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Public Audit Committee

New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802



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Public Audit Committee

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- (a) any accounts laid before the Parliament;
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2. No member of the Scottish Government or junior Scottish Minister may be a member of the Committee and no member who represents a political party which is represented in the Scottish Government may be convener of the Committee.



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Introduction

1. The Auditor General for Scotland (AGS) published his report, New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (the AGS's report) on 23 March 2022. The report is the outcome of an audit undertaken by Audit Scotland into the initial and more recent arrangements that are now in place to deliver the two vessels.
2. The AGS's report focussed on events after Scottish Ministers announced Ferguson Marine Engineering Limited (FMEL) as the preferred bidder on 31 August 2015. It does not audit any aspects of the procurement process before this point. During our scrutiny of the report, the Public Audit Committee (the Committee) sought to establish further detail about the initial stages of the procurement procedure which extend beyond the scope of the AGS's report.
3. The Committee considered the report for the first time at its meeting on 21 April 2022ⁱ. The Committee has heard a wide range of oral evidence from—
 - The AGS on [21 April](#) and [28 April](#) 2022
 - Scottish Government and Transport Scotland officials on [26 May](#) and [9 June 2022](#)
 - The former Director, Ferguson Marine Engineering Limited on [16 June 2022](#)
 - Caledonian Maritime Assets Limited (CMAL) on [30 June 2022](#)
 - The former Chief Executive of Transport Scotland and the former Minister for Transport and Islands/former Cabinet Secretary for Finance and the Constitution on [8 September 2022](#)
 - The First Minister of Scotland on [4 November 2022](#).
4. We also undertook an informal fact-finding visit to the Ferguson Marine shipyard on 31 October 2022 to engage directly with the workforce, senior management and trade union representatives about their experiences in relation to constructing the vesselsⁱⁱ. An [anonymised note](#) (see Annexe D of this report) of the key issues raised during the discussion with the workforce was prepared to help inform this report. The Committee recognises the vital contribution of the workforce and commend them for their commitment to the construction of the vessels.

ⁱ Details of all meetings where the Committee considered the AGS's report, New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 can be found at Annexe C – Extracts from Minutes.

ⁱⁱ Members in attendance at this visit were Richard Leonard MSP, Sharon Dowey MSP, Willie Coffey MSP and Craig Hoy MSP.



Source: The Scottish Parliament

5. A wide range of written evidence has also been received by the Committee. In total, we received [42 submissions](#), either in response to a request from the Committee

directly, or from organisations or individuals with an interest in the Committee's scrutiny of the AGS's report. These submissions highlight a range of different views about the nature, progress, and delivery of the contractⁱⁱⁱ.

6. We sought evidence from people who were involved in the early stages of the project as far as possible. This proved challenging, as many people have now left their post for various reasons given the time that has elapsed between the commencement of the project and present day. The Committee often found itself relying on the recollections of witnesses and occasionally on fading memories of the period under scrutiny.
7. The Committee is grateful to all those who contributed to our scrutiny of the report and shared their experience and knowledge, including those who are no longer in post.
8. That said, the lack of engagement by some stakeholders in our scrutiny work was disappointing. For example, delays occurred due to the unavailability of civil service officials as well as challenges in securing the attendance of a Portfolio Accountable Officer or Accountable Officer^{iv}. While these matters were ultimately addressed, concerns remain about the extent to which the role of Accountable Officers, and their obligations to Parliament were applied.
9. Late and incomplete information received from Transport Scotland, with little or no explanation, has further compounded the Committee's concerns about the level of respect and regard for accountability held for this important parliamentary scrutiny.
10. We were also disappointed with the written responses provided to questions we raised with the former Cabinet Secretary for Investment, Infrastructure and Cities. At the time the vessels were procured, the Cabinet Secretary was responsible for ferry services, supported by the Minister for Transport and Islands. The Committee was required to make three requests to the Cabinet Secretary for information before important written evidence was finally made available to us, which cast doubt on earlier oral evidence we received. This failure to assist the Committee's scrutiny work is a matter of serious concern^v.
11. The AGS's report ¹ covers a wide range of significant issues. The Committee focussed a substantial amount of its scrutiny on the initial stages of the project to deliver the vessels as we felt this required detailed examination. This includes aspects of the procurement exercise and the decision-making processes leading to

iii All submissions received are published on the Committee's website. Each should be read as the views of the respondent rather than those of the Committee. The Committee does not seek to comment on each submission received in this report.

iv The essence of the Accountable Officer's role is a personal responsibility for the propriety and regularity of the finances under their stewardship and for the economic, efficient and effective use of all related resources. Accountable Officers are personally answerable to the Parliament for the exercise of their functions. Portfolio Accountable Officers are responsible for the putting in place of appropriate framework documents for each Scottish Government Executive Agency, non-ministerial department and Scottish Government sponsored body, setting out the accountability arrangements and other relevant matters.

v There was division on this paragraph. See Annexe C, Minute of the Meeting of 23 February 2023, and note on 'Record of division in private' for more detail.

FMEL being awarded the contract. The Committee has also sought to gain a deeper understanding of the subsequent stages of the project and has set out a number of conclusions and recommendations in this regard.

12. In December 2020, the Session 5 Rural Economy and Connectivity (REC) Committee published a [report](#) on its [inquiry](#) into the construction and procurement of ferry vessels in Scotland. As part of its inquiry, the REC Committee considered the updated timetable and costs for vessels 801 and 802, set out in the Report on Updated Cost and Programme for Vessels 801 & 802, published by the Scottish Government on [18 December 2019](#).
13. The REC Committee's subsequent report highlighted serious failures in vessel procurement, project planning, project management, and communication. It also noted strong evidence to suggest that FMEL deliberately proceeded to construct specific sections of the vessels either out of sequence or not according to the proper specification purely as a means of triggering milestone payments on the contract. The REC Committee's findings have provided a helpful baseline from which to inform our own scrutiny work.
14. This report is also set against the background of a BBC Disclosure investigation on vessels 801 and 802, which was broadcast towards the end of our evidence-gathering, in September 2022. That investigation raised further serious concerns about the procurement procedure for vessels 801 and 802, beyond those initially raised by the REC Committee's inquiry. In light of the BBC investigation, the AGS has written to the Committee to advise he is considering whether future audit work is necessary and that any such work would likely focus on—
 - the circumstances that allowed FMEL to progress beyond the pre-qualification stage of the procurement, despite being unable to meet the mandatory requirements
 - FMEL's access to restricted technical information about the vessels, and its use of this when preparing its bid for the contract
 - CMAL's compliance with procurement rules (that apply to the Restricted Procedure) during the tender clarification and negotiation process.
15. The AGS also stated in his correspondence that—

” While CMAL is a company limited by shares under the Companies Act, it is classified as a public corporation and, as such, is required to comply with relevant sections of the Scottish Public Finance Manual (SPFM). In relation to fraud, the SPFM requires CMAL to undertake a thorough investigation and to take appropriate legal and/or disciplinary action where justified. It is further required to take appropriate disciplinary action where supervisory or management failures have occurred.”²
16. The Committee notes that these allegations will be fully investigated by CMAL through its own due processes in the first instance. The Committee awaits with interest the conclusion of this investigation.
17. It is hoped that the Committee's report will help to inform the scope of any future work the AGS may decide to undertake arising from the issues raised by BBC

Disclosure investigation, as well as the outcome of the investigation by CMAL.

18. In March 2022, the Net Zero, Energy and Transport (NZET) Committee agreed to undertake an inquiry into [A modern and sustainable ferry service for Scotland](#). It is therefore also hoped that the conclusions and recommendations in this report will help to provide more context to inform the NZET Committee's own scrutiny.
19. The Committee also notes that the Finance and Public Administration (FPA) Committee has launched an inquiry into [Public Administration - Effective Scottish Government decision-making](#). The Committee recognises that some of its conclusions and recommendations in this report regarding how decisions taken by Scottish Ministers were recorded may be of particular interest to the FPA Committee's inquiry work.

Background

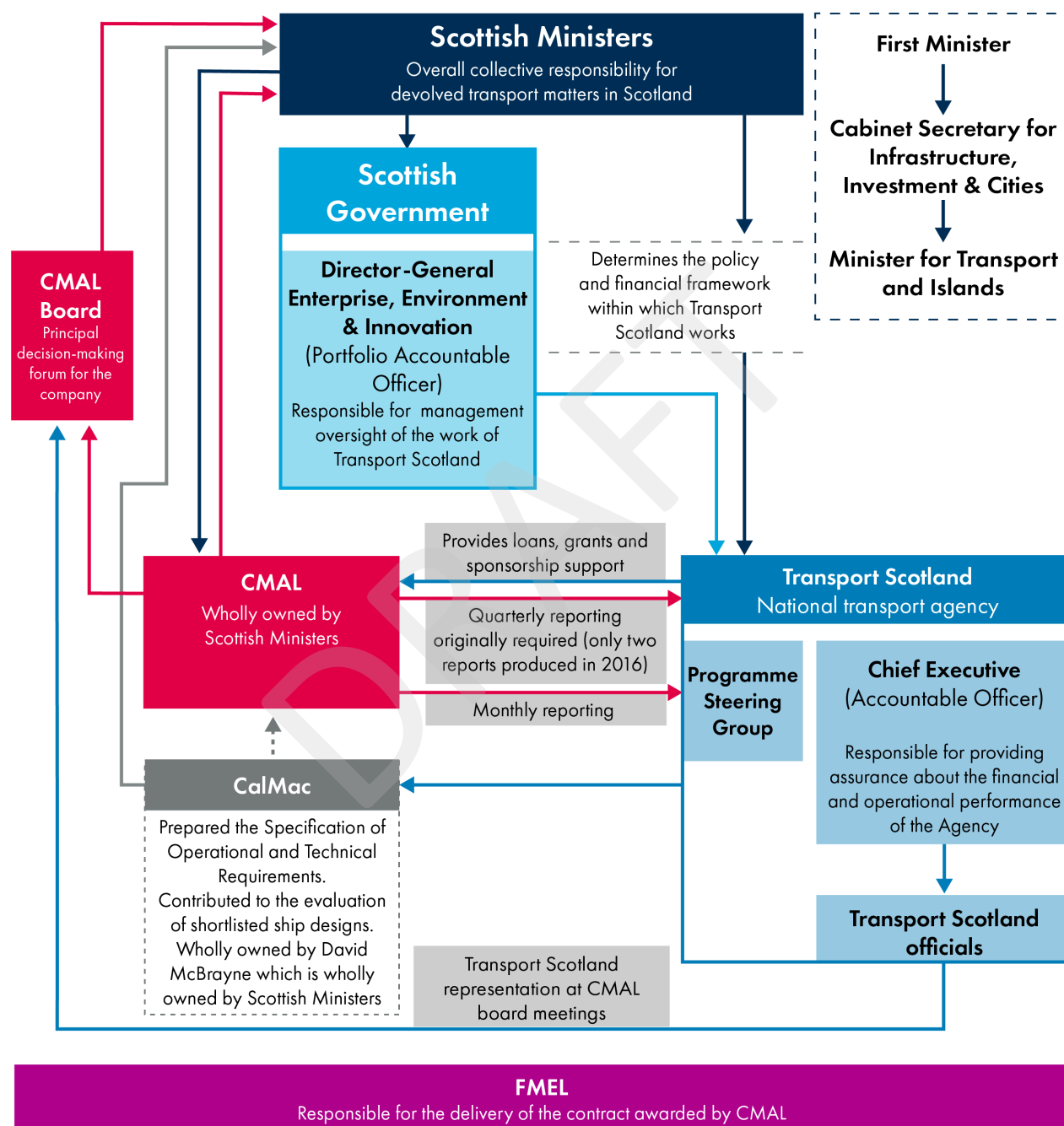
The landscape for procuring, managing and operating ferry vessels on the Clyde and Hebrides network

20. The landscape for managing and operating ferry vessels on the Clyde and Hebrides network is complex. Services are delivered by three parties—
- **Transport Scotland** - the Scottish Government's national transport agency, provides loans and grants to Caledonian Maritime Assets Limited (CMAL). The Chief Executive is accountable to Scottish Ministers and to the Scottish Parliament for the effective and efficient operation of the agency and for effective financial management. Transport Scotland is also the sponsor directorate for CMAL.
 - **Caledonian Maritime Assets Limited (CMAL)** - owns the ferries used by the operators of the Clyde and Hebrides and Northern Isles ferry service contracts, currently CalMac Ferries Ltd and SERCO Northlink. CMAL also owns or leases many of the ports and harbours served by Clyde and Hebrides ferries. CMAL is wholly owned by Scottish Ministers.
 - **CalMac Ferries Limited (CalMac)** - A company wholly owned by Scottish Ministers which provides ferry services to 22 islands and four peninsulas on Scotland's west coast. CalMac Ferries operate Clyde and Hebrides ferry services under contract to Scottish Ministers.
21. Scottish Ministers play a central role in the procurement and oversight of ferry services on the Clyde and Hebrides network. We provide more information about the role of Scottish Ministers in relation to the project to deliver vessels 801 and 802 at the relevant section of this report.
22. In March 2021, Transport Scotland commissioned consultants to review the governance arrangements for Clyde and Hebrides ferry services. This included the roles of Transport Scotland, CMAL and CalMac. The findings of this review, referred to as Project Neptune were published in September 2022 and work is currently underway to consult with island communities on next steps. Further information about Project Neptune can be found in the lessons learned section of this report.

Governance arrangements for vessels 801 and 802

23. A diagram is set out at Exhibit 1 showing the initial governance arrangements for the procurement and subsequent delivery of vessels 801 and 802.

Exhibit 1: Initial governance arrangements to procure and deliver vessels 801 and 802



Source: The Scottish Parliament

24. As we have already highlighted, many key stakeholders have now left their post for various reasons given the time that has elapsed between the commencement of the project and the present day. Recognising the level of turnover that has taken place at a Ministerial level, as well as within the Scottish Government, Transport Scotland and CMAL, we have set out at Annexe A the relevant decision makers and accountable officers, including the period for which they held their posts.
25. A separate diagram, outlining the current governance arrangements, including the relevant decision makers and accountable officers can be found later in the report, at Exhibit 2.

Background to the project

26. In October 2014, the Minister for Transport launched the procurement process to build and design two new ferries for use on the Clyde and Hebrides Ferry Services network. The vessels were designed to provide a fully flexible year-round service for the Arran and the Uig Triangle and be powered by hybrid marine gas oil /Liquid Natural Gas (LNG) engines.
27. Following the pre-qualification questionnaire and invitation to tender stages of the procurement process, Scottish Ministers approved the decision by CMAL to award the two shipbuilding contracts to FMEL as the preferred bidder in August 2015.³ Detailed negotiations subsequently took place between CMAL, FMEL, FMEL Holdings and Clyde Blowers Capital^{vi} throughout September up to 8 October 2015. That same day, Scottish Ministers were invited to approve the decision for CMAL to proceed to award the contract to FMEL.⁴
28. On 16 October 2015⁵, CMAL awarded two separate contracts, one for vessel 801 and one for vessel 802. The AGS's report stated—
 - ” Each contract was for a fixed price of £48.5 million. The two contracts were identical except for:
 - the contractual delivery dates
 - the milestone payment dates for the launch and delivery of the vessels¹
29. The AGS also stated in his report that “for simplicity, and unless there is a need not to, we have referred to there being one contract throughout the report”. The Committee has adopted the same approach throughout this report.¹
30. Many aspects of the procurement process are disputed and the accounts of those involved differ. We highlight where these disagreements exist throughout the report.
31. The new vessels project quickly encountered several problems and delays which contributed to a deterioration in the relationship between CMAL and FMEL. Cash flow problems also became apparent during 2016. In response, Scottish Ministers, CMAL and the Scottish Government each intervened to provide a range of financial and non-financial support to FMEL. We provide further detail on the support that was put in place at the relevant section of the report.
32. A claim for additional costs was made by FMEL to CMAL in July 2017 for £17.5 million. CMAL refuted this claim, resulting in an 18-month dispute. Over this period, the dispute and the value of the claim escalated and an independent view of FMEL's claim was commissioned by the Scottish Government. In June 2019, the Scottish Government advised both parties that there was no legal basis for CMAL to

^{vi} Clyde Blowers Capital III LP (CBC) acquired the assets of Fergusons Shipbuilders in September 2014 via a new company – Ferguson Marine Engineering Ltd (FMEL). As part of this, CBC established Ferguson Marine Engineering (Holdings) Ltd as the parent company of FMEL. CBC is the parent company of Ferguson Marine Engineering (Holdings) Ltd.

pay more than the fixed price of the contract.

33. In February 2019, the Scottish Government and Transport Scotland initiated a project to formally consider contingency plans for the vessels and the shipyard. In August 2019, FMEL entered administration and in December 2019, the Scottish Government completed a commercial transaction to bring the shipyard into public ownership.
34. A timeline of key events that took place between the procurement process up until the point at which the yard was brought into public ownership can be found at Annexe B.
35. Since the shipyard was brought into public ownership, work has continued under the new organisation, Ferguson Marine Port Glasgow Limited (FMPG) to complete the vessels. This has involved extensive remedial work which remains outstanding.
36. FMPG provides quarterly updates of progress on the vessels to the Scottish Parliament. These updates are required in response to a recommendation the REC Committee made in its report.
37. The updates are currently provided to the NZET Committee. At the time of publication, the [most recent update](#) that included an estimate of costs (September 2022) stated—
 - The costs to complete vessel 801 (named “Glen Sannox”) are now forecast not to exceed a total of £101 million, which includes a contingency of £2.7 million and a provision for warranty costs of £3.5 million.
 - The costs to complete vessel 802 (still to be named) are now forecast at a total not to exceed, of £108.6m, which includes inflationary impacts, a contingency of £3.5 million and a provision for warranty of £3.5 million.
38. As part of his [budget statement in December 2022](#), the Deputy First Minister announced that he is—
 - ” allocating £15 million in this financial year and £57 million in the next financial year to support the completion of vessels 801 and 802 at Ferguson Marine, along with the resources required to build the two new Islay class vessels under construction, and a further two vessels of the same type currently in procurement.
39. On 22 December 2022, FMPG provided a [further update to the NZET Committee](#), which stated—
 - ” The overall progress since my last report, apart from the LNG sensor issue, highlighted to you separately, has been broadly in line with the revised budget and schedule set out in my letter to you 28th September.
40. At the time of publication, vessel 801 is expected to be completed by the end of May 2023. This is five years later than the original delivery date of May 2018. Vessel 802 is expected to be completed by the end of March 2024, which is over five and a half years later than originally planned^{vii}.

vii The Committee agreed its report on the morning of 16 March 2023. Later that same day,

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the Deputy First Minister [advised Parliament of further delays in the delivery of the ferries](#). In his statement, he advised that vessel 801 is now scheduled for autumn 2023 with a contract backstop of no later than the end of December 2023. Vessel 802 is to be handed over in autumn 2024, with a contract backstop of no later than the end of December 2024.

