From: [Redacted] **On Behalf Of** DG Economy
Sent: 25 May 2017 15:40
To: [Redacted] First Minister; DG Economy; Deputy First Minister and Cabinet Secretary for Education and Skills; Cabinet Secretary for Finance and the Constitution; Cabinet Secretary for Economy, Jobs and Fair Work; Cabinet Secretary for the Rural Economy and Connectivity; Minister for Transport and the Islands
Cc: Maxwell S (Stewart) (Special Adviser); McAllister C (Colin); Lloyd E (Elizabeth); [Redacted] Director of Financial Management; PS/Transport Scotland; Nicholls J (John) (TRANS); [Redacted] Permanent Secretary; [Redacted] McAllan M (Mary); [Redacted] Brannen R (Roy); [Redacted]
Subject: RE: IMMEDIATE: meeting with Jim MColl

[Redacted] PS Cabinet Secretaries

Thanks for this. Please find attached update / summary note on FMEL (which I sent to you separately a short time ago so you could get it into FM's weekend box).

[Redacted]

DG Economy and DG Finance | Scottish Government | [Redacted]

FMEL Cash Flow Issues – Update for Ministers – 25 May 2017

The Contract

- In November 2015, CMAL placed orders at FMEL for the construction of two 100m Dual Fuel Ferries (Vessel 801 for deployment on the Arran service to Brodick and Vessel 802 for deployment on the 'Uig Triangle' service).
- The value of the contract is £97m, £48.5m per vessel. The total cost to Scottish Ministers is forecast at £106m (which includes some additional CMAL costs). There is an opportunity for FM to launch one of the vessels in August or November this year.

Issue

- There have been a number of challenges throughout the contract, including delays to the programme which Mr McColl has stressed to Ministers is recoverable. The main current issue for FMEL is cash flow difficulties for the business which Mr McColl has said are linked directly to the terms of the contract with CMAL.
- On 2 March 2017 Mr McColl met with Derek MacKay, Keith Brown and Humza Yousaf to outline his concerns. His key asks were that
    - CMAL reduce the £25m final delivery payment from 25% to 10% of the contract value and that CMAL's stage payments be re-profiled accordingly to bring forward a total of £14.55m.
    - SG underwrite the separate £25m surety bond for the contract, which is currently tying up £15m of FMEL's capital in escrow
    - That we consider more generally, and for the future, how Government can support shipyards to win contracts in the wider market.

SG response

- Since 2 March there has been significant work undertaken by SG, CMAL and Scottish Enterprise to assess the situation and respond. This has included regular dialogue between Mr McColl, senior officials and Ministers, and of course between CMAL and FMEL at working level.
- Taking into account our legal and financial advice, the following has been agreed with / proposed to Mr McColl:
    - CMAL is reducing the final delivery payment from 25% to 10% of the contract value and bring forward £14.55m (from mid 2018) via two payments in May and June 2017. The first of these (c£7m) has been delivered this week.
    - [Redacted] We are therefore looking to do everything we can outside of the contract, working with Scottish Enterprise, to further support the future viability of FMEL.
    - Scottish Enterprise has proposed three high-level options for further support: loan finance, equity finance and a Government-backed guarantor mechanism. Mr McColl is not convinced that these offer a solution but has agreed to work with us to develop and consider them further.

<u>Current situation</u>

- Mr McColl continues to express concern with the current contract arrangements. He says that bringing forward the £14.55m payments is not enough to bridge FMEL's cash flow gap which he estimates at £10m. He considers that the options proposed by SE will not work due to the treatment of FMEL's assets in the contract and performance bond. He maintains that Clyde Blowers Capital cannot/will not provide additional funds to FMEL, and the only way of securing FMEL's ongoing viability is through further changes to the contract.
- Mr McColl has highlighted previously that he had not yet filed fund accounts for FMEL however he told Liz Ditchburn on 4 May that he could likely put in place a short-term fix for this issue, in-lieu of a wider solution being reached.
- In the latest conversation between Mr McColl and Liz Ditchburn DG Economy on Tuesday 23 May, Mr McColl agreed to give the new SE account manager (appointed to address the specific circumstances that have arisen) full access to FMEL's financial information on the basis that this will be required in any scenario.
- SE will conduct an analysis of FMEL's current financial situation and are due to meet with [Redacted] and [Redacted] of FMEL on Tuesday 30th at 3pm in their offices in East Kilbride. If this secures all of the necessary information, SE should be able to have an initial analysis by the end of next week (w/b 29 May).
- They will report their findings to SG and use it to undertake a more informed consideration of potential opportunities for further support.
- Liz Ditchburn has arranged to have her next catch up call with Mr McColl about this issue on Tuesday 30 May at 2pm.

<u>**Summary / Key Points**</u>

- We are working with Mr McColl to address the current cash flow difficulties at FMEL. Due to FMEL's strategic importance to the future of shipbuilding in Scotland we have a shared objective of securing its future viability.
- We have responded to FMEL's concerns, most recently by re-profiling payments, bringing forward by over one year £14.55m of payments. This is in addition to earlier assistance under which CMAL agreed in November 2015 to a performance bond arrangement, allowing FMEL to release cash.
- We are working with the company through Scottish Enterprise to assess options for additional support.
- We know that Mr McColl has continued concerns about the contract terms, that he considers further changes to the terms (additional to the £14.55m re-profiling) to be the only viable way of addressing FMEL's cash flow issues. [Redacted]

- Mr McColl has agreed to provide a full insight into FMEL's financial situation, including the relationship with their parent company, Clyde Blowers Capital, and we will use this to undertake an analysis which will allow us to take stock and assess next steps. We estimate that we will have an initial analysis by the end of w/b 29 May, assuming that Scottish Enterprise are able to get full access to the relevant information at their meeting with FMEL on 30 May.
- Whilst we understand that Mr McColl may want to move more quickly than this, it will be necessary for us to undertake this analysis in any scenario, and the re-profiling of £14.55m in two payments in May and June should help towards mitigating the immediate difficulties that FMEL face.