the Proposal relying upon procurement law. Even if there were to be such a challenge, and in the highly unlikely event that such a challenge were to be successful, the only remedy likely to be granted would be a modest award of damages.

STATE AID LAW

Introduction

17. Under Article 107 of the Treaty on the Functioning of the European Union ("TFEU"), public funding, investment or other aid triggers the State aid rules if it:
    - is granted from state resources;
    - is selective in nature;
    - favours an economic undertaking; and
    - has an effect on competition and on trade between Member States of the EU.

18. All four of these elements must be present for there to be State aid. State aid is unlawful unless it falls within an exemption (set out in EU legislation) or is notified to the European Commission and the Commission approves the aid on the grounds that it is compatible with the internal market.

MEOP

19. The Market Economy Operator Principle ("MEOP") is a concept which has been developed by the Commission to determine whether a transaction entered into by a public body gives an advantage to a particular economic undertaking and therefore falls within the State aid regime. In broad terms, MEOP provides that an economic transaction carried out by a public body does not constitute State aid if it is carried out in line with

normal market conditions. Accordingly, the State aid rules are not triggered if a market operator, of a comparable size to the public body, operating in the normal conditions of a market economy could have been prompted to enter into the transaction on the same terms.

20. Whether a State intervention is in line with market conditions must be examined on an *ex-ante* basis, having regard to the information available at the time the intervention was decided upon: see, e.g. ***Commission* v *EDF***, C-124/10 P, ECLI:EU:C:2012:318 at paragraphs 83, 84 and 85 and 105. Whether a transaction is in line with market conditions must be established through a global assessment of the effects of the transaction on the undertaking concerned without considering whether the specific means used to carry out that transaction would be available to market economy operators. To assess whether certain transactions are in line with market conditions all the relevant circumstances of the particular case should be considered.

21. A relatively recent example of the application of MEOP can be found in the judgment of the English Court of Appeal in ***Sky Blue Sports & Leisure Ltd v Coventry City Council*** [2016] EWCA Civ 453. The Court of Appeal agreed with the High Court that a loan provided by Coventry City Council to Arena Coventry Limited (ACL), the operator of the Ricoh Arena, was not State aid because MEOP was satisfied. The Council indirectly owned a 50% stake in ACL. ACL had become unable to service a loan of £22 million from Yorkshire Bank because Coventry City Football Club (CCFC), which had both a licence and a lease over parts of the Arena, had defaulted on its rental and licence fees. This meant ACL was in a distressed state and vulnerable to both falling into default with Yorkshire Bank and being prey to a bid for control by the owners of CCFC, companies in the SISU group. Keen to avoid SISU gaining control over ACL by purchasing the bank's debt, the Council loaned to ACL the monies it needed to pay off its loan from Yorkshire Bank. SISU alleged that this amounted to unlawful State aid.

22. In arriving at its decision, the Court of Appeal confirmed the following general principles:

    a. A public body is afforded a wide margin of discretion when taking an entrepreneurial decision. There will often be a wide spectrum of reasonable reactions which entrepreneurs may have to a particular set of commercial circumstances, and a transaction will only involve State aid if it is manifestly clear that no rational market operator would have entered into a transaction on the same terms.

b. The comparator market operator need not be an unduly prudent investor. The Court recognised that entrepreneurs balance risk against reward, and if a market operator could have been prompted to enter into the transaction, that will be enough to satisfy MEOP. Therefore a degree of optimism as to future profits and calculated risk-taking is permitted. On the other hand, MEOP will not be satisfied if it is inconceivable that a market operator would have been willing to enter into the transaction.

c. A public body must base its decision on an economic evaluation comparable to that which a rational market operator would have carried out in the same circumstances. In the case of an investment, this will normally include consideration of a business plan justifying the investment.

d. The economic evaluation should be based on objective criteria and carried out by an expert with the appropriate skill and expertise. It is not necessary to use an independent expert, and the Court of Appeal confirmed in this case that the council's own officers could provide the economic evaluation for the council's elected members. However, the Court added that the use of an independent expert may help to bolster the credibility of the evaluation.

e. If a bank or other lender has made a contemporaneous offer of funding which demonstrates that the bank/lender believes the recipient is capable of servicing a loan of a particular amount, this is a relevant factor which a market operator would take into account.

f. A public body is entitled to have regard to its policy objectives when taking a decision. However, no account is to be taken of policy objectives when carrying out the MEOP assessment because a market operator would be motivated by profit rather than policy.

g. Any existing relationship between the public body and the aid recipient can be taken into account. For example, if a public body wishes to invest further monies into an undertaking in which it already has a shareholding, the comparator market operator would be a private investor with a similar shareholding.

h. A market operator may be looking to secure a profit over the longer term rather than being solely focussed on making a short-term profit,

particularly if it has an existing investment (such as a shareholding) to protect.

i. A public body with an existing investment may even be able to rely on MEOP when investing in a business which is currently in financial difficulties if there is a reasonable likelihood that the business will become profitable again. While a new investor would not make an investment which exceeded the net value of the business, a market investor with an existing investment to protect may be willing to do so in order to turn the business' fortunes around.