Overall Conclusions

41. The Committee's scrutiny has highlighted significant failings throughout the lifetime of the project to deliver two new vessels for the Clyde and Hebrides. Both vessels are now millions of pounds over budget and years behind schedule. Scotland's taxpayers and island communities have been badly let down by many of those involved in the project. We recognise the efforts by the Scottish Government to protect jobs at Ferguson Marine and commend the workforce for their resilience during the most challenging of times. Their experienced voices should have been paid much greater attention to throughout the project^{viii}.
42. There has been a significant lack of transparency and accountability throughout the project. FMEL was not open about its inability to provide a full builder's refund guarantee (BRG). FMEL instead chose to regard a letter from the former Minister for Transport and Islands to a constituency MSP as the 'green light' that it would not need to provide a full BRG. This was wholly inappropriate. We also consider that the former Minister showed poor judgement in responding to the constituency member during a live procurement process and it remains unclear why he told us he had no knowledge of the preferred bidder before going on annual leave when evidence suggests he was aware of the outcome.^{ix x}
43. We believe that the serious allegations raised about the procurement procedure for vessels 801 and 802 highlighted during the BBC Disclosure programme in September 2022 must now be thoroughly and urgently investigated by CMAL. As a matter of transparency, we expect an update of progress from both CMAL and the AGS, whom we urge to undertake a comprehensive audit of the entire procurement procedure for the vessels at the earliest opportunity.
44. The role of Scottish Ministers comes into question in our report. Given that it was clear that considerable negotiations were still required, we question the First Minister's decision to publicly announce the preferred bidder. In light of the contradictory views on offer, further explanation should have been sought by Ministers before the final decision was taken. Indeed, uncertainty remains over which Minister had the final sign-off on the contract. The lack of co-operation we experienced from the former Cabinet Secretary for Investment, Infrastructure, and Cities is also a matter of

viii Please refer to paragraphs 290 and 528 for further information about the Committee's conclusions regarding the importance of workforce engagement during the project.

ix Please refer to paragraph 129 for further detail regarding the Committee's conclusion on the former Minister for Transport and Islands' knowledge of the preferred bidder before going on annual leave.

x There was division on this paragraph. See Annexe C, Minute of the Meeting of 16 March 2023, and note on 'Record of division in private' for more detail.

serious concern.^{xi}

45. The Committee was also disappointed by the lack of engagement by some key stakeholders in our scrutiny work. For example, delays occurred in securing the attendance of some civil service officials and in receiving evidence from Transport Scotland, with little or no explanation provided. We question the level of respect and regard shown for accountability and parliamentary scrutiny.
46. The role of Transport Scotland throughout the vessel project is also a matter of serious concern. For example, the Programme Steering Group which it led, was weak and toothless. As CMAL's sponsor, Transport Scotland had a critical role in communicating important information to Scottish Ministers on its behalf. However, it consistently failed to accurately and timeously reflect CMAL's significant concerns to Scottish Ministers. Given the extent of the concerns raised by CMAL regarding the financial risks associated with the contract, Transport Scotland should have sought written authority from Scottish Ministers before any further progress was made with the project. We also firmly reject Transport Scotland's claim that it had no role in the contract given it was involved in discussions that resulted in CMAL agreeing at least two contract changes.
47. There is clear evidence at various points in the project of interventions by Scottish Ministers. However, record and note keeping of these meetings was weak and fell well short of the standards of transparency and accountability we would expect. It is particularly concerning that there does not appear to be a full record of the meeting held between the former director of FMEL and the First Minister in May 2017. A permanent civil servant should have attended and produced a record of that meeting in line with established protocols in the Scottish Ministerial Code. Instead, a special adviser attended, which may have blurred the lines regarding the purpose of the meeting.^{xii}
48. It is encouraging that the Permanent Secretary has issued new guidance on the recording of decisions. We expect the Scottish Government to further review and refine its record-keeping procedures to facilitate scrutiny and improved transparency.
49. CMAL considered it necessary to receive shareholder authorisation, otherwise known as a "letter of comfort" on two occasions. We recommend that Transport Scotland and CMAL clarify in writing the procedure for seeking reassurances from Scottish Ministers, including how and when either written authority, as set out in the Public Finance and Accountability (Scotland) Act 2000^{xiii} or shareholder authorisation should be sought. Occasions where written authority or shareholder authorisation is sought,

^{xi} There was division on this paragraph. See Annexe C, Minute of the Meeting of 16 March 2023, and note on 'Record of division in private' for more detail.

^{xii} There was division on this paragraph. See Annexe C, Minute of the Meeting of 16 March 2023, and note on 'Record of division in private' for more detail.

either by Transport Scotland or CMAL should be made publicly available and published on the Scottish Government's website. Indeed, the Committee invites the Scottish Government to consider adopting a similar approach to that of the UK Government in proactively publishing on its website a list of occasions when written authority was sought, to improve openness and transparency in this area.

50. The Committee notes that the Scottish Government's decision to nationalise the shipyard was informed by three objectives; to complete the vessels, safeguard jobs and give the shipyard a future. However, there should have been much greater transparency about this decision in the interests of greater public disclosure. The Scottish Government should consider how more information can be routinely shared with Parliament and published about its decisions to invest in private companies and the performance of those companies. We further believe that the Scottish Government should strengthen its business investment framework to better outline intentions over risk tolerance, risk appetite and the expected public benefit of future interventions.
51. It is regrettable that the AGS's report did not focus on how the significant amount of public money paid to FMEL for the vessels was spent. Despite the Committee's efforts, it has not been possible to establish this information in any detail. The Committee therefore strongly encourages the AGS to use his powers to undertake a forensic analysis of this information to shed more light on how this money was spent by FMEL.^{xiv}
52. The AGS's report states that "the Scottish Government is committed to paying additional vessel costs, regardless of the final price". In evidence to the Committee, Scottish Government representatives challenged this assertion. Nonetheless, the Committee is concerned at the ongoing significant risk that costs to the taxpayer will continue to rise.^{xv} The AGS may wish to consider undertaking future work to audit the full cost of this project from start to finish once the vessels have been completed.
53. While Project Neptune provides an opportunity for much needed reform of the governance arrangements around ferries, we believe that a formal review of the entire project on completion of the vessels is essential in learning important lessons for the future and preventing a similar situation from happening again.

^{xiii} [Public Finance and Accountability \(Scotland\) Act 2000](#)

^{xiv} Please refer to paragraph 522 for further information about the Committee's concerns regarding payments made to FMEL and its call on the AGS to undertake a forensic analysis of this information.

^{xv} Please refer to paragraph 526 for further information about the Committee's conclusion regarding the provision of additional funding to complete the vessels.

The procurement procedure

54. In his report, the AGS focussed on events that took place after Scottish Ministers announced Ferguson Marine Engineering Limited (FMEL) as the preferred bidder in August 2015, which cover the final aspects of the procurement procedure.
55. The wider procurement process, and the events that took place before the preferred bidder was announced, were of particular interest to the Committee during our scrutiny of the report. This section therefore seeks to set out our conclusions in response to concerns raised by the AGS as well as other issues that have emerged during our scrutiny of earlier stages of the procurement process.

Initial procurement stages

56. On 15 October 2014, the Minister for Transport launched the procurement process to build and design the two new ferries for use on the Clyde and Hebrides Ferry Services network. The first stage of the process was the publication of a Pre-Qualification Questionnaire (PQQ) by CMAL. The second stage involved six shipyards being issued with an invitation to tender (ITT) for the contract.
57. During its scrutiny of the report, the AGS, Transport Scotland and CMAL all clarified that a full Builders Refund Guarantee (BRG) was one of the mandatory requirements of the contract.
58. The AGS's report explained that at the ITT stage, a draft contract was issued to all short-listed bidders, including FMEL. The report goes on to explain—

” CMAL used the standard BIMCO New Build Contract (NEWBUILDCON) which is used throughout the shipbuilding industry. This is a design and build contract in which the shipyard undertakes to design and build a vessel to meet the buyer's specification at a fixed price. The contract stipulates that the full risk for the design and build remains with the builder throughout the construction of vessels.¹
59. The AGS further highlighted in his report that a BRG “is an integral part of the Baltic and International Maritime Council (BIMCO) contract and is the main source of financial security for a ship buyer” and that “with a 100 per cent refund guarantee in place, the full financial risk of the project rests with the shipbuilder”.¹
60. The former director of FMEL told the Committee that CMAL was aware throughout the procurement process that FMEL would be unable to provide a full BRG.⁶
61. By contrast, CMAL stated that it first became aware of issues regarding the provision of a BRG after the ITT stage of the process and just over a week before the preferred bidder announcement was made. The Interim Chair of CMAL confirmed during oral evidence—

- ” We became aware that FMEL could not provide a Clyde Blowers Capital guarantee on 21 August 2015. We were not aware until about 25 September that it was also having problems in producing a guarantee from a bank or an insurance company, and it gave its final position in relation to that on 7 October, by which time it was already the preferred bidder and we had stood down the other bidders.⁷

Requirements of the builder's refund guarantee

62. During our scrutiny of the report, the Committee heard different accounts of what was required by way of a refund guarantee for the contract. The former director of FMEL referred to a requirement in the contract to provide a “cash refund guarantee”.⁶
63. The former director of FMEL explained during oral evidence that—
- ” A cash refund guarantee means that, for a £100 million contract, you have to deposit £100 million in the bank...no one in their right mind will put up a guarantee like that.⁶
64. However, in written evidence, CMAL confirmed—
- ” 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.⁸
65. We sought to establish further information to better understand what was required at these important initial stages of the procurement process, and to try to establish what was known by whom and by when.

Pre-qualification Questionnaire stage

66. Section 43 of the PQQ stated—
- ” If requested, would you be willing to provide either a parent company guarantee or a bank guarantee? If you cannot provide any of these assurances, and it is determined by CMAL that your financial strength is not adequate then your company may not pass the financial evaluation. If you can provide the assurances as detailed above, CMAL may explore these options with you before determining whether your company can be taken forward in this procurement exercise as per the Guideline on Financial Health of Suppliers.⁹
67. CMAL confirmed to the Committee that “All bidders, including FMEL, answered this question affirmatively”.¹⁰
68. Section 44 of the PQQ stated—

” The ability to provide staged payment refund guarantee from a suitably accredited bank is sought for this project as a MANDATORY MINIMUM REQUIREMENT. The guarantee must be in place before work starts. Please provide an evidentiary statement in the form of a letter from your bank confirming their willingness to provide the guarantee if requested to show you can provide this requirement.⁹

69. In written evidence to the Committee, CMAL explained that none of the bidders initially provided an evidentiary statement in the form of a letter. Instead, CMAL received a range of responses including “a letter of creditworthiness, a letter of credit, a letter confirming available facilities, an email from a Managing Director, a letter of goodstanding and an example of previous guarantees used by one bidder for an earlier project”.¹⁰ Only one bidder fully complied with the requirement as set out in section 44 of the PQQ.

70. CMAL also provided further clarity on section 44 of the PQQ, with reference to the two sentences stating—

” The first sentence prominently describes the issue of a Bank Guarantee for the project as a MANDATORY MINIMUM REQUIREMENT. The second sentence describes when such a guarantee shall be required to be provided, namely “before work starts”.¹⁰

71. The written evidence went on to state that—

” It is very important not to confuse the two deliverables identified in this question and, critically, their timing. Question 44 makes clear that the bidding yards should provide an evidentiary statement from their bank (at the time of submitting their response to the PQQ); and, if successful and awarded the contract, a Refund Guarantee from their bank (before work starts). The second, future, deliverable was expressed as a mandatory requirement. The first, PQQ phase, deliverable was not expressed as a mandatory requirement.¹⁰

72. CMAL’s written evidence also commented that in written correspondence from the AGS² to the Committee, he had “mistakenly conflated the two deliverables as both being mandatory at the time of the PQQ response.”

73. We therefore wrote to the AGS to seek his response. He stated—

” I would like to clarify that I was referring to the broad requirements of the pre-qualification stage of the procurement, not specifically to question 44 of CMAL’s Pre-Qualification Questionnaire.¹¹

Invitation to Tender stage

74. Following a review of the responses received by CMAL, six shipyards were invited to progress to the second stage of the process, which involved being issued with an invitation to tender (ITT) for the contract by the deadline of 31 March 2015.

75. In written evidence to the Committee, CMAL confirmed that the draft contract

included in the ITT stated that the builder must provide full coverage refund guarantees for the value of pre-delivery instalments to be made by CMAL as buyer. Specifically, the draft contract within the ITT required the provision of refund guarantees on behalf of the builder by "a first-class international bank".¹²

76. CMAL's Chief Executive Officer confirmed to the Committee during oral evidence that—

” The process at the invitation to tender clearly asks all the tenderers whether there are any problems with what is proposed. At that stage, FMEL made no comment that it would struggle with a builders refund guarantee. It stayed silent on that. Normal practice in shipbuilding and other contracts—we also do civil engineering contracts—is that, if somebody stays silent, it is tacit acceptance of what is written.⁷

77. During the ITT stage, the former director of FMEL approached the constituency MSP for Greenock and Inverclyde, (where the shipyard is based) to raise concerns about FMEL's ability to provide a full builder's refund guarantee. The MSP subsequently wrote to the Deputy First Minister on 23 December 2014 to ask whether the Scottish Government would be in a position to introduce “a more flexible bonding arrangement”.¹³

78. A response was prepared by civil servants and signed off by the Minister for Transport and Islands. The response stated—

” While CMAL's board in line with standard industry practice has a preference for refund guarantees it has on occasion taken alternative approaches to ensure that ship yards, including Ferguson under its previous owners, were not excluded from bidding for those government contracts.¹³

79. The former director of FMEL confirmed to the Committee that the Minister's response to the constituency MSP—

” ...gave us the green light and said that we did not necessarily need to put up a cash refund guarantee, as something else could be negotiated.⁶

80. As part of its scrutiny, the Committee wrote to Transport Scotland to ask for examples of when CMAL had on occasion taken an alternative approach to refund guarantees. The response from Transport Scotland confirmed—

” Three contracts for vessel construction have been awarded by CMAL to Fergusons without a Builder's Refund Guarantee being in place. On each occasion, alternative forms of security were provided.¹⁴

81. The submission went on to confirm that for two of those contracts, awarded in 2011, “CMAL took ownership of the vessel and constituent parts as they were delivered”. The performance of the third contract, awarded in 2014, was secured by way of a Parent Company Guarantee.¹⁴

82. During oral evidence, the Committee asked the former Chair of CMAL whether he had ever known a ship to be built without a builder's refund guarantee. He responded, “not that I can recollect”.⁷ It is therefore clear that different versions of

events appear to exist between Transport Scotland and the former Chair of CMAL on this point.

83. Following the Minister's response to the constituency MSP, FMEL proceeded to submit a tender bid to CMAL by the deadline date of 31 March 2015. The validity of the tenders received was originally due to expire on 30 June 2015. At the agreement of the tenderers, the expiry date was extended to 31 August 2015.
84. The Committee is aware that one of the central allegations of the BBC Disclosure programme is that FMEL's tender bid largely replicated the original Statement of Operational Technical Requirements (SOTR) prepared by CalMac. The BBC programme reported that none of the shortlisted bidders should have had access to this original document.
85. While this is a serious allegation, the Committee does not in this report draw conclusions from the BBC programme. It is right and proper that due process is followed and these are first investigated internally. In written correspondence to the Committee, the AGS confirmed that he has had initial discussions with CMAL and Transport Scotland (as CMAL's sponsor) about their duties to investigate. They intend to keep him informed about their planned actions, which he will take into account when considering the scope and timing of any future audit work.
86. **It is clear that a full Builders Refund Guarantee (BRG) was a mandatory requirement of the contract. The evidence we have received suggests that CMAL was not aware of FMEL's inability to provide a full BRG until the final stages of the procurement process.**
87. **The Committee considers that there was sufficient opportunity for FMEL to be more transparent at both the Pre-Qualification Questionnaire and Invitation to Tender stages about its inability to provide a BRG. The fact that it remained silent at both stages on this point suggests that FMEL did not sufficiently engage with CMAL during the procurement process.**
88. **The constituency MSP for Greenock and Inverclyde was undertaking his duties as an elected representative by approaching the then Cabinet Secretary for Finance, Constitution and Economy to ask what alternatives to a BRG existed, in a bid to support the shipbuilding industry in the area they represent.**
89. **Recognising that a live procurement process was ongoing at the time, the Committee calls into question how appropriate it was for the former Minister to reply to the constituency MSP stating that CMAL had on occasion taken an alternative approach to a full BRG. FMEL interpreted this response as being the "green light" to proceed to the ITT stage of the procurement process on the basis that it would not need to provide a full BRG. It is therefore the Committee's view that the former Minister's response showed poor judgement given the procurement process that was taking place at the time and that it compromised the integrity of the procurement process.^{xvi}**

^{xvi} There was division on this paragraph. See Annexe C, Minute of the Meeting of 23

90. **We accept that CMAL has on occasion, taken an alternative approach to the requirement to provide a full BRG. However, we consider it extraordinary that FMEL chose to regard correspondence from a Scottish Minister to a constituency MSP as the basis for submitting a bid to CMAL at the ITT stage of the procurement process.**
91. **Different interpretations exist between CMAL and the former director of FMEL as to what was required by way of a builder's refund guarantee. FMEL state that a "cash refund guarantee" was required. CMAL state that no cash deposit of any kind was required, rather a guarantee or a bond. The Committee considers that FMEL should have made every effort to engage with CMAL to establish what was required by way of a BRG during the procurement stage of the project.**
92. **The Committee expects CMAL to continue to pursue a thorough investigation of the allegations put forward by the BBC, with the appropriate support from Transport Scotland as CMAL's sponsor^{xvii}, and to take action as required. The Committee seeks an update on progress with this investigation.**
93. **The Committee has concerns regarding the disposal of public funds in relation to payments made to FMEL and therefore strongly encourages the AGS to undertake a comprehensive audit of the entire procurement procedure for vessels 801 and 802 in a timeous manner. This should include how any lessons learned have been implemented for future vessel contracts. Later in this report we make further recommendations in relation to reviewing the project.**

Approval and announcement of the preferred bidder

94. As outlined at paragraph 83, the validity of the tenders received was due to expire on 31 August 2015.
95. On [20 August 2015](#), the then Cabinet Secretary for Infrastructure, Investment and Cities received a submission from Transport Scotland recommending approval for the award of the two shipbuilding contracts by CMAL to FMEL. Approval was sought from the Cabinet Secretary in the absence of the then Minister for Transport and Islands, who was on annual leave until 31 August 2015.
96. Asked what Transport Scotland's process would have been for providing a submission to Scottish Ministers in the former Minister for Transport and Islands's absence, the Interim Director-General Net Zero explained—

February 2023, and note on 'Record of division in private' for more detail.

