

[REDACTED]
1 April 2019

DG ECONOMY

FERGUSON MARINE (FMEL) LOAN – FINAL DRAWDOWN

1. On Friday (29 March) we advised Ministers that FMEL had requested the final £5 million of the SG loan and we intended to authorise the payment on the expectation that funds would flow in the early part of this week.

2. **This note seeks your formal confirmation that you are content as Accountable Officer for ED Directorate to proceed with the drawdown.**

Background

3. You are well-acquainted with the background to the £30 million loan facility for FMEL which Ministers agreed and you approved as Accountable Officer in June 2018.

4. The broad aims of the loan were to improve the liquidity of FMEL and thereby support delivery of two vessels for Caledonian Maritime Assets Ltd (CMAL), protect employment and shipbuilding capacity on the Clyde, and provide a platform for the shipyard to thrive in the longer-term. Specifically, the stated commercial purpose of the loan agreement is: “to assist with the long term viability and enhanced capabilities of the businesses carried on at the Property” and for “other general working capital purposes of FMEL, all as identified in the Business Plan and/or Financial Model”.

5. The ferries contracts are between FMEL and CMAL (SG is not a party) and any failure to meet agreed delivery milestones under the construction contracts is not a default trigger under the SG loan agreement. The SG loan agreement does not direct the application of funds other for than the stated purpose.

[REDACTED]

[REDACTED]

Loan conditions

8. The loan is a “fully committed facility” to be drawn down as required by FMEL according to the terms of the loan. SG is obliged to make payment to FMEL within 5

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Business Days of service of a drawdown notice provided Conditions Precedent to drawdown are met. The conditions are as follows:

- No Potential Event of Default or Event of Default remaining outstanding, unwaived or unsatisfied.
- Satisfaction that the aggregate amount of drawdowns as at the proposed Utilisation Date will be in an amount not exceeding the level set out opposite the relevant month in which the proposed Utilisation will be made in the table set out in Part 3 of the Schedule (Maximum Cumulative Drawdown Amount).
- Satisfactory assurance from the Scottish Ministers' independent operational expert that progress of the build of the vessels known as 801 and 802 is proceeding in accordance with the overall resource program presented by FMEL on 28 and 29 May 2018 at Port Glasgow, taking account of factors that are outside FMEL's control.

9. The first two conditions are met without ambiguity according to the advice of our external lawyers but the third is less clear-cut owing to the level of uncertainty surrounding the CMAL ferries programme and, in particular, the absence of an updated ferry delivery timeline and an account of the latest slippage.

10. The independent operational expert who supports our assurance processes around the third condition is Commodore Luke Van Beek. Luke's latest assurance report dated 8 March 2019 was prepared following his most recent visit to the yard on 5 and 6 March. In the report Luke acknowledges the lack of a programme but nevertheless concludes in favour of allowing drawdown thus:

“Against my original remit (a deliverable programme) I see challenges since no programme exists. I believe the factors which have led to this position were outside FMEL's control. I repeat that I believe FMEL have the managerial and technical capability to deliver both ships. On this basis I believe that, to maintain FMEL as an ongoing entity, draw down should be approved.”

11. The precision of Luke's assessment was hampered substantially however by the absence of a revised delivery programme from the yard setting out expected delivery milestones and resources.

12. Separately, the yard has refused CMAL's request for an up-to-date cardinal date programme on the grounds that no meaningful programme can be presented until the yard has visibility of funding for 801/802 beyond April. The contract dispute between CMAL and FMEL remains unresolved.

Scrutiny and assurance

13. In formulating our view on drawdown we have reviewed SG's contractual obligations and rights, and consulted with you (DG Economy as Accountable Officer), the Chief Financial Officer, Transport Scotland and our [REDACTED]

commercial advisers. We discussed the issues surrounding this drawdown request on a conference call with you, Gordon Wales, Mary McAllan, Roy Brannen, Chris Wilcock and our external commercial (PWC) [REDACTED] on 28 March.

14. Two central considerations in our discussions were (a) commerciality (MEIP compliance) and (b) the safeguarding Ministers’ contractual rights under the agreements – in particular:

- Ministers’ rights under the loan agreement to exercise SG’s share warrants to take partial ownership of the business and
- the compulsory purchase provisions (e.g. nationalisation) in the shareholders’ agreement which are triggered by imminent insolvency (Ministers’ right to buy FMEL at fair value of [REDACTED]).

15. On the first point, commerciality, Mark Addley (partner, PWC) advised on the conference call that it was “sensible to pay” the drawdown request; that step being justifiable on the grounds of not jeopardising Ministers’ future commercial options and to lessen the risk of undermining the value in the loan amounts already drawn.

16. [REDACTED]
[REDACTED]

- [REDACTED]
[REDACTED]

- [REDACTED]
[REDACTED]
[REDACTED]

17. [REDACTED]
[REDACTED]
[REDACTED]

Proposed information request

18. Under the loan agreement SG can call upon FMEL for any information that it may reasonably require. If the information requested is not forthcoming within the specified timescales then this would trigger a default. SG cannot introduce new information requests as Conditions Precedent to utilisation of the loan without the agreement of CBC, however.

19. [REDACTED]
[REDACTED]
[REDACTED]

- [REDACTED]

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- [REDACTED]
[REDACTED]
[REDACTED]
- [REDACTED]
[REDACTED]
[REDACTED]

Conclusion

20. Based on the above and the input you received direct from senior SG colleagues in Economic Development, Transport Scotland and Finance – and with the support of [REDACTED] operational and commercial advisers, are you content as Accountable Officer for Economic Development Directorate to:

- proceed with the £5 million drawdown?
- formally request from FMEL an updated delivery programme for the CMAL vessels and a financial account of past and future expenditure funded by the loan?

[REDACTED]
Economic Development Directorate

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