23. It is these principles which require to be applied to the Proposal in order to determine whether or not MEOP is applicable.

The Proposal

24. If the foregoing principles are applied to the Proposal, it is consistent with MEOP and therefore does not fall within the State aid regime. The Proposal is in line with normal market conditions. A market operator, of a comparable size, operating in the normal conditions of a market economy could have been prompted to enter into the Proposal on the same terms in the circumstances as they currently exist. A reasonable market economy operator, faced with the current situation, would accept the Proposal as offering the best economic prospects of the available options. This is because the Proposal is the best means of recovering the loans made to FMEL and also of securing, at the lowest possible cost, completion of the contracts and delivery of the vessels on which significant funds have already been expended.

25. The Proposal sets out the following reasons why a reasonable market economy operator faced with the current situation would accept it as offering the best economic prospects of the available options:

"It provides the best possible chance of recovery of the £30m loan. Without the involvement of CBC and the current senior management team, which would not continue in the event that SG took 100% ownership in FMEL, SG as owner and operator of the business is unlikely to be able to exploit the current opportunities the business has. In particular, it is highly likely that the MOD business will be lost. The risk of the business failing to generate the revenues necessary to repay SG's loans would therefore be significantly increased.

Linked to the above, should SG not accept the proposed structure, it may be that other creditors take action which would be prejudicial to the recovery of the SG loan monies and the completion of the vessels. In that situation, a market economy operator would take action designed to avoid that risk, i.e. accepting our proposal.

The proposal would give CMAL and SG comfort that they will not have to deal with some form of litigation proceedings in the future arising out of the current circumstances.

The alternative to the proposal would, in the absence of any other secured creditor taking action, be for SG to take ownership of FMEL at fair value. That fair value assessment would have to include the value of FMEL's claim against CMAL, even if SG would ultimately not pursue that claim."

26. All of these points are well made. As the Court of Appeal made clear in ***Sky Blue Sports & Leisure Ltd,*** *supra* a public body is afforded a wide margin of discretion when taking an entrepreneurial decision and the comparator market operator need not be an unduly prudent investor. A degree of optimism as to future profits and calculated risk-taking is permitted. Importantly, the Court of Appeal recognised that a public body with an existing investment may even be able to rely on MEOP when investing in a business which is currently in financial difficulties if there is a reasonable likelihood that the business will become profitable again in the longer terms. In the present case, the Scottish Government has already committed significant sums to FMEL and the Proposal will allow FMEL to return to profitability in the longer term and offer the Scottish Government its best chance of recovering its loans and other expenditure. The permitted margin of discretion would enable the Scottish Government to lawfully accept the Proposal which is based on not unduly optimistic economic predictions.

27. It is for these reasons that I consider that the Proposal does not fall within the State aid regime.

Nationalisation

28. EU law is neutral with regard to the system of property ownership and does not in any way prejudice the right of Member States to act as economic operators: see Article 345 of the TFEU which provides that *'The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership".* However, when public authorities directly or indirectly carry out economic transactions in any form, they are subject to Union State aid rules: see, e.g. ***Belgium*** **v** ***Commission,*** 40/85, ECLI:EU:C:1986:305 at paragraph [12].

29. Accordingly, even if the Scottish Government were to nationalise FMEL, it would still be subject to State aid law in exactly the same way as it is at the present time. Nationalisation is not a mechanism for circumventing State aid rules, which apply equally to both privately and publicly owned undertakings.

30. I trust that the foregoing answers all of the questions posed by Agents. If I can be of any further assistance Agents should not hesitate to contact me.

THE OPINION OF:

[redacted]
Advocates' Library,
Parliament House,
Edinburgh.
26th July 2019

OPINION by SENIOR COUNSEL

For

CLYDE BLOWERS CAPITAL &
FERGUSON MARINE
ENGINEERING LIMITED

Re

LAWFULNESS OF PROPOSAL
MADE TO SCOTTISH
GOVERNMENT

2019

[redacted]

BRODIES LLP