^{xvii} **Sponsor teams are the first point of contact between a public body and the Scottish Government. They provide advice, help and support to public bodies and advice on accountability, governance and performance to Ministers and Portfolio Accountable Officers.**

” Mr Mackay, as Minister for Transport and Islands, would have been reporting to the cab sec, under that portfolio. The advice would have been the same to either the cab sec or a minister. I am assuming that the minister and cab sec agreed between them who will take decisions in the other person’s absence if a minister is not available. ¹⁵

97. During our scrutiny, we attempted to establish the extent to which the former Minister was aware of the status of the tender bids before going on annual leave. We specifically asked him during oral evidence—

” Prior to your going on annual leave, did you get the impression that the preferred bidder status would likely be awarded to FMEL, and that that was the direction of travel? Were you comfortable with that? ¹⁶

98. The former Minister for Transport and Islands responded stating—

” No, I do not think that there was any suggestion of that. As you would expect, I would have been briefed that submissions would be forthcoming to ministers. However, I was on annual leave, which is just a matter of fact. I was advised that papers would be forthcoming at some point. Of course, the timing of when submissions would have been presented to us for decision was in the hands of civil servants. ¹⁶

99. The Committee notes from written evidence received from the former Cabinet Secretary for Infrastructure, Investment and Cities that the former Minister for Transport and Islands received a verbal briefing before he went on annual leave and was “aware of (and supportive of)” the outcome. This evidence is helpful to our scrutiny. However, it only became available to us after three requests made by the Committee. This lack of co-operation is disappointing and obstructed our scrutiny work. ^{xviii}

100. The written information provided by the former Cabinet Secretary for Infrastructure, Investment and Cities confirms that he received the submission from Transport Scotland on 20 August 2015 at 18:38. Included in the submission was the deadline for the former Cabinet Secretary to respond by, and the date in which both the successful bidder and unsuccessful bidders must be notified by—

- “Ministerial approval in principle is sought by Thursday 27 August”.
- “Given procurement deadlines, Caledonian Maritime Assets Ltd (CMAL) are required to a notification of contract award letter to FMEL, and ‘Alcatel’ letters to the 5 unsuccessful bidders no [later] than Monday 31 August – after that date the tenders will no longer be valid”. ³

101. The former Cabinet Secretary’s office confirmed that he was content to approve the award of the two shipbuilding contracts by CMAL to FMEL the following day, 21 August 2015 at 09:14. ¹⁷

102. We asked Transport Scotland during oral evidence whether the decision made by

^{xviii} There was division on this paragraph. See Annexe C, Minute of the Meeting of 23 February 2023, and note on ‘Record of division in private’ for more detail.

the former Cabinet Secretary was rushed. The Director of Aviation, Maritime, Freight and Canals at Transport Scotland responded—

” I would not categorise the process as being rushed. CMAL might be able to offer more regarding its direct experience of the procurement process. It is typical for the contract terms to be refined from preferred bidder to conclusion of the contract. That would have been recorded in the advice to ministers, in line with the obligations that you have set out and the desire to ensure that there is a full record of risks and issues. However, I am not aware of there having been any particular rush, nor of ministers’ holiday arrangements influencing the timing of decisions in any way. ¹⁵

103. In the submission from Transport Scotland to the Cabinet Secretary, under the heading of “Presentational issues”, it stated—

” As with any procurement, a legal challenge from one of the unsuccessful shipyards cannot be discounted. CMAL have not identified any particular risks in this regard and, in any case, are confident that any challenge can be defended. That said, the relationship between Scottish Ministers and Ferguson’s owner is well known. ³

104. We asked the former director of FMEL to clarify what his relationship with Scottish Ministers was at the time Transport Scotland prepared the submission during oral evidence. He replied—

” Yes. I was on a number of entities and non-paying organisations such as welfare to work, and I got involved in campaigns to get people into work, working with Skills Development Scotland and so on, so I had a lot of interaction with the Government. ⁶

105. The former director added—

” Whenever any issues came up with businesses that were in trouble, I always got a phone call from Alex Salmond^{xix} asking me whether I would have a look at it or whether I would be interested in it. I would have a look at it and say that I was not interested. I saw my role as a businessman to support whoever was in power and to do my best to support the Government. That was the relationship that I had with the Government. When Alex Salmond asked about the shipyard, we had a further look at it, did diligence on it and decided to go ahead with it. It was very much a working relationship. ⁶

106. The former director of FMEL also confirmed to the Committee that he was on the Council of Economic Advisers.

107. When asked whether he had preferential access to Scottish Ministers, the former director of FMEL stated—

” No. You only need to look at the history to see that I did not. I know many businesspeople, university principals and so on who had the same access because the Government tended to talk to a lot of people to get input. ⁶

^{xix} The former First Minister of Scotland from 2007 to 2014.

108. We also asked the former Chief Executive of Transport Scotland for his views about the relationship between Scottish Ministers and the former director of FMEL and whether this had any influence on the decision to approve the awarding of the contract to FMEL. He responded—

” If there was an underlying motivation from our part to try to secure the award of the contract, it was because the importance and significance of Ferguson’s was well known and well understood. On the politics of the Jim McColl angle, we understand the point about the awareness of that, but that was not at the forefront of our minds at all. ¹⁶

109. During oral evidence, we also asked the First Minister directly what her relationship with the former director of FMEL was. The First Minister confirmed that she had a “professional relationship” with the former director and made reference to his involvement on the Council of Economic Advisers as well as his work with Skills Development Scotland. She went on to state—

” I would have come across him in what I would describe as a more political context, but I would not say that I had, or have had at any time, what I would describe as a personal relationship with him. It is a professional relationship. ¹⁸

110. The Interim Chair of CMAL confirmed during oral evidence that the CMAL Board first became aware that Transport Scotland had sought approval from the then Cabinet Secretary for Infrastructure, Investment and Cities the day after the submission had been issued. CMAL was also advised on this same day that Clyde Blowers Capital (CBC) would not provide FMEL with a parent company guarantee. The Interim Chair went on to state—

” prior to 31 August, all that we were hearing from CBC and FMEL was that CBC could not grant a guarantee. We were not hearing at that stage that there was no guarantee on offer. However, you will see from the minutes of the 25 August CMAL board meeting, which took place at Victoria Quay, that we were very concerned about it. The refund guarantee was discussed, but Transport Scotland was clear that the announcement was going ahead. ⁷

111. The CMAL Board minute of 25 August 2015 confirms that the issue of refund guarantees was discussed. The Committee notes that at this meeting, the Chair of CMAL requested that Transport Scotland provide CMAL with a “letter of comfort if required”. The minute also confirms that “Ministers were clear on the position and progress that must be made in order to proceed with the contract award.” ¹²

112. The issue of refund guarantees was raised in the Ministerial Engagement Briefing for the preferred bidder announcement on 31 August 2015 which was prepared by Transport Scotland and issued to the First Minister on 28 August 2015. In the briefing it states—

” Although this is a major milestone in the procurement process there is still considerable work and negotiation to be undertaken until it reaches a stage where CMAL can take a decision to award the formal contract. This includes complexities around the level of guarantees that FMEL can provide (although there has been some movement on this element – with some distance still to go). ¹⁹

113. During oral evidence, we asked the First Minister to what extent she was aware of the negotiations that were ongoing between CMAL and FMEL at this stage in the procurement process. In her response, she referred to the briefing she was issued—

” I have reviewed the briefing that I got for that event and it rightly says—which I would have assumed anyway—that there were still significant negotiations to be concluded before the final contract award. Although it is not flagged up in that briefing as a particular issue of concern, there is a very clear reference to the on-going negotiations, including issues and complexities around the level of guarantee that FMEL would provide. So, yes, before I made the announcement of the preferred bidder on 31 August, of course I knew that it was not a concluded negotiation, because it was still at the preferred bidder stage of the process.¹⁸

114. Written evidence received from CMAL included a timeline setting out key events that took place during the procurement process. From this timeline, the Committee notes the negotiations and key events that were taking place between the date the decision was taken to approve FMEL as the preferred bidder on 21 August 2015 and the preferred bidder announcement on 31 August 2015.

Negotiations and key events between 21 August and 31 August 2015

Date	Event
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 Refund Guarantees
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	FMEL solicitor provides second draft milestone schedule (15% final instalment)
31 August 2015	FMEL announced as preferred bidder by the First Minister

115. The Committee notes from CMAL’s written evidence that these negotiations continued until a seventh draft of the shipbuilding contract was signed on 16 October 2015.
116. In Transport Scotland’s submission to the former Cabinet Secretary for Infrastructure, Investment and Cities on 20 August 2015 inviting him to approve the awarding of the contract to FMEL, under the “Presentational issues” heading it stated—
- ” It would be appropriate for Mr Mackay as Minister for Transport and Islands to lead on this announcement, highlighting the benefits to the islands as well as the jobs and training opportunities in Inverclyde.³
117. The Interim Chair of CMAL confirmed during oral evidence that the CMAL Board was advised via e mail on 21 August 2015 by the then Chief Executive Officer of CMAL that—

” the public relations machine was getting into gear, that the public announcement was going to be on 31 August and that the First Minister would be doing that. From memory, we knew on 21 August that the First Minister would be making that announcement.⁷

118. Despite Transport Scotland’s advice of 20 August 2015 that the Minister for Transport and Islands should lead on the preferred bidder announcement, it was the First Minister who announced that FMEL was the preferred bidder for the contract, on 31 August 2015.

119. During oral evidence, the First Minister was asked why she made the announcement, and whether this was something she would normally do. In her response, the First Minister referred to the announcement she had made in 2016 that CalMac was the preferred bidder for the Clyde and Hebrides ferry services contract. It was therefore the First Minister’s position that this suggested—

” that it is not completely unknown for preferred bidders to be announced or, indeed, for me to do it.¹⁸

120. The First Minister went on to explain the decision-making process that would have taken place before the decision was made as to who would lead on the announcement—

” judgments would have been made about whether the profile, subject matter and importance of the announcement meant that it should be a minister making the announcement or that it should be a First Ministerial announcement. That would have emerged as a result of the consideration that special advisers and communications officials do. They would have come to me to say, “There is a proposal that you should make this announcement,” and I would have said, “Yes, I will do that.”¹⁸

121. Throughout our scrutiny, we sought to establish whether written evidence existed which documented this process, in order to establish the rationale for this change in media approach from the original proposal. The First Minister confirmed that this information did not exist.

122. We also sought to explore the rationale for making such a high-profile public announcement about the preferred bidder for this particular contract. During oral evidence, the Interim Chair of CMAL stated that the then Chief Executive of CMAL had highlighted the risks involved with a public announcement to a senior Transport Scotland official as negotiations were still ongoing with the preferred bidder “on a number of technical aspects as well as a number of issues on the contract”.⁷ CMAL went on to state that despite the concerns that were raised, “we were told it was going ahead”.⁷

123. The Committee also explored whether the decision to make such a public announcement had an impact on CMAL’s negotiating position with witnesses. Different views were offered in response to this question. For example, the former Chief Executive of Transport Scotland stated—

” I do not. At the end of the day, the negotiations were between CMAL and FMEL. They were in the room together.¹⁶

124. When asked whether the public announcement strengthened FMEL's hand during contract negotiations with CMAL, the former director of FMEL stated—

” It did not. Having been named the preferred bidder, you would normally expect—and we did expect—the order to be signed by September. We did not sign the order until 16 October because we were holding out for some changes that we wanted to be made to the contract. It was not acceptable to us in the form that we had seen it.⁶

125. During oral evidence, the Interim Chair of CMAL was asked why none of the non-executive board members attended the preferred bidder status announcement. She responded—

” Because we were concerned that it would appear to be a *fait accompli* at that point. You will see from our submission that our preference was for that to be done on a confidential basis and for there not to be a public announcement. We thought that there was risk to the procurement process, because we had not yet issued the Alcatel standstill letters. Inevitably, if a negotiation is undertaken in a very public domain, that makes it quite difficult.⁷

126. We also asked CMAL during oral evidence whether making a public announcement had in effect, forced its hand during the negotiation period. The Interim Chair of CMAL responded—

” It made negotiations more difficult—that was our reason. That was particularly because, by then, we knew that we were in discussions on a refund guarantee. At that point, prior to 31 August, all that we were hearing from CBC and FMEL was that CBC could not grant a guarantee. We were not hearing at that stage that there was no guarantee on offer. However, you will see from the minutes of the 25 August CMAL board meeting, which took place at Victoria Quay, that we were very concerned about it. The refund guarantee was discussed, but Transport Scotland was clear that the announcement was going ahead.⁷

127. We asked the First Minister whether she was aware of CMAL's concerns regarding the public announcement. In response she stated—

” I had no awareness or knowledge that CMAL had concerns about the announcement....I have reviewed the briefing that I had that day and, far from having a knowledge that CMAL was concerned about that, my briefing included a set of questions and answers that had been prepared by CMAL, and the list of people who were due to attend included the then chief executive of CMAL, so nothing would have given me any sense that CMAL was unhappy with any of that.¹⁸

128. The First Minister provided a copy of this briefing, as well as e mail exchanges regarding the preferred bidder announcement to the Committee. From this information, we observe that—

- a Transport Scotland draft press release and a CMAL draft press release were

both included in the briefing to the First Minister.

- two press releases about the preferred bidder appear to have been published in the end by CMAL, one of which appears to use the wording of the Transport Scotland draft press release.¹⁹

129. It is clear from the information provided by the former Cabinet Secretary for Infrastructure, Investment and Cities that the former Minister for Transport and Islands was briefed and should have been fully aware before going on annual leave that Transport Scotland intended to seek ministerial approval for the award of the two shipbuilding contracts by CMAL to FMEL. The Committee is therefore unsure why the former Minister told us he had no knowledge before going on annual leave that the preferred bidder would be awarded to FMEL. The Committee notes that the former Minister was also aware of issues associated with FMEL's ability to provide a full builder's refund guarantee, raised through correspondence received from a constituency MSP.^{xx}
130. The Committee considers that it would have been prudent for the former Minister to have shared this information with the relevant Cabinet Secretary before going on annual leave. The Committee has seen no evidence to suggest that this happened, despite repeatedly asking the Cabinet Secretary what discussions took place on these matters. The Committee has also been unable to establish whether a handover meeting took place. The uncertainty around this issue gives us cause for concern.
131. The timing of the decision made by the former Cabinet Secretary for Infrastructure, Investment and Cities to approve FMEL as the preferred bidder is also a source of concern. While the former Cabinet Secretary could have taken up to seven days to provide Ministerial approval, it took less than 24 hours for a decision to be taken and communicated to Transport Scotland. The Committee considers that taking more time to fully consider the options available may have led to a better outcome.^{xxi}
132. The Committee is not convinced that such a public announcement was necessary or indeed appropriate for this project, especially at that time, given the considerable work and negotiation that was required before CMAL could take a decision to award the formal contract. We believe that this almost certainly weakened CMAL's negotiating position with FMEL, particularly as important details of the contract were still being worked out. It also remains unclear why the First Minister led on the preferred bidder announcement and why the First Minister's press release and associated social media communications did not reflect that there were "significant negotiations to be concluded".^{xxii}

xx There was division on this paragraph. See Annexe C, Minute of the Meeting of 23 February 2023, and note on 'Record of division in private' for more detail.

xxi There was division on this paragraph. See Annexe C, Minute of the Meeting of 23 February 2023, and note on 'Record of division in private' for more detail.

xxii There was division on this paragraph. See Annexe C, Minute of the Meeting of 23

133. **It is evident that CMAL was concerned about the decision to make a public announcement on the preferred bidder for the contract, and these issues were raised with Transport Scotland officials. The First Minister has confirmed that she had no knowledge of CMAL's concerns. The Committee is disappointed that such important information does not appear to have been communicated to Scottish Ministers at this stage in the project.**
134. **It is unclear why CMAL ended up publishing two press releases, one of which had originally been intended for issue by Transport Scotland.**

Contract negotiation

135. Between the preferred bidder decision and the agreement of the contract, CMAL stated during oral evidence that its executive team and its board “negotiated with FMEL, FMEL Holdings and CBC to make that contract as good as it could be”.⁷
136. CMAL’s written evidence to the Committee explained that these negotiations involved both written correspondence and meetings “with successive drafts of the proposed contracts and billings schedules prepared and discussed between the parties and their lawyers”.¹²
137. At the CMAL board meeting of 25 September 2015, the Committee notes that the issue of refund guarantees was discussed once again. The minute of this meeting stated—
- ” 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.”¹²
138. The minute also showed that a senior Transport Scotland official requested that a detailed note of the risks, including how risks will be mitigated should be prepared by CMAL’s Director of Vessels and sent to Transport Scotland “for onward briefing to the Minister”.¹²
139. CMAL’s written evidence confirmed that following the Board meeting, CMAL, FMEL and CBC met on 28 September 2015. At this meeting, CMAL stated that CBC made it clear that no improvement would be made to the security offered, and that guarantee coverage at 25%, could be made available. CMAL went on to confirm that—
- ” The following day, FMEL increased the propose[d] final milestone instalment from 15% to 25%, leaving CMAL broadly with 50% of the pre-delivery payments at risk.”¹²
140. The Chief Executive of CMAL summarised to the Committee during oral evidence where negotiations with FMEL, FMEL Holdings and CBC had begun and what the

February 2023, and note on 'Record of division in private' for more detail.

final outcome of these negotiations were—

- ” The initial position was “There is no refund guarantee”; where we ended up was with a 25 per cent refund guarantee. The initial position was that, for the final payment, which ordinarily is 20 per cent, they were offering 0.5 per cent; that improved to 25 per cent. We also agreed with them that as any material, equipment or machinery came across the yard’s doorstep, effectively we vested it. Vesting means that it is then legally in our ownership.⁷

Awarding the contract

Submission to Scottish Ministers

141. On 8 October 2015, Transport Scotland issued a submission to Scottish Ministers by e mail, requesting approval for CMAL to proceed to award the contract to FMEL. The submission was issued to the former Minister for Transport and Islands, the former Cabinet Secretary for Infrastructure, Investment and Cities as well as senior Scottish Government and Transport Scotland officials and a senior special adviser to the First Minister working in the Scottish Government.

142. During oral evidence, we sought to establish why a senior special adviser to the First Minister would have been included in the e mail to Scottish Ministers. The Director of Aviation, Maritime, Freight and Canals at Transport Scotland stated—

- ” all special advisers are appointed as special advisers to the First Minister and the working practice is that they will have a particular affiliation to a minister or a cabinet secretary....to my knowledge, all special advisers are designated as special advisers to the First Minister, and nothing should be inferred from that.
20

143. Included in Transport Scotland’s submission was—

- the risk note prepared by CMAL.
- an e mail exchange between the former Chief Executive of CMAL to the former Chair of CMAL on 25 September 2015 and the former Chair’s response the following day, 26 September 2015.
- a draft voted loan letter from the Head of Ferries Unit, Transport Scotland to the former Chief Executive of CMAL setting out the agreement for the funding. It is explained in the submission to Scottish Ministers that this was an enhanced version of the standard voted letter which gave “...greater assurance to CMAL that Scottish Ministers—
 - have been sighted on the CMAL note
 - are aware of the potential risks associated with this contract; and
 - are content to give approval to CMAL to proceed”.
- A draft letter from the former Director - Aviation, Maritime, Freight & Canals,

Transport Scotland to the former Chair of CMAL. The submission to Scottish Ministers explains that this letter “provides more general assurance to the CMAL Chair and Board of Scottish Ministers’, and Transport Scotland’s, commitment to CMAL in respect of the contract”.²¹

144. We asked CMAL about Transport Scotland’s submission to Scottish Ministers on 8 October 2015, during oral evidence. The Interim Chair of CMAL stated—

” We got to a point where we had got to the position of negotiation with FMEL. It was going no further. At that point, I think that it is fair to say that Transport Scotland was keen to get something to the minister. We agreed that we would write the risk paper, which referred to [the former Chair of CMAL’s] email, and agree the terms of the letter of comfort—all the board members of CMAL were absolutely unanimous that we would not proceed without that letter—and that that would go, via Transport Scotland, to the minister.⁷

145. In written evidence, CMAL explained the rationale and purpose of the letter of comfort—

” The CMAL Directors were...concerned in respect of their duties always to act in the best interests of the company, and always in a position of solvency, and ... a letter of comfort was considered an appropriate mitigation. In particular, the Board members sought and received a shareholder authorisation 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." This wording was negotiated in correspondence and discussions with Transport Scotland representatives.¹²

Written authority

146. The Committee notes that under the terms of the Public Finance and Accountability (Scotland) Act 2000, there is a statutory duty on the Principal Accountable Officer and designated Accountable Officers to obtain “written authority” from Ministers before taking any action which they consider to be “inconsistent with the proper performance” of their functions.
147. Recognising that it appeared to the Committee that CMAL was being asked to take action that it was not comfortable with, we explored in more detail whether the letter of comfort sought by CMAL could be considered as obtaining written authority.
148. During oral evidence, the AGS confirmed that no written authority had been requested of Scottish Ministers from civil servant accountable officers. He also explained that—

- ” It is clear that, had a civil servant considered that they would not be achieving value for money, they had the option of asking for a written authority, but it remains our understanding that no such request was made.²²



Source: The Scottish Parliament

149. The Committee further notes that in the “letter of comfort” from the former Director - Aviation, Maritime, Freight & Canals, Transport Scotland to the former Chair of CMAL, the wording used raises questions as to whether written authority may have been requested of Scottish Ministers as follows—
- ” The Scottish Ministers, both in their capacity as CMAL’s sole shareholder and more generally, also confirm that CMAL is authorised to enter into the Contracts and any associated documentation.¹²
150. The letter goes on to state—
- ” I confirm that the Scottish Ministers have considered and approved the contents of this letter.
151. During oral evidence, we put forward the conclusion to the AGS that from the wording used in the letter, it could be argued that written authorisation had been sought, but not recorded, as is required under the legislation. The AGS responded—

” That is a fair assessment. The substance of the discussions was consistent with what I understand to be ministerial direction^{xxiii} or written authority, but the application of that was inconsistent with the requirements of the [Scottish public finance manual](#). One of those requirements is that the Auditor General for Scotland should be informed in writing if there is an event that is identified as a request for written authority. No such information came to the office of the Auditor General for Scotland during those discussions. Although there was an exchange of correspondence and a clear setting out of views, we did not see that translate into the formality—the record keeping—that we would say is clearly consistent with a request for written authority.²²

152. During this same evidence session, the AGS confirmed—

” I am clear that no Government officials have identified that written authority was requested from ministers and approved as such, and, on that basis, we have not been able to say that that happened, and we are clear in our judgment that there was no formal written authority.²²

153. The AGS also stated at a separate oral evidence session that—

” On the extent of concern from CMAL and how it communicated that to Transport Scotland, we would typically have expected that, if there was such concern, that would have resulted in a request for written authority. However, as we know, that was absent as part of the process.²³

154. We asked the Interim Director-General Net Zero at the Scottish Government for his views on whether written authority would have been expected for the project. He responded—

” all the key considerations were included in the exchange that went up from the director. What you will no doubt wish to ask [the former Chief Executive of Transport Scotland] is what consideration he gave, on the basis of that information, to whether it departed from the duties of the accountable officer...there is nothing in there that suggests to me that that was something that he considered to be required.¹⁵

155. We also asked the former Chief Executive of Transport Scotland in post at the time these events were taking place, what consideration he gave to seeking written authority during oral evidence—

” I had no reason to seek a written authority. In a sense, the main thing was that the matter was written up and put to ministers so that they were fully aware of all the facts and positions.¹⁶

156. In response to the question of whether he was ultimately responsible, as Accountable Officer for the propriety and regularity of Transport Scotland's finances, and therefore this project, the former Chief Executive of Transport Scotland

^{xxiii} “Ministerial directions” are used by the UK Government when an Accountable Officer does not consider that a course of action they are being asked to take represents value for money. The equivalent term used by the Scottish Government is “written authority”.

stated—

” It did indeed but, ultimately, I was not saying that I regarded the contract as unwise or poor value for money or that entering into it was a poor judgment. We still had the outcome of the procurement, which told us that it was the best bid for price and quality, and we had secured some negotiations of risk from CMAL to Ferguson’s and from us with CMAL. Therefore, I did not see how I was exposed, and I do not think that the Auditor General’s report said anywhere that I should have sought a written authority. That is why I do not see any reason to review that now. ¹⁶

157. We also considered the perspective of CMAL in relation to the request for written authority. In written evidence to the Committee, CMAL stated—

” 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. ¹²

158. The written submission went on to state—

” 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. ¹²

159. The Committee sought to explore this point further with CMAL during oral evidence. The Interim Chair of CMAL confirmed CMAL’s position as follows—

” it is true that we were told not to ask for a ministerial direction, but I was not entirely sure in any event that a ministerial direction was competent in relation to the board of a non-departmental public body...

What clearly was competent was a shareholder authorisation in relation to the shareholder’s reserved powers under the articles of association. That protects the directors in terms of their fiduciary duties, so that was what we sought. It was a shareholder authorisation by the Scottish ministers, and that is contained in the letter from [the former Director - Aviation, Maritime, Freight & Canals at Transport Scotland]. ⁷

CMAL’s concerns and how they were communicated to Scottish Ministers

160. The Committee also sought to establish the extent to which CMAL was comfortable with Transport Scotland’s submission to Scottish Ministers on 8 October 2015, and whether its concerns regarding the contract award to FMEL had been ignored or overruled. During oral evidence, the Interim Director-General Net Zero

commented—

” As I understand it, from the moment that the chair expressed concern to the point at which the advice went up to the minister, quite a bit of negotiation had taken place between CMAL and FMEL on getting the contract to a place where both parties were content. At that point, CMAL was content to award the contract and was seeking approval from the minister to do so. That approval was sought and given. ¹⁵

161. During oral evidence, the former Chair of CMAL responded to the evidence provided by the Interim Director-General Net Zero stating—

” It is not correct to state that we were content with the contract. We were not, and that was clearly expressed also in the email that was submitted to board members and Transport Scotland at the time. ⁷

162. The Interim Chair of CMAL also clarified during oral evidence that there was no recommendation in the material provided by CMAL and included in Transport Scotland's submission to Scottish Ministers, to award the contract.

163. In written evidence to the Committee, the former director of FMEL stated that the AGS's report highlighted that the Scottish Government had “forced CMAL to place the order with Ferguson against their will”, and had FMEL been aware of this, it would have caused them to “seriously question accepting the order”. ²⁴

164. The Committee notes that in the submission to Scottish Ministers, Transport Scotland explained—

” Procurement risk can rarely be removed entirely in complex contracts and CMAL have addressed this, taking their own legal advice, and in particular by agreeing contractual terms with FMEL which are broadly comparable with the tender specification. ²¹

165. The submission went on to state—

” in discussions between Transport Scotland officials and CMAL Senior executives on Tuesday 29 September and on Friday 2 October, the CMAL Senior Executives made clear that CMAL would likely be facing similar problems no matter who the preferred tenderer was. Their Senior Executives also made the point that despite receiving stronger financial assurances in previous shipbuilding contracts they still subsequently faced problems, and in one instance significant challenges, during the respective construction phase. ²¹

166. We asked the AGS during oral evidence whether it was reasonable for Scottish Ministers to conclude, based on the information included in the submission, that sufficient mitigations were in place. In response, the AGS stated—

” I am not sure that we would arrive at the same conclusion that a 25 per cent builder's refund guarantee, plus some of the additional safeguards, is broadly comparable with 100 per cent. ²³

167. The former Director of FMEL stated during oral evidence however that—

” CMAL got a better-than-100 per cent refund guarantee because it had everything that was going into the vessels and £25 million on deposit that could be called on.⁶

168. During oral evidence, the Interim Director of Performance Audit and Best Value drew the Committee’s attention to Annexe B of the e mail submission provided to Scottish Ministers, which is the former Chair of CMAL’s e mail of 26 September 2015. In that e mail, the former Chair states—

” If FMEL don’t get back with substantially improved conditions in this respect the board of CMAL have no other option than once again reject the deal. This will imply a) Shelving the project until further notice...or reopening the contract negotiations with another of the bidders.²¹

169. The Interim Director concluded from this evidence that “there are different bits in the information that was provided to Ministers that offer differing views”.²³

170. We asked the former Minister for Transport and Islands for his views on the e mail submission issued by Transport Scotland to Scottish Ministers in order to make a decision. He stated—

” Having raised all CMAL’s concerns about the lack of a full builders refund guarantee, the submission then outlined the ways in which those fears could be allayed. It talked about it being the “best deal” in the circumstances and how we could best address CMAL’s concerns. It said that Government lawyers had been advised and were content, and that SG finance and procurement had fairly assessed the risk. It spoke about how similar problems can arise even when a full builders guarantee is in place and, ultimately, it asked whether I was content to proceed. I was, because...the information that was submitted showed that there had been progress from the worst point of negotiations between CMAL and FMEL to a far more satisfactory position, so much so that CMAL, as we heard subsequently, co-produced the note that came to me.¹⁶

171. During oral evidence, the First Minister offered her view on the information contained in the submission stating—

” To be fair to [the former Minister for Transport and Islands], let me be clear that, had that submission of 8 October been brought to my attention, and based on everything that was in it, I am not saying that I would have reached a different decision.¹⁸

Approval of the contract by Scottish Ministers

172. One of the main criticisms raised by the AGS in his report was the lack of “documentary evidence to explain why Scottish Ministers accepted the risks and were content to approve the contract award in October 2015.

173. We asked the AGS and Audit Scotland about the documentation available during oral evidence. The Interim Director of Performance Audit and Best Value set out how decisions of this nature are normally handled—

” one would expect the accountable officer in Transport Scotland to share their thoughts, ideas, risks and concerns, and to make proposals to the Scottish ministers, on which ministers can reflect and make a formal decision. As the Auditor General has indicated, one would expect that to be recorded and documented. ²²

174. The AGS also commented during oral evidence that—

” I am sure that the civil service will want to reflect on how it best documents the process around the making of important decisions that significantly influence not only the use of public money but the provision of extremely important aspects of public services. ²²

175. On [11 May 2022](#), the current Minister for Transport announced to Parliament that this information had been sourced, stating—

” The missing documents have been found. Ministers were advised of this by officials shortly before noon today, and I wanted to take the first available opportunity to give Parliament the news. The document is an email that makes clear who approved the decision to award the contract to build vessels 801 and 802 to Ferguson’s shipyard.

Sent in response to the key submission on 8 October 2015, it is dated 9 October, at 14:32, and it reads:

“The Minister is content with the proposals and would like to be moved on as quickly as possible please”. ²⁵

176. The Minister went on to confirm that in her view, the missing documents that had been located evidenced that the decision had been taken “rightly and properly” by the former Minister for Transport and Islands. ²⁵

177. In response to this new evidence, Audit Scotland issued the following statement—

” The email confirms that Ministers approved the award of the FMEL contract. But there remains insufficient documentary evidence to explain why the decision was made to proceed with the contract, given the significant risks and concerns raised by CMAL. ²⁰

178. During oral evidence, we asked the Director of Aviation, Maritime, Freight and Canals at Transport Scotland about Audit Scotland’s position on this new information—

” That is Audit Scotland’s view, to which it is, of course, entitled. To my mind, the submission of 8 October provides a comprehensive assessment of the issues that were under consideration, and the response from 9 October is clear that they had been taken into account and is clear on the minister’s position in relation to them. ²⁰

179. During oral evidence, the Interim Director-General Net Zero at the Scottish Government was asked about the AGS’s concerns regarding the lack of documentary evidence available to explain why Scottish Ministers accepted the

risks and were content to approve the contract award. The Interim Director-General explained to the Committee that the evidence that had been located—

” confirmed that the Minister had indeed considered the evidence that had been put in front of him, made a decision and responded accordingly.¹⁵

180. The Interim Director-General went on to accept that “on this occasion that one bit of paper was not easy to find” but referred to the Scottish Government’s future record keeping processes, stating—

” Our focus is on record keeping more generally going forward. I know that the permanent secretary has written recently to the Finance and Public Administration Committee about our new strategy to improve our records management.¹⁵

181. In addition to the e mail from the former Minister for Transport and Islands to Transport Scotland confirming that he was content to approve the awarding of the contract to FMEL, further e mail exchanges between senior Scottish Government and Transport Scotland officials were also located. These exchanges highlight that the Scottish Government’s Director of Procurement and Property and the Deputy First Minister (DFM) discussed the contract approval decision after it had been made by the former Minister in the event that the DFM may want further reassurance on “financial/procurement issues”. The e mail exchange also shows that the Scottish Government’s Director of Financial Management asked the Director of Procurement and Property to “confirm the absence of banana skins” after his call with the DFM. Following this call, the Director of Procurement and Property emailed the then Chief Executive and Director - Aviation, Maritime, Freight & Canals at Transport Scotland to state that “the way is clear to award.”⁴

182. We asked the Director-General Net Zero what role the Deputy First Minister - who was also the Cabinet Secretary for Finance, Constitution & Economy - would have had in the decision-making process. He responded—

” The finance secretary would agree the budget, which he did, but he did not have a role in signing off. The decision to sign off on CMAL awarding the contract rested with the transport minister of the time.¹⁵

183. We sought to further explore the involvement of the Deputy First Minister in this decision, as a result of the information that had been located.

184. The Committee notes that in the submission to the former Minister for Transport and Islands on 8 October 2015, the second sentence of this submission read as follows—

” DFM approved the financial implications of the contract award prior to the announcement by FM on 31 August that FMEL were “preferred bidder.”²¹

185. During oral evidence, the Interim Director-General Net Zero stated—

” With regard to the Deputy First Minister’s involvement in that exchange, given his responsibility for finance and budget, it is right that there would be a final check on whether there were any other financial or budgetary requirements.¹⁵

186. The Committee also asked the former Chief Executive of Transport Scotland for his views on the involvement of the Deputy First Minister. He responded—

” having the DFM cross-checking at the final stage that he was content and understood what was going on was not abnormal in the context of our business. I do not think that that should lead you down the route of thinking that there was some great clever game going on. ¹⁶

187. The Committee was told on a number of occasions during oral evidence sessions that the decision to sign off on CMAL awarding the contract to FMEL rested with the Minister for Transport and Islands. During oral evidence, we asked the Interim Director-General Net Zero whether the decision to award the contract would have been considered by the Scottish Cabinet. He responded—

” There is no necessity for a particular issue to go to the Cabinet depending on scale or influence. If it is a ministerial portfolio issue, it is dealt with by the minister. The decision to take ScotRail into public ownership was taken at Cabinet because of the gravity and size of the decision and the need for cabinet secretaries to be aware of it. However, given all that we were procuring at the time of the ferries contract—bear in mind that we had more than £2 billion or £3 billion-worth of work under way with the Queensferry crossing, the M8-M73- M74 and the Aberdeen western peripheral route— it would have been entirely a decision for the transport minister. ¹⁵

188. The Committee notes that there is a section in the Scottish Ministerial Code regarding Cabinet Business. It states—

” 2.11 Matters wholly within the responsibility of a single Minister which do not significantly engage collective responsibility need not be brought to the Cabinet unless the Minister concerned wishes to inform his or her colleagues about the matter in question or to have their advice in a full meeting of the Cabinet. It is not possible to give a precise definition of the matters which should be referred to the Cabinet for decision. As a general rule, however, Cabinet members should put before their colleagues the sorts of issues on which they themselves would wish to be consulted.

2.12 Issues should not be brought to Cabinet until there has been appropriate consultation with Ministers with a direct portfolio interest and their views have been fully reflected in the paper to be submitted for Cabinet consideration. Questions involving more than one Minister which require collective consideration by Cabinet should be examined by the officials concerned before submission to the Cabinet so that the decisions required may be clearly defined. When there is a difference between Ministers, it should not be referred to the Cabinet until other means of resolving it have been exhausted, including discussions between the Ministers concerned. It is the responsibility of the officials concerned to ensure that proposals have been discussed with other interested officials. The outcome of these discussions should be reflected in the paper submitted for Cabinet consideration. ²⁶

189. We asked the First Minister for details of all occasions when the Scottish Cabinet discussed decisions taken by the Scottish Government in relation to Ferguson Marine shipyard. In follow-up written evidence to the Committee, the First Minister

stated—

” Cabinet received a number of reports and updates related to Ferguson Marine, however no formal decisions were taken by Cabinet on these matters. ¹⁹

190. On 9 October 2015, the Head of the Ferries Unit at Transport Scotland wrote to the then Chief Executive of CMAL stating—

” The Scottish Ministers have seen [the risk note prepared by CMAL’s 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). ²⁷

191. In written evidence to the Committee, CMAL stated—

” CMAL was effectively instructed to proceed with the purchase from FMEL despite the concerns raised. ¹²

192. **A range of documents offering contradictory opinions regarding the award of the contract to FMEL were presented to Scottish Ministers in the submission from Transport Scotland officials. The Committee considers that this information could have been presented in a more coherent way by CMAL and Transport Scotland to assist Scottish Ministers in making a well-informed decision.**

193. **The very fact that this submission highlighted so many conflicting views should have raised enough questions to prompt the Minister to pursue further explanation regarding CMAL’s position, as well as taking up its offer to meet with a representative of the CMAL Board.**^{xxiv}

194. **There appear to be different interpretations regarding whether CMAL was content to award the contract to FMEL between the Scottish Government and Transport Scotland and CMAL. It is unclear the extent to which CMAL’s concerns were taken on board and communicated to Scottish Ministers by Transport Scotland.**

195. **Different and conflicting perspectives also appear to exist regarding the extent to which Scottish Ministers were asked to authorise and approve the contract. Indeed, the Committee notes that CMAL considered it necessary to receive shareholder authorisation, otherwise known as a “letter of comfort” before it awarded the contract to FMEL. We suggest that there is scope for Transport Scotland and CMAL to work together to clarify in writing the procedure for seeking reassurances from Scottish Ministers, including how and when either written authority, as set out in the Public Finance and Accountability (Scotland) Act 2000 or shareholder authorisation should be sought.**

^{xxiv} There was division on this paragraph. See Annexe C, Minute of the Meeting of 23 February 2023, and note on 'Record of division in private' for more detail.

196. The Committee recommends that where the board of a company wholly owned by Scottish Ministers considers it necessary to seek and receive shareholder authorisation, this should be a matter of public record. This could be achieved by the Scottish Government proactively publishing this information on its website as well as providing a written copy for information of the shareholder authorisation to the AGS and the Clerk to the Public Audit Committee.
197. As noted in the Scottish Public Finance Manual, the Chief Executive of Transport Scotland has responsibility for the “propriety and regularity of the finances under their stewardship and for the economic, efficient and effective use of all related resources”. Given the extent of the concerns raised by CMAL regarding the financial risks associated with the contract, we believe it would have been appropriate for Transport Scotland to have sought written authority from Scottish Ministers before any further progress was made with the project.
198. The Committee notes that the Scottish Government does not have a dedicated area on its website where all occurrences of written authority sought by civil service accountable officers can be found. This differs from the approach taken by the UK Government, where all Ministerial Directions since 2015 have been brought together and published on its website. The Committee invites the Scottish Government to consider adopting a similar approach to the publication of written authority, to improve openness and transparency in this area.
199. The Committee shares the AGS’s view that the e mail confirming that the Minister was content to proceed with the awarding of the contract does not sufficiently evidence how the risks were considered or would be managed during the running of the contract.
200. We are aware that the Finance and Public Administration Committee has recently launched an inquiry which will look to establish and bring more transparency around the Governmental decision-making process. It will draw on comparative evidence to recommend any improvements identified. We consider this inquiry to be a welcome development, given our experiences and findings in relation to our scrutiny work. We hope that our insights set out in this report provide helpful evidence.
201. While it appears that the Deputy First Minister had approved the financial implications of the contract award prior to the preferred bidder announcement, it was only after further information had been received by the Deputy First Minister that CMAL was able to proceed to award the contract. This raises uncertainty around which Minister had final sign-off on the decision to award the contract.^{xxv}
202. The Committee notes from the evidence we have taken that no decisions

^{xxv} There was division on this paragraph. See Annexe C, Minute of the Meeting of 23 February 2023, and note on 'Record of division in private' for more detail.

appear to have been made at the Scottish Cabinet regarding the procurement of vessels 801 and 802.

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Initial work to build the vessels

203. The AGS's report highlighted the clear breakdown in the relationship between CMAL and FMEL. The report states that the breakdown largely centres on a dispute between the two organisations about "the level of concept design that was carried out on the vessels, changes to the design of the vessels after the contract was awarded, and whether the vessels were a prototype".¹
204. During the project, the AGS also reported that—
- "milestone events in the contract were not clearly defined and had no link to quality standards. CMAL was legally required to make those milestone payments despite its concerns about FMEL's performance".
 - there were weaknesses in project governance, including specific weaknesses in the Programme Steering Group arrangements. The AGS stated that the PSG, led by Transport Scotland had no clear role and there were no formal escalation processes in place. He also highlighted that "project documentation, including the Project Initiation Document, was not finalised" and that "CMAL's updates to the PSG did not include details on expenditure or risk and appeared to be for information only". Any significant decisions on the vessels were made outside of the PSG. The AGS also raised concerns that there was a lack of robust risk management arrangements in place for the PSG.¹
205. The Committee notes that the Rural Economy and Connectivity (REC) Committee's report highlighted that while the Ferguson Marine shipyard had an established track record with respect to the construction of new ferry vessels for the Clyde and Hebrides fleet, it predated the existence of FMEL. Indeed, FMEL was incorporated^{xxvi} on 28 August 2014 after CBC rescued the previous company from administration.²⁸
206. This section of the report outlines the Committee's findings and conclusions in relation to the concerns raised by the AGS at this stage of the project based on the information gathered.

Commencement and sequencing of the work

207. The AGS highlighted the differing views of CMAL and FMEL as to what caused the problems with the project, and how this contributed to the deterioration of the relationship between CMAL and FMEL in his report—

^{xxvi} Incorporation is the process by which a new or existing business registers as a limited company.



- FMEL considers that the vessels were prototype and CMAL's conceptual design was inadequate. It reports that CMAL changed its requirements and interfered in the design process throughout the project, and that it delayed making decisions which hindered FMEL's progress and increased costs. It also considers that CMAL became hostile and was not willing to engage in discussions.
- CMAL contends that the vessels were not prototype, the tender documents were clear that the concept designs and drawings were to be fully developed as the project progressed, and the contract was clear that the detailed design was the sole responsibility of the builder. It reports that FMEL overstated the number of design changes and that it simply wanted FMEL to deliver to the specification. It disputes that it was hostile and considers that it supported FMEL on several occasions.¹

208. The Committee notes that the REC Committee made its own conclusions regarding the design of the vessels—



- Based on the evidence it has received, the Committee is forced to conclude that, although the conceptual design of the vessels was clear, the original design specifications were insufficiently detailed and had not been agreed between FMEL and CMAL before construction of the vessels started.
- There is also strong evidence to suggest that FMEL lacked the appropriate level of design capabilities and consequently failed to manage the design iteration process effectively thereafter and proceeded to build the vessels before the design had been suitably developed and signed off.²⁸

209. The Committee sought to establish more information about the contract, and how changes could be made to the vessels during the build process.

210. As we outlined earlier in the report, CMAL used the standard BIMCO New Build Contract (NEWBUILDCON) for the project. This type of contract is described as a design and build contract in which the shipyard undertakes to design and build a vessel to meet the buyer's specification at a fixed price.

211. The AGS's report explained that the usual payment schedule for a standard NEWBUILDCON contract "typically includes five equal payments worth 20 per cent of the contract price".¹

212. In oral evidence to the Committee, an Audit Manager at Audit Scotland confirmed that in the shipbuilding industry, typically the payment schedule is five equal payments of 20 per cent. They went on to state however that—

- ” it is not unusual for the buyer and the shipbuilder to agree to a payment schedule that best suits the project. It is our understanding that, during discussions in the period between FMEL being announced as the preferred bidder and the contract being awarded in October, seven iterations of the milestone payment schedule were suggested by FMEL, to ease its cashflow issues during the project. We discussed the matter with CMAL, which said that how the funding was distributed and when was not a concern because, ultimately, more than the £97 million would not be paid.²²
213. In written evidence to the Committee, CMAL explained that the proposal for the type and design of the vessels was set out in CalMac Ferries Limited ship specification entitled "Specification of Operational and Technical Requirements".¹²
214. CMAL's written submission to the Committee included an extract of FMEL's detailed quality submission which formed part of its tender bid. The extract read as follows—
- ” 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.¹²
215. During oral evidence, the former director of FMEL provided an example of how CMAL changed its requirements and interfered in the design process—
- ” The order was signed on 16 October 2015. By April 2016, CMAL had to concede that the specified deadweight capacity could not be met without a change to the draught of the vessels. That is a key part of the specification. It tells you the deadweight—the cargo that the vessels have to carry and the number of people—and the draught... That should have been nailed down in the spec. That work should be done by the buyer and it should be in the tender document before an order is placed. The decision came six months after the contract award and 20 per cent into the contract period.⁶
216. CMAL's written submission states that FMEL raised no concerns about the specification, including that of the deadweight, at the ITT stage.
217. Of particular interest to the Committee was the commencement of the work by FMEL. Indeed, the AGS commented in his report that FMEL began "cutting steel" for both vessels in December 2015, two months after the contract was awarded and one day after FMEL provided CMAL with a high-level project plan for the vessels. The Committee further notes that this milestone event triggered a payment of £2.8 million to FMEL.
218. The AGS raised concerns about the timing for cutting steel in his report given—

- ” • FMEL’s high-level project plan indicated that it would take three months to design the hull midship (the starting point for vessel construction)
- the contract stated that FMEL must provide CMAL with detailed drawings and plans for the vessels at least 30 days prior to starting construction.¹

219. The REC Committee’s report also concluded that there was strong evidence that the contractor deliberately proceeded to construct specific sections of the vessel either out of sequence or not according to the proper specification purely as a means of triggering milestone payments on the contract.²⁸

220. We put this conclusion to the former director of FMEL during oral evidence, to try and establish how milestone payments were triggered. The former director responded by stating—

- ” The milestones were laid out according to the percentage of fabrication. We did the fabrication in a different order from the one that we had intended to do it in, but that was valid. We did it for a very good reason, which was to keep the work going and the project progressing.⁶

221. During oral evidence, an Audit Manager at Audit Scotland commented that—

- ” We have spoken to independent shipbuilders, which have said that out-of-sequence working is not necessarily an issue and that that can take place to keep the project moving and to make for more efficient working. However, CMAL reported that FMEL’s approach in out-of-sequence working was an issue and caused problems with the project.²²

222. The former director of FMEL explained during oral evidence the change in approach that FMEL was required to make to the way it had originally intended to build the vessels—

- ” ...we wanted to build two ships side by side on the slipway, starting with the sternmost blocks and building them out, so that we could always get the equipment past until we had the last block on. We could not do that, so the vessels were built out of our planned sequence, which contributed to the delays, but that approach allowed us to continue with work and minimise the delay.⁶

223. In written evidence to the Committee, CMAL stated that the “alleged disruption to the intended block sequence is one of the most critical issues to be understood by the Committee”. In its written evidence, CMAL included a copy of a project planning document referred to as a Cardinal Date Programme (CDP), which was produced by FMEL in December 2015. The submission highlights that the CDP’s for each vessel—

- ” ...show for both Vessels a sequence of building from the mid-ships and not, as the witness contends, from the stern.¹²

224. CMAL concluded in its written evidence that—

” ...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.¹²

225. The Committee did not seek technical guidance from independent maritime industry experts to obtain advice on the conflicting statements and assertions presented by witnesses. Our conclusions and recommendations consider the apparent confusion between CMAL and FMEL on the sequencing of work, rather than pass comment on the merits of any particular approach to construction.

FMEL decision making

226. In addition to concerns raised regarding the sequence of the work to build the vessels, the Committee also received evidence highlighting concerns about some of the decisions made by FMEL's management regarding the construction of the vessels.
227. During our meeting with FMPG workforce representatives, a wide range of examples of management and build errors that they believe took place during the time in which FMEL owned the yard were highlighted to the Committee. This included—
- Work being driven by bonus payments for management staff. On one occasion, it was explained that this led to a funnel being built without pipes, triggering bonus payments for some members of staff. This work was required to be redone
 - Subcontracting work to companies when it could have been done at the shipyard
 - Purchasing equipment that was not fit-for purpose
 - Employing overseas agency workers, leaving existing staff with limited work to do
 - Leaving equipment out in adverse weather conditions
 - Employing a significant number of management staff.²⁹
228. The Committee also recalls the workforce representatives explaining that the vessels were required to be built using a clamshell-door design. However, the representatives had never built ships to that design before.
229. Workforce representatives also raised concerns about the decision to reconfigure the shipyard at the same time as building the vessels. It was commented that FMEL's approach was to “knock everything down” and construct new buildings which the workforce representatives felt had a negative impact on the operation of the yard. The representatives also commented that building the two ferries concurrently as well as making significant changes to the layout of the yard all at the same time, made the original timescales “impossible” to achieve.²⁹ This issue

was also raised by CMAL in written evidence where it stated—

” Old buildings were torn down and new buildings erected, and significant work was done on the hardstanding at the yard during 2016. ¹²

230. While CMAL accepted that “the redevelopment was positive for the yard”, it stated that this was “to the detriment of the progress in fabrication of the vessels”. ¹²

231. FMPG workforce representatives also told the Committee that staff regularly explained to FMEL management that certain approaches or ideas, including the decision to reconfigure the yard, would be detrimental to the success of the project and FMEL. However, at many points during the project they did not feel that FMEL management were prepared to listen to them.

Launch of vessel 801

232. One high profile milestone event associated with the project was the launch of vessel 801 by the First Minister on [21 November 2017](#).

233. In written evidence to the Committee, CMAL highlighted its concerns regarding this launch stating that this decision was—

” ...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 practice. ¹²

234. When asked about the “premature” launch during oral evidence, the Chief Executive Officer of CMAL stated—

” Our opinion, in line with normal shipbuilding practice, is that you should do as much as you can under cover in the first instance, you should join things up outside and you should do as much as you possibly can when the ship is dry—it is only then that you should launch the ship. I will put it very simply: we could not dictate to the yard what it should do, but, on 21 November, when vessel 801 was launched, we had very active discussions with [the former director of FMEL’s] team in which we said that the launch would be too premature. ⁷

235. The Interim Chair of CMAL stated her view during oral evidence regarding the catalyst for the launch—

” As far as we are concerned, the launch was driven by FMEL. There is a note from ... our director of vessels, saying: “FMEL’s main priority is putting the ship in the water on 21st November 2017, regardless of the problems that will be encountered later”. ⁷

236. The Interim Chair also explained that at this stage of the project, there were “two versions of the truth” regarding the status of the vessels—

” We were saying that there were real issues and that we did not believe that the deadline dates and delivery dates would be met. FMEL was saying that that was nonsense, that CMAL was not telling the truth and that there was no problem. Therefore, there was a drive to launch to show that there was no problem and that FMEL was right, and we were wrong.⁷

237. We asked the former director of FMEL about the rationale for the decision to launch vessel 801 when it did—

” ...because we could not build from block 1 up, we could not build both vessels side by side. To progress with all the work that we had to do on 802, we had to be able to free up the slipway. We had completed all the work on 801 so that the hull was watertight—there was a lot of work done in the hull. There was work that we would have liked to finish on the slipway, but we could finish it on the quayside, and that would give us plenty of room on the slipway to accelerate work on 802.⁶

238. We also asked the former director of FMEL who made the decision for the First Minister to launch the vessel. He commented—

” That would be the Government and its PR people. They knew that we were putting 801 in the water to make way for 802 and the First Minister wanted to come out and be part of the launch, just like she wanted to come out on 31 August to stand with the workforce and have a picture taken.⁶

239. Asked whether the First Minister regretted her involvement in the launch of vessel 801, particularly in light of the concerns CMAL had. She responded—

” ...if I knew then what I know now, of course I would not have wanted to do that, but I did not know then what I know now.¹⁸

240. In terms of the knowledge the First Minister had about the status of vessel 801, the First Minister stated—

” I was aware that there was a slippage in the contract delivery date... However, I was not aware that CMAL had concerns about doing the launch at that point. In fact, having reviewed my briefing for that event, there were plenty of CMAL executives and nonexecutives on the attendance list.¹⁸

241. Following the oral evidence session with the First Minister we requested all email exchanges and any other items of correspondence regarding the launch of vessel 801. We also requested the briefing prepared by civil servants in advance of the launch. The information received confirms that CMAL's concerns were not included in the briefing. It also confirms that—

- the former chair and Chief Executive Officer of CMAL were listed as “participants” at the launch.
- had the First Minister been unavailable, alternative arrangements would have been put in place for the launch to have proceeded in her absence.¹⁹

Quality standards

242. Of particular concern to the Committee during its scrutiny of the report was that the contract did not state what would happen in the event that no general quality standards were applied by the builder.
243. The AGS's report highlighted that the contract between CMAL and FMEL specified that "the builder had sole responsibility for the design and build of the vessels, that it had to apply general quality standards, and that it was responsible for ensuring that the completed vessels—
- complied with relevant regulations, including those of the Classification Society (Lloyd's Register) and Flag Authority (MCA)
 - had the required certificates to confirm they were safe to operate." ¹
244. The AGS also explained that—
- ” a full BRG provides a shipbuilder with a significant incentive to build a quality product as the buyer can cancel the contract and claim a full refund of all payments if the ship does not meet its required specification. ¹
245. As the contract that was put in place for this project did not include the provision of a full BRG, the AGS explained in his report that "this placed greater importance on the link between CMAL's milestone payments to FMEL and the quality of FMEL's work". ¹
246. The AGS's report also raised serious concerns that some of the milestone payment events in the contract "were not clearly defined and did not explicitly set out any expectation of quality". This included not setting out what was meant by "fabrication" for the six fabrication milestones, how the fabrication would be assessed and whether fabricated parts were required to be erected onto the vessel for the event milestone to be successfully achieved. ¹
247. The AGS reaffirmed this position when he gave oral evidence to the Committee, stating—
- ” During our audit work, it became clear that the use of milestone payments in the contract did not necessarily relate directly to quality or progress. That is the industry norm for shipbuilding contracts, but it is perhaps at odds with other large public sector infrastructure contracts. ²²
248. Of further concern to the Committee, as set out in the AGS's report, was that the way the contract was set out meant that if CMAL had concerns about the standard of FMEL's work, it was unable to do anything about it. Indeed, the Interim Director of Performance Audit and Best Value explained during oral evidence—
- ” ...the contract was such that it had no power to intervene in or stop the on-going fabrication of the ship. That touches on the nature of the new-build contract, which is fairly standard in the shipbuilding industry, and which becomes more of an issue where there is no full builder's refund guarantee and there is more risk associated with the purchaser. ²³

249. We asked the former director of FMEL about its quality processes during oral evidence to which he responded—

” We have evidence of people who have done audits, including CMAL, giving us 97 out of 100 per cent—“excellent” is the term that is used in the form that they fill in—for our procedures and so on. ⁶

250. When asked specifically whether an agreed framework between CMAL and FMEL was in place to resolve issues for vessels 801 and 802, the former director responded—

” We had all of that in place. We were audited by the people who were looking at the British shipbuilding strategy. Sir John Parker did a review of the shipyards in the UK, and we got a glowing report. It went into all the control processes that we had. We got to the stage where we were nominated as a consortium partner with Babcock. ⁶

251. We also asked CMAL during oral evidence for its views on the application of quality standards and whether they were fit for purpose. The Chief Executive Officer responded—

” When everything was fine and the shipyard was operating as it should do, there were no issues. Issues started to arise when it evidently started to get into financial difficulty. That manifested itself first in corners being cut, but then the production of the ships slowed down substantially because— fairly obviously—if you cannot pay your subcontractors, they are not on site, building the ship. ⁷

252. During the meeting we held with workforce representatives at FMPG, the Committee heard that early into the contract to deliver vessels 801 and 802, the workforce was told not to talk to CMAL inspectors, which the FMEL workforce found very hard to do given the long-standing relationships they had developed with CMAL staff members, many of whom were former employees of FMEL. ²⁹

Change requests

253. The AGS’s report referred to FMEL’s submission to the REC Committee’s which reported that—

- ”
 - the requirement for CMAL to sign off every vessel drawing slowed down its design process significantly
 - it could take several months for it to process CMAL’s comments on individual drawings and that it had to prioritise constructing the vessels to meet the milestone dates. ¹

254. In both written and oral evidence, the former director of FMEL stated that specification changes to the vessels made by CMAL resulted in delays. We asked the former director of FMEL during his oral evidence session about these changes. He responded by stating—

” The ships were prototypes that were costing more to build than was in the budget. It was variations to what was asked for and delays that caused the increase in costs.⁶

255. The former director of FMEL also stated in written evidence that—

” Early in fulfilling the contract for CMAL it became obvious to FMEL management, that variations to the original contract were resulting in significant changes and cost increases well beyond what would be expected in a Standard New Build contract. Despite repeated attempts to engage CMAL in a meaningful discussion about these changes, and the serious cost implications, they repeatedly refused to discuss the issues.²⁴

256. CMAL highlighted in its written evidence that the standard BIMCO New Build Contract (NEWBUILDCON) used for the project included a variation to contract mechanism (VTC). The evidence provided a summary of the VTC mechanism. Of particular note, CMAL’s summary stated—

” 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.¹²

257. CMAL also highlighted in its written evidence that “the contracts specifically guard against the Builder being out of time or money for design changes that are instructed by the Buyer”.¹²

258. The Committee notes that the AGS explained in his report that CMAL was able to communicate its concerns through owner observation reports (OORs) when it identified that—

- ”
- a technical issue where the specification had not been met
 - a potential safety concern or quality issue where work was not carried out to a satisfactory standard
 - that vessel parts were fitted prior to a survey taking place or being checked against an approved drawing.¹

259. The AGS also highlighted in his report that the contract stated that “FMEL had to comply with CMAL’s reasonable demands but did not define what these were”. The AGS’s report went on to state—

” FMEL senior management reported that it rejected several of CMAL’s OORs as they considered them unnecessary and would increase costs and delays. CMAL reports that failure to address OORs is poor shipbuilding practice.¹

260. The former director of FMEL provided his perspective of the OOR’s during oral evidence, stating—

” An owner observation report is the owner—that is, CMAL— coming back and saying, “We would like to change this”. We said no to, probably, 70 per cent of what it asked for, because it was not necessary. We were designing the vessel and we knocked CMAL back. ⁶

261. During oral evidence, we asked the Chief Executive Officer of CMAL how changes were managed. He stated—

” There seems to be complete confusion in the mind of the previous owner as to what a comment is. There are formal variations to contract... There were 111 discussions and 81 actuals, 46 of which were proposed by the yard and 35 of which were proposed by us, resulting in the £1.55 million. Owner observation reports are us attempting—as we attempted an awful lot—to help the yard to say, “Look, this is not normal shipbuilding practice. Can you please rectify the problem that has manifested itself?” That is not a change; that is us simply saying, “You are not a building a ship to normal shipbuilding standards. ⁷

262. We also asked the Chief Executive Officer at CMAL about the 346 OOR's referred to in the AGS's report that had been issued to FMEL by CMAL before it went into administration, and whether they were connected to specification changes. The Chief Executive Officer stated—

” No, none whatsoever...As I say, the variations to contract... are about actual changes that are being actively discussed and that have to be paid for. Some of the changes that were asked for by FMEL even resulted in our getting a credit. So, within the £1.55 million are some credits, when the VTC says, “Do you really want this? We would like to do it in a different way,” and we agree with that. Other ones are us saying, “Can we change something?” One of the specific changes that was asked for involved building a couple of extra crew cabins for cadets, so that Caledonian MacBrayne could train more cadets. ⁷

263. CMAL was also asked during oral evidence if it had told FMEL which order to build things in. The Chief Executive Officer of CMAL stated—

” No, not at all. It is a very standard international contract. It is a design and build contract, and it does what is written on the tin. In effect, it is up to the builder to decide how it wants to build the vessel. ⁷

264. The Chief Executive Officer of CMAL went on to state—

” ...ordinarily in a contract, we would accept that there will be some changes from time to time...The changes that we agreed amounted to £1.55 million...we had 111 changes that were discussed between us. Thirty of them we both agreed would not go forward. Forty-five of the changes were as a result of things that CBC and FMEL wanted to change. That left the balance for us, which was 36. That is a completely normal process....the actual figure of £1.55 million is far below what you would ordinarily expect with a contract. ⁷

Governance arrangements

265. The AGS reported weaknesses in relation to the project's governance arrangements, including no formal escalation processes, and an overall lack of strategic oversight of the project.
266. The terms of the voted loan, as set out in the letter from the Head of Ferries at Transport Scotland to the then Chief Executive of CMAL stated—
- ” CMAL shall keep the Scottish Ministers fully informed of the progress of the Project in the form of quarterly reports to Transport Scotland. Details shall include actual progress to date of the project against the schedule, actual expenditure to date compared with profiled expenditure, and the reasons for any changes or delays. ²⁷
267. The AGS stated in his report however that—
- ” CMAL only produced two quarterly progress reports for Transport Scotland (in January and April 2016). After this, it was agreed that CMAL's monthly updates to the Project Steering Group (PSG) were sufficient. ¹
268. The AGS's report also raised concerns about the PSG, which was led by Transport Scotland, stating that “it had no clear role, and there were no formal escalation processes in place”. The AGS also reported on the limitations of the PSG, stating—
- ” Neither the PSG nor Transport Scotland were contracting parties. This meant that they had no scope to intervene, and no action was taken in response to CMAL's project updates. ¹
269. During oral evidence, the Director of Aviation, Maritime, Freight and Canals at Transport Scotland further explained the role of the PSG to the Committee in relation to the project—
- ” ...the PSG...had no formal role in the contract. That group was a product of the tripartite—Transport Scotland, CMAL and CalMac—coming together to look at the programme, or portfolio, of investment across the network to make sure that it all worked together and that all parties with an interest were aware of progress and how other projects and programmes in the portfolio were impacted. ²⁰
270. The Director of Aviation, Maritime, Freight and Canals further explained—
- ” Under the contract, the PSG would have had no contractual role: the contract was between CMAL and Ferguson's, so escalation of contractual disputes to the PSG or ministers would have been inappropriate. ²⁰
271. The Committee notes that the AGS highlighted in his report that in December 2015, “CMAL alerted the PSG that FMEL was failing on some of its contract deliverables, which included project meetings, project planning and vessel designs”. ¹
272. We asked the Director of Aviation, Maritime, Freight and Canals what the purpose of the PSG was. She responded—

- ” It intends to bring together all the projects and programmes within the ferries investment strategy, to make sure that interactions, where they exist, are managed well. It is a profile, or programme, approach, rather than a project-specific approach; the PSG has no role in the management of the contract.²⁰
273. Based on this answer, the Committee put forward the suggestion to Transport Scotland officials that when CMAL escalated an issue to the PSG, it was “a waste of time”.²⁰
274. The Head of Ferries Unit, Transport Scotland responded, stating—
- ” It would not have been escalated just to PSG; it would also have been escalated to TS officials, with direct engagement. As is clear in the Audit Scotland report, there were points at which issues were reported but it looked like the programme might be recoverable. At such points, we would not necessarily have escalated things directly to ministers. Later, when it looked like dates would not be made and things would slip, that was the point at which we would formally advise ministers.²⁰
275. The AGS’s report stated—
- ” Although CMAL consistently reported problems to its board, Transport Scotland and the PSG, the contract did not allow CMAL to intervene in FMEL’s running of the project, even when it became apparent to CMAL that FMEL was not making sufficient progress on the vessels.¹
276. In terms of when Scottish Ministers became aware of CMAL’s concerns, the AGS’s report confirms—
- ” Transport Scotland verbally updated Scottish ministers on the project and notified the Minister for Transport and the Islands in December 2016 that there was a risk that FMEL would not recover the vessel delays. In February 2017, Transport Scotland officially informed Scottish ministers that it was highly probable that the vessels would be late.¹
277. The Committee notes that during oral evidence to the Committee, the Chief Executive of CMAL explained how it usually communicated information to Scottish Ministers—
- ” Our direct line of communication under normal circumstances...is with our sponsor team. Once a year, ...the minister attends a board meeting for a period of time. Therefore, our direct communication in these respects is not directly with the minister; it is with our sponsor.⁷
278. The Committee also notes from the AGS’s report that CMAL’s initial register for the project set out 25 risks that were assessed—
- ” ...according to likelihood and impact. The risks that it assessed as being unlikely to happen included insolvency of the shipbuilder, vessel modifications and changes, and substandard construction.¹
279. The Committee observes that among these “unlikely” risks, a significant number

eventually occurred, not least the insolvency of FMEL.

280. During oral evidence, the Director of Aviation, Maritime, Freight and Canals acknowledged that while the governance arrangements in place for the project departed from best practice, “there was still good evidence of risk management and escalation throughout the project, albeit that that was not documented in the manner that we might have liked”.²⁰
281. The Director of Aviation, Maritime, Freight and Canals also confirmed that Transport Scotland have made improvements to its governance arrangements for the future, stating “we have enhanced the project groups for defined projects and programmes going forward. We have increased the emphasis on the discipline around recording all decisions, particularly our approach to recording risks”.²⁰
282. Referring to these improvements, and how Scottish Ministers are kept up to date on progress for the Islay vessels^{xxvii}, the Head of Ferries Unit at Transport Scotland stated—
- ” ...the approach that we would adopt now would be to advise ministers when we get the monthly or quarterly reports from CMAL, even if the project is going well, in a very similar vein to the approach that we take to 801 and 802.²⁰

Cancelling the contract

283. The AGS’s report stated that CMAL could only cancel the contract if—
- FMEL failed to complete any work on the vessels for 14 days
 - The vessels were delivered more than 120 days late (excluding any additional permissible days)
 - FMEL was deemed insolvent
 - the completed vessels did not meet speed, deadweight, and fuel consumption requirements.^{xxviii}
284. In written evidence to the Committee, CMAL provided additional context regarding what scope there was to cancel the contracts—

^{xxvii} In April 2018, Scottish Ministers announced the next vessel procurement exercise would be for a new ferry for Islay to replace the MV Hebridean Isles. Two new ferries for Islay are currently under construction. The first vessel is expected to be delivered by October 2024. The second vessel will follow in early 2025.

^{xxviii} The contract set out the financial penalties that would be applied if the completed vessels did not meet speed, deadweight, and fuel consumption requirements. If these penalties exceeded a specified amount, CMAL had the right to cancel the contract.

” 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

285. During oral evidence, we asked the Interim Director-General Net Zero at the Scottish Government who was the former Chief Executive of Transport Scotland between 2016 and 2021 whether he could have cancelled the contract. He responded—

” It was not in my gift; it was in the gift of CMAL, as the party to the procurement. I apologise for restating this, but Transport Scotland was not a party to the contract. The buyer was CMAL; the builder was FMEL. Under the terms of the contract, it is entirely right that CMAL could have triggered a termination or suspension of the contract. I have mentioned a couple of times what the conditions for that were. If there was no work undertaken in the yard for more than 14 days, CMAL could have triggered a cancellation of the contract and requested all the money back.

Another important aspect is that, even though there was a partial refund guarantee, the contract clauses still required the contractor to repay if there was a suspension or termination. That would have meant that the yard would have had to find the money to pay back the buyer, CMAL, and the yard would probably have become insolvent much earlier.¹⁵

286. **It is unclear why FMEL chose to start “cutting steel” when it did, particularly as the contract stipulated that FMEL must provide CMAL with detailed drawings and plans for the vessels at least 30 days prior to starting construction. It appears that FMEL did not comply with this aspect of the contract.**
287. **Different versions of events exist regarding the sequencing of the work on vessels 801 and 802 by CMAL and FMEL. CMAL has provided evidence to the Committee which demonstrates that FMEL always intended to build from the mid-ships rather than from the stern. The Committee therefore does not accept the claim by the former director of FMEL that it was forced to deviate from its planned sequence to build the vessels.**
288. **Based on the evidence the Committee has received, the Committee agrees with the conclusion drawn by the REC Committee that FMEL deliberately constructed specific sections of the vessels either out of sequence or not according to the proper specification as a means of triggering milestone payments on the contract.**
289. **The contract stated that FMEL was required to apply general quality standards throughout the design, construction, material selection and workmanship, in accordance with good shipbuilding standards. The contract did not set out what would happen if general quality standards were not met. Coupled with the absence of a full BRG, CMAL’s position was**

significantly weakened when problems with the standard of FMEL's work became apparent.

290. FMEL was a relatively new entity, established just one year before it was announced as the preferred bidder for two significant vessel contracts. Given there would have been a lack of certainty regarding management capabilities at FMEL, it would have been prudent for FMEL to have engaged more effectively with its experienced workforce about its plans to construct the vessels and reconfigure the yard.
291. The REC Committee concluded in its report that although the conceptual design of the vessels was clear, the original design specifications were insufficiently detailed and had not been agreed between FMEL and CMAL before construction of the vessels started. While we have not gathered sufficient evidence about the design specifications to agree or disagree with this conclusion, the Committee is clear that not addressing these issues at an early stage appears to have had significant and wide-reaching consequences for the project.
292. The Committee agrees with the AGS that there were weaknesses in the governance arrangements for the project. The PSG, led by Transport Scotland, appears to have been completely "toothless" and there was therefore limited value in CMAL raising its concerns about the project through this forum.
293. It also remains unclear why CMAL only produced two quarterly reports to Transport Scotland. This appears to have been a missed opportunity for CMAL to raise its concerns about the way in which FMEL was constructing the vessels with Scottish Ministers.
294. Indeed, Scottish Ministers indicated that they only became aware of these concerns one year after they had been raised through the PSG. The Committee also notes that Scottish Ministers appeared not to have any knowledge of CMAL's reservations regarding the launch of vessel 801 in November 2017. However, the Committee considers that there was scope for Scottish Ministers to have played a more pro-active role in seeking detailed reassurances from both Transport Scotland and CMAL before proceeding with the launch, particularly given it was known that there had been slippage in the project.^{xxix}
295. While the Committee accepts that Transport Scotland had no formal role in managing the contract, it is clear that, as CMAL's sponsor, it had a critical role in communicating important information to Scottish Ministers on its behalf. It appears to the Committee that Transport Scotland consistently failed to reflect CMAL's concerns to Scottish Ministers in an accurate and timely manner.
296. The Committee also questions some of CMAL's judgements at this stage of

^{xxix} There was division on this paragraph. See Annex C, Minute of the Meeting of 2 March 2023, and note on 'Record of division in private' for more detail.

the project. For example, given the strength of CMAL's concerns about awarding the contract to FMEL, it is surprising that it assessed outcomes such as insolvency of the shipbuilder, vessel modifications and changes, and substandard construction as being low risk in its initial risk register.

DRAFT

Delays and cash flow problems before nationalisation

297. The AGS's report stated that the project experienced a series of problems and delays, and that CMAL and FMEL hold differing views regarding the cause of these problems which we have set out at paragraph 207.

298. During oral evidence to the Committee, the former director of FMEL summarised the four main factors that he considered led to the significant cost overruns and extensive delays—

” First, the wrong type of vessel was selected. The second was the insufficient development of the specification prior to the placing of the order. The third factor was the shutting down of all opportunities for dispute resolution during the build process. The fourth was that nationalisation and the steps that have been taken since then have been catastrophic. ⁶

299. In written evidence, CMAL summarised its position to the Committee —

” ...the primary cause of the Vessels' delay and associated cost overrun is a catastrophic contractor failure between October 2015 and August 2019. 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. ¹²

300. The Committee notes that CMAL began raising concerns that FMEL was failing on some of its contract deliverables as early as December 2015. In written evidence to the Committee, CMAL explained certain events that were taking place around this time—

- ”
- CMAL had refused the first iteration of FMEL's second milestone payment request due to “a lack of vouching and FMEL's failure to correctly use the payment processes contained in the Contracts”
 - FMEL were ordering components for the vessels, “despite lacking design staff to finalise the vessel design, leading to a high likelihood of purchasing mistakes by the yard
 - FMEL were pursuing a re-development of the yard concurrent at the same time as building the vessels. ¹²

301. CMAL also explained in its written evidence that these factors “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

Milestone payments

302. The AGS's report stated that despite CMAL's concerns about FMEL's performance, it was still legally obliged to make milestone payments. The AGS's report highlighted that there was a discrepancy between the milestone schedule and one

update provided by FMEL. Indeed, the AGS stated—

” According to the milestone schedule, FMEL had achieved 100 per cent fabrication for vessel 801 and 75 per cent fabrication for 802. But per FMEL’s June 2019 update, a further six months of fabrication work was required on vessel 801 and over a year of fabrication work was required on vessel 802. ¹

303. The AGS also reported that FMEL and CMAL both confirmed that “stringent checks” were in place before CMAL signed milestone certificates and made milestone payments. However, as we have already referred to in this report, milestone events in the contract were not clearly defined, nor did they link to the quality of the work undertaken.

304. The AGS also explained in his report that CMAL sought legal advice regarding whether it was required to make certain milestone payments given its concerns about FMEL’s performance. This included the amount of outstanding work and known issues, such as vessel designs not being signed off and a significant proportion of OORs remaining outstanding. The advice was that CMAL was legally obliged to make these payments.

305. We asked CMAL for further information during oral evidence about the requirement to make these milestone payments. The Chief Executive Officer of CMAL stated—

” We receive certificates at points in time in this contract—or any other contract that we have in shipbuilding or civil engineering—to say that a payment is due. We cannot interrupt that process. That is contract law. If something has happened— if a milestone has been reached—we have to pay that money. ⁷

306. When questioned on the legal advice sought, the Chief Executive Officer stated that CMAL regularly takes legal advice and there was nothing specifically unusual in taking legal advice for this particular project.

307. The Committee notes that CMAL have since made changes to the way in which milestone payment certificates are signed off for the Islay vessels, which are currently under construction. Indeed, milestone payment certificates are now tripartite which means that as well as payments being signed off by both CMAL and the builder, the attending surveyor of the vessel’s Classification Society must now also sign the certificate.

308. CMAL also indicated in written evidence that the mere achievement of a milestone event (such as reaching a percentage of steel fabricated) is now insufficient on its own to trigger the payment for that work. The builder must also obtain the necessary Class approval of all the design drawings up to that stage. CMAL explained that the benefit of this new approach provides 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.

12

Financial and non-financial support for FMEL

309. The AGS highlighted in his report that FMEL made “several requests to CMAL and

Scottish Ministers to change the contract terms to aid its cash flow and support vessel delivery”. Both CMAL and the Scottish Government “took action to support FMEL to try and get the project back on track”.¹ This included financial and non-financial support for FMEL which we explored as part of our scrutiny.

Support provided by CMAL

310. The AGS highlighted in his report that CMAL made the following allowances to support FMEL including—
- allowing FMEL to extend the vessel delivery dates to June 2019 for vessel 801 and March 2020 for vessel 802, on the condition that FMEL extended the surety bond dates.
 - agreeing reductions in the technical specification of the vessels, including reducing their carrying capacity (known as deadweight) by 77 tons each.
311. The AGS also highlighted that CMAL made attempts to support FMEL to get the project back on track. This included CMAL offering to assist with the commissioning programme and undertaking vessel surveys seven days a week.
312. The Committee notes that additionally, CMAL agreed two main contract changes to release funding for FMEL “after seeking legal advice, due consideration of the risks, and discussions with Transport Scotland and the Scottish Government”.¹
313. The first change took place in November 2016, when CMAL agreed to replace the Builder’s Refund Guarantees with surety bonds. In written evidence to the Committee, CMAL provided further detail about this agreed change to the contract decision stating—
- ” 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.^{xxx 12}
314. The AGS reported that this change released approximately £9 million of FMEL’s cash held in escrow^{xxxi} and presented no change to the risk or security for CMAL. In its written evidence, CMAL states that this change “served FMEL only”.¹²
315. The second change was in May 2017, when CMAL agreed to reduce the final delivery payment for each vessel from 25 per cent to ten per cent of the value of each contract. The AGS reported that this involved restructuring the milestone schedule, to accelerate £14.55 million of payments to FMEL.
316. In written evidence, further context was provided by CMAL in relation to this contract change—

^{xxx} The AGS refers to this organisation as HCC plc in his report

^{xxxi} The AGS explains in his report that this is “a legal arrangement in which a third party temporarily holds a sum of money, or property, until a particular condition has been met”.

” Following representations by CBC to [the former Cabinet Secretary for Finance and the Constitution], 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 cashflow for the yard.¹²

317. The Committee notes that CBC’s representations were discussed at a meeting in March 2017 between the former director of FMEL and Scottish Ministers including the then Minister for Transport and the Islands, the then Cabinet Secretary for Economy, Jobs and Fair Work and the then Cabinet Secretary for Finance, Economy and Fair Work. The key points raised under this item were recorded as follows—

” **Contract 801/802: funding profile**

- Mr McColl tabled the attached paper setting out the FMEL position on cashflow. A substantial amount of cash remained tied up in the Surety Bond, and was thus not available to CBC/FMEL to invest in other projects. Mr McColl requested that SG should underwrite the refund guarantee and that CMAL reduce the £25m retention amount to 10% of contract value. Mr McColl further asked that CMAL’s stage payments be re-profiled to assist with cashflow.
- Mr Mackay indicated that he would, as a matter of urgency, consider this further on advice from transport and finance officials and CMAL. Whilst noting that proper account would need to be taken of the likely risks, he wanted to be as helpful as possible. He asked for advice from officials, to include impacts on CMAL cashflow Action: TS Ferries colleagues to pursue with CMAL and TS/SG Finance.³⁰

318. The Committee further notes that on 29 April 2017, the then Chief Executive and Accountable Officer for Transport Scotland provided a submission to the then Cabinet Secretary for Finance and the Constitution. The submission explained that following advice issued by Transport Scotland officials to the Cabinet Secretary on 13 April 2017 and 24 March 2017, Transport Scotland had sought “further advice from CMAL regarding the legal, technical, procurement and financial issues arising from the request from FMEL in respect of the potential removal of the Surety Bond and the bringing forward of stage payments to a different milestone schedule than that set out in the contract”.³¹

319. Based on this information, the Accountable Officer of Transport Scotland provided the following advice to the then Cabinet Secretary—

15. My advice has considered the propriety and regularity issues with regard to the significant risks of challenge of any substantive changes to the Surety Bond arrangements requested. Given the legal advice received I cannot recommend any such relaxation. In addition, given the significant risks and potential liabilities to which Ministers would be exposed I cannot recommend a course of action whereby SG surety over the yard would be an acceptable proposal.

16. Notwithstanding the legal advice received I have also had to consider the precedent this would set given an on-going vessel replacement programme, industry norms and the need to protect interests moving forward. In addition, any such arrangement would represent a contingent liability and under the terms of the Scottish Public Finance Manual would be subject to notification to the Scottish Parliament.

17. With regard to the request for the re-profiling of milestone payments, given the advice received and our need to maintain appropriate milestones for the completion of the vessels and the appropriate management of risk I would be content to recommend that CMAL work with FMEL on a revised list of additional milestones to accelerate payment while ensuring that the economic balance of the contract is not altered to the extent that the risk of challenge is heightened. If such an agreement can be satisfactorily reached, a key component will be retaining sufficient financial incentive until the end of the contract to complete the vessels and therefore maintaining adequate leverage over FMEL to point of delivery. The retained position with regard to the surety bond ensures significant safeguards in this regard. The timing and quantum of payments to FMEL to have input from SGLD, Procurement and State aid colleagues to minimise the risk of challenge and to maintain an appropriate level of security over on-going construction of the vessels.³²

320. The former Accountable Officer for Transport Scotland, who was the Interim Director-General Net-Zero when he provided oral evidence to the Committee referred to this accountable officer advice during the evidence session. He stated—

It became clear in 2017 that the contract had exhausted any further potential to assist in the yard. I put a piece of accountable officer advice up that laid that out and said that the additional help that CMAL had provided with milestone payments and the request that had come from CBC to remove the final guarantee could not go any further and that the contract had its limit. There was no more that the contract could do to assist the supplier to deliver the vessels.¹⁵

321. While no change was made to the surety bond in response to FMEL's requests, its request to reduce the final delivery payment for each vessel from 25 per cent to ten per cent of the value of each contract was made, as outlined at paragraph 315.

322. During oral evidence, we asked CMAL to what extent it was responsible for making the decision to accelerate the payments. The Interim Chair of CMAL responded—

- ” [The former Cabinet Secretary for Finance and the Constitution] agreed to that before it had been approved by the CMAL board. The CMAL board subsequently rejected the proposal twice. What we eventually agreed to was accelerated payments against specific invoices for specific equipment, because we were concerned, at that stage, that FMEL was clearly not paying its suppliers; there was a backlog with suppliers and it could not get equipment on order. There was concern that FMEL might have a liquidator or an administrator appointed to it. The last thing that we wanted was £14 million of public money sitting in FMEL’s bank account.⁷
323. CMAL received a further “letter of comfort” from Transport Scotland before it proceeded with the acceleration of the payments to FMEL. The Interim Chair of CMAL explained why this letter was important—
- ” At the end of the day, we receive voted loans from the Government, so we are effectively using public money. We must have a trail that says, when there is a substantive change—£14.55 million is a substantive change—that we have approval for that change, because we do not have that kind of money.⁷
324. The former Cabinet Secretary for Finance and the Constitution was asked about the milestone payments during oral evidence. He stated—
- ” ...further down the line, when there were clear issues with FMEL being able to proceed, we had to try to find further flexibility and support to assist with construction, cash flow, the payment of suppliers and so on. Those would have been considerations in my mind at the point of looking again at the milestone payments and at the loan support that the Scottish Government gave directly to FMEL. The original milestone payments were an arrangement between CMAL and FMEL.¹⁶
325. During oral evidence, the Chief Executive Officer of CMAL explained how it managed the accelerated payments at this stage of the project—
- ” We spent literally 18 hours a day for two days going through each invoice, sifting out those we recognised as being part of our newbuild contract from those that we did not. As an example of that, within the package, there were some invoices that related to the redevelopment of the yard and the head office and stuff like that. We went through a sifting process of reading every invoice and verifying whether it was to do with our vessel, because at the time there were other vessels being built. Basically, we ended up with two large piles, which were, effectively, payable and not payable. When we ended up with the payable amounts, we found that, of the £14.55 million, about £9.5 million was a backlog of invoices.⁷
326. The AGS stated in his report that in making this change to the contract, the financial incentive to deliver the vessels for FMEL was reduced while the financial risk to CMAL increased.
327. During oral evidence, the Chief Executive Officer of CMAL explained the financial implications of this risk—

” ...if the figure of 25 per cent for the final payment had remained in place, the sum would not have risen to £82.55 million; it would effectively have been £68 million at that stage.⁷

328. In written evidence to the Committee, CMAL confirmed the rationale for these additional forms of financial support to FMEL—

” Such decisions were taken to do whatever could reasonably be done by CMAL and others to get the Vessels delivered for the island communities.¹²

Meeting with the First Minister

329. The Committee notes that during the same month as CMAL agreed to reduce the final delivery payment for each vessel from 25 per cent to ten per cent of the value of each contract, the First Minister met with the former director of FMEL on 31 May 2017. We asked the First Minister what was discussed at this meeting. She responded—

” Mr McColl had concerns about cash flow, and he had had concerns about the structure of the milestone payments. He had a concern, which he continued to express, about the amount of money that, in his view—it is not a view that I or CMAL would share—was unfairly caught up in what I think had, by that point, become the surety bond that replaced the builders refund and the partial builders refund guarantee. Those were the kinds of concerns that he was expressing to me.¹⁸



Source: The Scottish Parliament

330. Following the oral evidence session with the First Minister, the former director of FMEL wrote to the Committee to explain the purpose of the meeting. He stated—

” 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.³³

331. The former director went on to state—

” 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.³³

332. Recognising the different accounts regarding the purpose of the meeting, we asked the First Minister for a copy of the minute or note that was taken. She responded—

” ...a special adviser was present at the meeting and the actions arising were relayed to officials following the meeting and clearly indicating the topics discussed.¹⁸

333. The First Minister’s response also included a copy of an e mail sent by the Director General Economy’s office to the former Director - Aviation, Maritime, Freight & Canals at Transport Scotland. This e mail was copied to a number of Scottish Ministers as well as senior Scottish Government and Transport Scotland officials. The former Director - Aviation, Maritime, Freight & Canals was asked to provide the following information—

- Briefing on the surety bond, including how it was detailed in the tender information, how it was accounted for at the point of contract award and how it has evolved since.
- The legal advice regarding any further changes to the contract arrangements.¹⁹

334. Upon consideration of this information, we responded to the First Minister to confirm whether a minute or note of the meeting existed. The First Minister responded—

” Officials have been unable to locate a note of this meeting over and above the document already provided. As I confirmed in my last letter, in compliance with the Ministerial Code, a Special Adviser was present at the meeting and actions arising were relayed to officials and clearly indicate the topics discussed.³⁴

335. Special advisers are temporary civil servants appointed in accordance with Part 1 of the [Constitutional Reform and Governance Act 2010](#). This Act states that special advisers “hold a position in the civil service’ and are appointed by the First Minister, with their appointment ending at the end of the Administration or of that First Minister’s time in office.

336. The Code of Conduct for Special Advisers working in the Scottish Government states—

” Special advisers are a critical part of the team supporting Ministers. They add a political dimension to the advice and assistance available to Ministers while reinforcing the political impartiality of the permanent Civil Service by distinguishing the source of political advice and support.”³⁵

337. According to the Civil Service Code, a civil servant is a permanent staff member who must “serve the Government, whatever its political composition, to the best of [their] ability in a way which maintains political impartiality and is in line with the requirements of the Code”.³⁶

Support provided by the Scottish Government

338. In addition to the support provided by CMAL, the Scottish Government also independently provided two commercial loans to FMEL. We sought to understand the terms of these loans during our scrutiny of the AGS’s report.

339. During oral evidence to the Committee, the Interim Director-General Net Zero explained the rationale for Scottish Government loan support. He indicated that in his former role as the Chief Executive of Transport Scotland, it became clear to him that the contract for the vessels had exhausted any further potential to assist FMEL and he provided advice to the then Cabinet Secretary for Finance and the Constitution as referred to at paragraph 320.

340. The Interim Director-General Net Zero went on to explain that this advice “moved the matter out of the territory of the contract into the yard as an economic asset needing support” and that it was “important to keep these two issues separate”.¹⁵

341. The Committee notes that in August 2017, the Scottish Government commissioned PricewaterhouseCoopers (PwC) to consider options for public-sector financial support for FMEL. The following month, the Scottish Government provided FMEL with a £15 million unsecured commercial loan.

342. The AGS highlighted in his report that—

” In November 2017, the Scottish Government started to consider contingency plans for the shipyard, which concluded with it awarding FMEL a £30 million secured commercial loan in June 2018.”¹

343. The AGS reported that the purpose of the £30 million loan was “to support the long-term viability and enhanced capabilities of FMEL”. However, the AGS also reported that the loan conditions were specifically linked to the progress of vessels 801 and 802.

344. The AGS highlighted that for both loans, the Scottish Government drew on external commercial and legal advice to determine their conditions and requirements. This included FMEL providing the Scottish Government with an update on the progress of the vessels, and information on its finances, business plans, and senior staff changes to secure the loans. The Committee notes that PwC was commissioned to

monitor and report FMEL's delivery against these conditions.

345. Before the £30 million loan was awarded to FMEL, the Committee understands that in May 2018, the Scottish Government appointed a consultant "to review whether FMEL's resources (ie, labour input) were adequate to complete the vessels in line with its updated Cardinal Dates Programme (CDP)". The review took three days to complete, and the AGS highlights that the final report by the consultant stated—
- the shipyard was impressive for a small commercial shipyard, with improved infrastructure that allowed the shipyard to adopt a new approach to shipbuilding, reducing the time and labour input required
 - FMEL had applied lessons learned from vessel 801 to the design and build of vessel 802
 - FMEL's resourcing plan was adequate to complete the CMAL contract.¹
346. The Committee further notes that the consultant's report contradicts CMAL's assessment of FMEL's capabilities at that time.
347. The AGS also reported that for the £30 million loan, additional conditions were required—
- ” This included FMEL allowing an independent operational expert to review progress at the shipyard and Scottish ministers receiving satisfactory assurance that the vessels were progressing in accordance with FMEL's updated CDP.¹
348. In July 2018, the Scottish Government appointed the independent operational expert. CMAL provided its view in relation to this appointment in written evidence to the Committee—
- ” 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.
- 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.¹²
349. The independent operational expert was required to provide the Scottish Government with "a brief assurance report each time FMEL requested to drawn down part of the loan". The AGS's report provided further information about these reports—

” The initial drawdown reports were positive about vessel progress and FMEL’s ability to meet the delivery dates. Subsequent drawdown reports highlighted increasing delays and problems, which the expert determined were due to the poor relationship between FMEL and CMAL and outwith FMEL’s control. The expert also considered that FMEL had the managerial and technical capability to deliver both vessels. Each of the expert’s reports included a recommendation for loan drawdown although none of the reports provided specific assurance that FMEL was progressing the vessels in accordance with its CDP.¹

350. In written evidence to the Committee, CMAL stated that the independent operational expert “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”. CMAL explained that the independent operational expert only met with CMAL twice. CMAL also raised concerns that while the independent operational expert had advised the Scottish Government and CMAL that a number of activities in the CDP had successfully been completed, none of them had been achieved.¹²

351. The AGS’s report also stated that “the Scottish Government allowed FMEL to drawdown the full £30 million loan despite evidence of vessel delays”. The reason this was possible was due to the way the loan agreement was set up, stating that “satisfactory progress with the vessels must take into account factors that were outside FMEL’s control”.¹

Compliance with loan conditions

352. The AGS’s report explained that the terms of the second loan required CBC to invest £8.5 million in FMEL in two tranches. The report further explained that while CBC invested the first tranche, worth £3 million, it did not invest the second tranche, due to a disagreement with the Scottish Government over the funding structure of the loan.

353. During our scrutiny, we asked the Scottish Government about compliance with the loan conditions. The Deputy Director Manufacturing and Industries, Scottish Government stated—

” CBC defaulted on the second loan. The business defaulted. In October 2018, when the business, FMEL, had drawn down £17 million from the second loan facility, there was an obligation on the business and the shareholder to put in up to £1.7 million to subscribe capital—up to £1.7 million of new equity. It defaulted on that condition, and at that point drawdown of the remainder of the second loan was suspended until we renegotiated with CBC. Ultimately, it put in £3 million, not as equity but as debt, and we agreed to that.¹⁵

354. We also raised the issue of CBC’s compliance with the second loan during the oral evidence session with the First Minister. She commented—

” I became concerned that it felt as if the ink was not even dry on the agreement and Clyde Blowers was not fulfilling the requirement on it as part of the agreement. In summary, that was to invest its own equity as well as drawing down the Scottish Government loan.¹⁸

355. We also asked the Scottish Government whether it believed that the loans would ever have been repaid, given the range of concessions that were required to be made to FMEL to keep the yard operational. The Deputy Director Manufacturing and Industries stated—

” ...in essence, the loans were not going to be paid back from the completion of 801 and 802 but over the subsequent period of future years as the business won more work. The risk for the business and the directors in taking on that loan was in being sure that they could pay those debts as they fell due. The risk for the Government was that we had to believe in the business plan and that the loans could be paid back.¹⁵

356. Asked whether the Scottish Government believed in the business plan, the Deputy Director Manufacturing and Industries explained that advice had been sought from PwC who said that there was a prospect of the Scottish Government making a return on the money. He went on to state that while no return has been made, the Scottish Government has been able to “recover some of the debt via the money that was offset against the loan for buying the business”.¹⁵

357. The AGS concluded in his report that financial and non-financial interventions made by CMAL and the Scottish Government to support FMEL had clear and well-documented objectives. However, these interventions had limited impact on the progress of the vessels.

358. In written evidence, the former director of FMEL challenges the AGS’s conclusion stating—

” It is factually incorrect to say that the additional cash had little impact on the progress of the vessels. All the moneys advanced were used exclusively to progress the vessels. The work done had to be checked and signed off by PwC and [the independent operational expert]. His reports document the progress made.²⁴

359. The AGS’s report referred to the importance of transparency when the Scottish Government decides to invest in private businesses, including the expected outcomes. The AGS noted that, at the time of writing his report, the Scottish Government was developing a framework for its investment in private businesses.

360. In December 2022, the AGS provided an update on this framework in his report on [the 2021/22 audit of the Scottish Government Consolidated Accounts](#), stating—

” A framework has been developed by the Scottish Government which outlines its principles and approach for decisions about future investment in private companies. There is scope to strengthen this framework so that it better outlines intentions over risk tolerance, risk appetite and the expected public benefit of future interventions.³⁷

Claim for additional costs

361. The Committee notes that in July 2017, which was around the same time as the Scottish Government began considering public-sector financial support for FMEL (resulting in the provision of two commercial loans as abovementioned) FMEL submitted a £17.5 million claim to CMAL for costs incurred due to unforeseen complexities with the contract.
362. The AGS stated in his report that FMEL “did not want the loans, and only accepted them as an interim solution to its claim for additional payment from CMAL”. The former director of FMEL confirmed this position in written evidence to the Committee, stating—
- ” FMEL management accepted the loans on the understanding that this was a short-term measure until a resolution was reached to cover the additional costs.²⁴
363. The catalyst for the £17.5 million claim centred on FMEL’s assertions that CMAL had not sufficiently developed the concept design and that it interfered in the design process. A technical rebuttal of the claim was made by CMAL in August 2017 on the basis that “the contract was clear that FMEL was responsible for the detailed vessel designs”.¹
364. In written evidence to the Committee, CMAL provided further information about FMEL’s claim—
- ” On 7 July 2017, FMEL issued CMAL with a spreadsheet...seeking a contribution by CMAL to FMEL of some £17,500,000. The spreadsheet provided almost no narrative, no vouching, no reference to the Contracts and specifically did not follow the [variations to contract] mechanism that the Contracts required. CMAL rejected the claim and requested further details.¹²
365. The AGS’s report explained that the contract “contained clauses and provisions which allowed CMAL (and FMEL) to request changes to the vessel design, and FMEL to recover any additional costs and time incurred as a result”. However, the claim for additional costs made no reference to these clauses.¹
366. CMAL explained in written evidence that correspondence was exchanged between CMAL and FMEL up until February 2018, at which point—
- ” FMEL confirmed that their request for payment went 'beyond the terms of the contract' (i.e. there was no contractual basis for more money).¹²
367. The AGS stated in his report that CMAL and FMEL disputed for two years over vessel design and costs. In March 2018, FMEL presented CMAL with an independent report which stated that CMAL had not fully developed the concept design when it issued the ITT, and that it was not unusual for construction costs in these circumstances to significantly increase. The following month, FMEL advised CMAL that the value of its claim had increased to £27.4 million.
368. In May 2018, CMAL commissioned its own independent opinion. The AGS’s report stated—

- ” CMAL commissioned a naval architect to provide an independent opinion. This concluded that the ITT was sufficiently detailed and that FMEL should have foreseen that the vessels would require multiple design iterations. FMEL, however, disputed that it was an independent process as it was not consulted on the appointment of the architect.¹

369. The AGS report went on to state—

- ” Over the next few months, progress with the vessels and resolving the dispute stalled. FMEL reports that throughout the dispute, the Scottish Government encouraged it to continue working on the vessels, despite its increasing costs. In December 2018, FMEL issued CMAL with a new claim for £65.8 million, which CMAL rebutted in March 2019. By May 2019, the relationship between CMAL and FMEL had broken down completely. FMEL had indicated it would make significant redundancies and CMAL notified Scottish ministers of its intention to cancel the contract for vessel 801 and make a call on the surety bond (ie, it would request £12.125 million from the insurance company HCC plc).¹

370. In recognition of the complete breakdown in the relationship between CMAL and FMEL, the Scottish Government commissioned an independent view of FMEL's claim. The AGS reported that both parties had agreed to accept the outcome of the independent view.

371. The former director of FMEL explained in written evidence to the Committee how the Scottish Government communicated its decision to commission an independent view of the claim—

- ” 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...

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.”²⁴

372. The AGS's report stated that in June 2019, the independent view concluded that there was no legal basis for CMAL to pay more than the £97 million fixed price for the contract.

373. In written evidence to the Committee, the former director of FMEL challenged this position stating—

” 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.³³

374. The former director also raised concerns about the scope of the opinion sought being too narrow and heavily caveated.

Dispute resolution mechanism

375. The Committee notes that while the contract included a dispute resolution mechanism, for various reasons they were not used. We sought to explore this mechanism in more detail as part of our scrutiny of the AGS's report.

376. The AGS's report explained that the contract included a three-stage contract dispute resolution mechanism—

- **Mediation** - An assisted negotiation whereby a neutral party (ie, a mediator) is appointed to help parties reach a compromise.
- **Expert Determination** - An independent expert (or experts) is appointed by the parties to resolve the matter.
- **Court of Session in Edinburgh** - A specialist judge with experience in dealing with commercial cases is appointed by the court service to hear and rule on the dispute.

Mediation

377. The AGS's report stated that in August 2017, FMEL requested that CMAL and FMEL enter mediation. While initial progress was made by both parties to agree the draft terms of mediation and identify a preferred mediator, by February 2018, both FMEL and CMAL had failed to agree the terms of reference and the mediation contract dispute resolution mechanism was abandoned.

378. During oral evidence, the former director of FMEL commented on the initial mediation attempts stating—

” Early on, we were pushing for mediation in order to agree on who was at fault. I was not expecting FMEL to get off with it; I was expecting it to be responsible for some of it. However, for sure, CMAL should not have got off with it, but it has done.⁶

379. We asked the AGS about the contract dispute mechanism during oral evidence. In relation to the mediation mechanism, the AGS stated—

” Mediation, which might have led to a better outcome, was not pursued in relation to the contract, and that feels like a missed opportunity...Mediation might have provided a better, cheaper and quicker alternative to the circumstances that we set out in the report. ²³

380. We also asked the First Minister during oral evidence what Scottish Ministers' view was in relation to mediation mechanism. She responded—

” ...there was definitely a view on the part of the Government that we wanted to encourage mediation. There was a period in which mediation was agreed to by both parties, but it did not happen. ¹⁸

381. In relation to the failed mediation attempts, CMAL explained in written evidence that—

” 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. ¹²

382. CMAL went on to explain why it considered that mediation was not possible, stating—

” 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. ¹²

383. CMAL also explained in written evidence that on 25 January 2018, FMEL accepted in writing that their claim was non-contractual in nature. ¹²

Expert Determination

384. The AGS reported that in April 2018, Transport Scotland asked CMAL and FMEL to consider Expert Determination. However, “a shipping law firm advised CMAL that this was not suitable as the fundamental disagreement was not a technical matter”. ¹

385. In written evidence to the Committee, CMAL shared the conclusions of the shipping law firm's advice. An extract of this view is as follows—

” 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. ¹²

386. CMAL also stated in its written evidence that the advice also stated that should FMEL increase its claim, which proved to be the case, 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. ¹²

387. During oral evidence, the former director of FMEL provided his perspective on the use of Expert Determination, stating that there was a degree of urgency for this mechanism to be employed so that FMEL could start paying its subcontractors and resume work on the vessels. The former director went on to state that Expert Determination was “pushed by Transport Scotland” but the Chair of CMAL refused this mechanism. He went on pose the question—

” ...if CMAL was so sure of its position, why would it be afraid to enter into a process of independent expert determination? ⁶

388. In written evidence to the Committee, the former director of FMEL stated that he met with the former Cabinet Secretary for Finance and the Constitution in July 2018 to insist that the Scottish Government intervene to instruct CMAL to take part in an Expert Determination Process. At this meeting, the former director stated that he was told by the former Cabinet Secretary that the Scottish Government was unable to instruct CMAL to take part in Expert Determination “because Ministers had received a legal letter from the CMAL Board, threatening to resign en masse, if the government interfered with them”. ²⁴

389. We asked the former director about the meeting he had with the former Cabinet Secretary during oral evidence. He stated—

” I met him in Holyrood, and I begged him to force CMAL to accept an independent expert determination because, if he did not, things were going to get out of hand, and they needed to be brought to a head. He asked the officials in the room to leave, and he told me that he could not force CMAL to do that because the CMAL board had sent a legal letter to Government ministers that threatened that, if they interfered or continued to interfere with it as an independent board, the board would resign en masse and would say why. ⁶

390. We asked CMAL about the legal letter during oral evidence. The Interim Chair of CMAL stated—

” We did not send any such letter; we did not instruct any such letter to be sent. The board did not threaten to resign en masse. ⁷

391. We also asked the former Cabinet Secretary for Finance and the Constitution whether he had advised the former director of FMEL in private that the CMAL board would resign if he interfered in its proceedings. He responded—

” No, I do not recall that kind of detail. At the time, I would have expressed to Mr McColl—I think that the evidence fairly shows this now—that there had been a breakdown in relationships and that ministers could not interfere. ¹⁶

392. In relation to the letter, the former Cabinet Secretary for Finance and the

Constitution stated—

” There was no letter. I have seen the evidence, and on hearing about that, I checked that there was no letter about resignation from the CMAL board. I do not remember saying that, but I remember expressing concern about all the issues, and about how dissatisfied CMAL was. FMEL was clearly frustrated as well. They were having that dispute, and I was trying to navigate a way through it in the interest of taxpayers, island communities and the workforce at the yard in order to try to find a resolution.¹⁶

393. There appears to be a contradiction between these two comments provided by the former Cabinet Secretary. Indeed, on one hand he stated that Ministers were unable to interfere in the dispute, while on the other, he was “trying to navigate a way through it.”

394. On the wider question regarding the role the former Cabinet Secretary played in seeking a resolution to the dispute, he explained during oral evidence that he had “encouraged all sorts of interventions”, however—

” ...fundamentally, the reason why expert determination or mediation could not have proceeded was that the advice was that mediation could not lead to the conclusion that FMEL fundamentally wanted, which was more money for a fixed-price contract, given that CMAL’s view was that that could not and should not be done and that no mediation would sort that. In short, that is why it was felt that mediation could not proceed, according to CMAL. That is what I was advised.¹⁶

395. The Committee notes that in written evidence provided by CMAL, reference is made to the engagement between CBC, led by the former director of FMEL, and “certain MSPs” stating—

” 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.¹²

396. While there is evidence of meetings between Scottish Ministers and CBC happening during this time, there is little evidence of a deliberate back channel. Nevertheless, private, and sometimes unrecorded meetings do not represent transparent or good record keeping.

397. CMAL also challenged an assertion made by the former management of FMEL that the Scottish Government “were afraid to confront CMAL and insist on them taking part in a dispute resolution process” in its written evidence stating—

” There is no basis for this. Indeed, the Scottish Ministers put significant pressure on CMAL to mediate.¹²

398. We asked the First Minister during oral evidence for her views on how the dispute should have been handled. She commented that Expert Determination would not have been appropriate—

” because of the scale of the claim that FMEL was making outside the contract, which ultimately became £66 million. The right way to resolve it was therefore for FMEL to go through the court process, which—as was its right—it never chose to do. ¹⁸

399. In written evidence to the Committee, the former director of FMEL challenged this position, stating—

” There is no restriction on the scale of a claim in an Expert Determination process. ³³

Court of Session

400. As outlined above, the final stage of the contract dispute resolution mechanism was for FMEL to pursue its claim in the Court of Session.

401. The AGS highlighted in his report that both the Scottish Government and CMAL asked FMEL on a number of occasions to pursue its claim in court. The AGS went on to report that FMEL considered this option to be impractical, as work would have stopped on the vessels and led to substantial redundancies.

402. During oral evidence, we asked the former director of FMEL why this route was never pursued. He responded—

” All along, we were led to believe that there was going to be dispute resolution and that the Government was working with both of us to try to get that to happen. Every time that was put up, the Government was told no by CMAL. ⁶

403. In follow-up written evidence to the Committee, the former director of FMEL stated that FMEL “could not fund a long drawn out and extremely expensive legal action through the Courts”. The former director also stated that—

” 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. ³³

404. We asked Transport Scotland for its view on the alternatives to court proceedings, and whether they could have been implemented. The Director of Aviation, Maritime, Freight and Canals at Transport Scotland stated—

” There is always a choice between alternative dispute resolution mechanisms, and the one that is appropriate to the quantum or nature of the dispute is selected. In this case, although best practice is to seek to avoid litigation, litigation would have been the appropriate remedy, but Ferguson’s did not take that forward. ²⁰

405. The Interim Director-General Net Zero was categorical during oral evidence

that Transport Scotland had no role in the contract, and that it was between CMAL as the buyer and FMEL as the builder. However, from the evidence we have gathered, Transport Scotland was in fact involved in discussions that resulted in CMAL agreeing two contract changes which released around £23.55 million^{xxxii} to FMEL. Indeed, the Interim Director-General Net Zero, then the Chief Executive of Transport Scotland, was himself at the centre of those negotiations. The Committee therefore rejects the claim that Transport Scotland had no role in the contract and questions why it did not get involved at an earlier stage.

406. It is of considerable concern to the Committee that milestone events in the contract had no link to the quality of work undertaken. The Committee is deeply concerned that CMAL was legally required to make milestone payments despite the significant concerns it had about FMEL's performance. While too late for vessels 801 and 802, the Committee welcomes the additional quality compliance measures that have since been put in place by CMAL for future vessels.
407. The Committee recognises that CMAL is wholly owned by Scottish Ministers. However, the decision by Scottish Ministers to amend the milestone payment structure of the contracts before it was considered and approved by the CMAL Board does not appear to represent good governance.
408. The Committee notes that CMAL considered it necessary to receive a further "letter of comfort", otherwise known as shareholder authorisation, to proceed with one of the contract changes. As previously concluded, these occurrences should be a matter of public record and could be achieved by the Scottish Government proactively publishing this information on its website as well as providing a written copy for information to the AGS and the Clerk to the Public Audit Committee.
409. The Committee shares the AGS's conclusion that the Scottish Government could not have obtained sufficient assurances about FMEL's resources following a three-day review. The very fact that the review contradicted CMAL's assessment of FMEL's capabilities around that time should have prompted the Scottish Government to reconcile these differences before awarding the £30 million loan to FMEL.^{xxxiii}
410. While the £30 million loan was intended "to support the long-term viability and enhanced capabilities of FMEL", the loan conditions were specifically linked to the progress of the two vessels. It is therefore apparent that this money was not used for the stated purpose. The Committee considers that transparency over the use of public money is essential. This example falls

^{xxxii} This figure is comprised by adding the just under £9 million of FMEL's cash that Investec had held in escrow that was released in November 2016 (referred to at paragraph 314) and the acceleration of £14.55 million of payments to FMEL in May 2017 (see paragraph 315).

^{xxxiii} There was division on this paragraph. See Annexe C, Minute of the Meeting of 2 March 2023, and note on 'Record of division in private' for more detail.

well short of the standards of transparency we would expect.^{xxxiv}

411. Significant additional financial support was provided to FMEL by CMAL and the Scottish Government to maintain momentum on the construction and delivery of vessels 801 and 802. The fact that these investments had limited impact on the progress of the vessels is extremely worrying to the Committee in terms of the cost to the public purse. The Committee supports the AGS's call for the Scottish Government to strengthen its framework for its investment in private businesses to better outline intentions over risk tolerance, risk appetite and the expected public benefit of future interventions and to improve transparency and disclosure.
412. The Committee notes that the Scottish Government required additional reassurances in order to provide additional financial assistance to FMEL. This included commissioning PwC to monitor and report on FMEL's delivery against loan conditions set as well as the appointment of the independent operational expert to approve the draw-down of the loans. These measures represent further additional and unforeseen costs to the project, over and above the other financial support provided by CMAL and the Scottish Government referred to in this section of the report.
413. There is clear evidence at various points in the contract of interventions by Scottish Ministers. The Committee understands that Ministers were keen to help resolve the dispute between CMAL and FMEL. However, we consider that a record of all of these meetings should have been produced. The Committee considers this does not represent transparent or good record keeping and which some Members believe could be contrary to the Ministerial Code. We also believe that a permanent civil servant should have attended the meeting between the former director of FMEL and the First Minister in May 2017. There is a risk that the attendance of a special adviser only could have blurred the lines regarding the purpose of the meeting, given that a part of their role is to provide political advice and assistance to Scottish Ministers.^{xxxv}

^{xxxiv} There was division on this paragraph. See Annexe C, Minute of the Meeting of 2 March 2023, and note on 'Record of division in private' for more detail.

^{xxxv} There was division on this paragraph. See Annexe C, Minute of the Meeting of 2 March 2023, and note on 'Record of division in private' for more detail.

Nationalisation

Events before nationalisation

414. The AGS reported that in May 2018, CMAL and Transport Scotland updated Scottish Ministers on problems with the project and advised them of contingency plans. Options included FMEL completing the vessels or towing the vessels to another shipyard. The AGS reported that nationalisation of the shipyard was also discussed at that time, but no decision was taken on this option.
415. The AGS stated that the preferred option agreed to at the meeting was to complete the vessels at FMEL. The Committee notes that in June 2018 (i.e., one month after Scottish Ministers were updated on the problems with the project) the Scottish Government provided FMEL with a £30 million loan to aid cash flow.
416. By February 2019, the Scottish Government and Transport Scotland launched [Project Kildonan](#) to formally consider contingency plans for the vessels and the shipyard. As part of this project, Transport Scotland commissioned PwC “to consider potential options and provide commercial advice”.¹ PwC identified 29 potential options, which the Scottish Government shortlisted to three for detailed appraisal as follows—
- Retendering the contract
 - Allowing FMEL to enter administration
 - Nationalisation.
417. The AGS stated that as well as these shortlisted options, an intermediary option put forward by FMEL was considered by PwC. This involved CMAL being replaced by an independent body to oversee the project. The AGS reported that PwC’s report, published in April 2019, concluded—
- ” ...that doing nothing would likely result in the insolvency of FMEL. It identified that nationalisation or the appointment of administrators created risks for the Scottish Government but could help ensure delivery of both vessels. PwC considered that retendering was not practical, and the intermediary option did not overcome funding issues and had procurement and state aid issues.¹
418. The Committee notes that separate to the work undertaken by PwC, the Scottish Government assessed a proposal from CBC in June 2019. The AGS report set out what this proposal involved—
- ” ...restructuring FMEL’s debt, and CBC and the Scottish Government sharing the costs to complete the vessels. CBC proposed that the Scottish Government invest £50 million for a 95 per cent equity stake in FMEL but did not propose to inject any new funding itself.¹
419. We asked the former director of FMEL about CBC’s proposal during oral evidence. The former director explained—

” We came to the 11th hour and I realised that we were not going to get a dispute resolution process and that we did not have enough money to finish the vessels.⁶

420. The former director went on to explain that his proposal involved a financial restructuring, which would bring the total cost of the project to “£194 million or £195 million.”⁶ The former director stated during oral evidence that FMEL’s solution would have saved the taxpayer £100 million. In follow-up written evidence provided to the Committee, he however stated that the proposal “would have saved at least £200 million of taxpayers money.”³³ It is therefore unclear exactly how much it is claimed exercising this option might have saved the taxpayer.
421. The AGS confirmed in his report that the Scottish Government rejected CBC’s proposal “because of numerous legal and financial risks”. The former director of FMEL confirmed this decision during oral evidence, stating that the then Cabinet Secretary for Finance, Economy and Fair Work explained to him that it did not meet State aid rules.¹
422. The former director also explained during oral evidence that he had sought legal advice to establish whether CBC’s proposal would breach “any EU or State aid rules”. This advice, provided by a senior QC set out their view that no rules would be broken if the Scottish Government proceeded with CBC’s proposal.⁶
423. A copy of the legal advice was shared with the Committee by the former director. The summary of this advice sets out the issues on which the QC was asked to provide an opinion and the response, which is highlighted in bold—
- 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 the 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.**³³
424. During oral evidence, the former director of FMEL confirmed that a copy of this legal advice was shared with the former Cabinet Secretary for Finance, Economy and Fair Work. He stated that the former Cabinet Secretary had advised that he disagreed with the advice. The former director also stated that the Cabinet Secretary did not seek his own legal advice on the matter and that if he had, “it would have been clear cut that it did not breach EU rules”⁶
425. We asked the former Cabinet Secretary for Finance, Economy and Fair Work about the legal advice sought and shared by FMEL during oral evidence, and what action he took upon receipt of this information. He responded—

” Of course, I explored it. There was never anything that I did not explore on hearing sympathetically from anyone who was involved in the issue. The reason why I did not take it forward is that it could not proceed, frankly because we did not have a legal basis to do so. ¹⁶

426. Asked whether the former Cabinet Secretary had specifically sought legal advice on this matter, the former Cabinet Secretary confirmed—

” a legal opinion was sought to inform that advice. ¹⁶

427. The AGS’s report stated that in July 2019, the Scottish Government sought approval from Scottish Ministers “to continue to work toward taking FMEL into public ownership”. This was based on the appraisal work conducted by PwC as well as its own considerations. On 9 August 2019, FMEL filed an intention to appoint administrators. ¹

428. The AGS’s report stated that “this allowed HCC plc, as first-ranking creditor, to appoint Deloitte as independent administrators on 16 August 2019”. Deloitte was responsible for commercially marketing FMEL. Four bids were received, with Deloitte assessing the Scottish Government’s bid as “representing the best return for creditors”.

429. Two days before FMEL entered administration, the Scottish Government appointed a Turnaround Director to conduct an initial assessment over a period of 11 weeks of—

- what work had, and had not, been completed on the vessels to date
- the status of the vessels’ design
- the shipyard’s capability to support delivery of the vessels, in particular the suitability of its management and control systems for engineering and production.

430. According to the AGS, the Turnaround Director’s report to the Scottish Government set out the main issues with the build including “incomplete designs and the need for significant construction and remedial work on the vessels to meet the technical specification”. The AGS further reported that a number of operational issues were also highlighted by the Turnaround Director in his report including—

- lack of project management and project planning, resulting in insufficient management information
- weak design processes and controls
- poor inventory management, with no bill of materials and materials stored incorrectly leading to significant deterioration
- no comprehensive defect management system. ¹

431. The Turnaround Director’s report estimated that it would cost between £110.3 million and £114.3 million to complete the vessels, additional to the £83.25 million that had already been paid to FMEL for this purpose. The report also included

details of further delays to the delivery of both vessels.

432. The Scottish Government established a Programme Review Board (PRB) to support the Turnaround Director. The PRB was chaired by Transport Scotland and comprised a range of stakeholders including FMPG, CMAL, David MacBrayne Limited^{xxxvi} and Marine Scotland.

433. In his report, the AGS raised concerns regarding what the PRB was able to achieve in the time available to it—

” ...the PRB did not have the opportunity to scrutinise the updated vessel costs, which were significantly higher than the £70 million that CMAL estimated it would cost to complete the vessels. There is also no evidence that the Scottish Government or Transport Scotland scrutinised the updated costs, or that the new timescales for the vessels were challenged.¹

434. We asked the Scottish Government and Transport Scotland during oral evidence about PRB’s ability to undertake robust scrutiny of the updated vessel costs^{xxxvii} by the AGS during oral evidence. The Deputy Director Strategic Commercial Interventions, Scottish Government stated—

” From memory, I think that the Audit Scotland report reflected the view that there was no cause to question those costs—they appeared to be valid from Audit Scotland’s perspective, because it was clear that a lot of work was required. I do not think that Audit Scotland called those costs into question.²⁰

435. The Director of Aviation, Maritime, Freight and Canals, Transport Scotland further added—

” The programme review board...was part of the assurance and diligence process that was undertaken to understand the costs of completing the vessels, but it did not have a role in scrutinising the costs themselves; it would not have had access to the information to do that.

The programme review board was put in place for the period from August to December 2019 with the intention of ensuring that the methodology was appropriate, that the correct questions were being addressed and that a sensible approach was being adopted. It was intended to be a support to the turnaround director when he was preparing that assessment and to the Scottish ministers when they were assessing that information.²⁰

The decision-making process to nationalise FMEL

436. In his report, the AGS stated that while the Scottish Government conducted some due diligence, it did not have a full understanding of the scale of the challenges at the shipyard when it made its decision to nationalise FMEL. Indeed, the AGS explained that the Scottish Government was unable to undertake technical diligence

^{xxxvi} The parent company of Calmac

^{xxxvii} These costs refer to those identified by the Turnaround Director in his report.

of the vessels until FMEL had gone into administration. The AGS further explained the implications of this lack of information—

” This meant that the Scottish Government made the decision to nationalise the shipyard without a full and detailed understanding of the amount of work required to complete the vessels, the likely costs, or the significant operational challenges at the shipyard.¹

437. During oral evidence, we asked the Scottish Government why a detailed appraisal was not possible. The Director of Economic Development, Scottish Government began his response by stating—

” ...anybody who is representing the Scottish Government here today is driven by a determination to spend public money wisely. Any option that we considered for the future of the yard would have had to have satisfied the accountable officer tests.²⁰

438. The Director of Economic Development went on to state—

” The team that considered the options around the future of the yard, and which ultimately prepared the advice for Ministers that led to the final decision, took due diligence that included external legal and commercial advice.

439. Referring to the AGS's report, and the conclusion that the Scottish Government did not have a full understanding of the scale of the challenges at the shipyard when it made its decision to nationalise FMEL, the Director of Economic Development stated that this was—

” not unusual in the case of decisions that are taken on a distressed asset. Those decisions sometimes need to be taken quickly, because there is a balance to be struck between the extent of the due diligence that one can undertake and the need to preserve as much of the value of the business as possible.²⁰

440. The Director of Economic Development further added—

” ...we were under no illusions that there were problems with the yard, because we had worked for two years and more to address some of those issues. As Audit Scotland pointed out, the level of complexity was not clear because of the level of diligence that we undertook, and the work of the turnaround director identified an awful lot of those complexities in the immediate aftermath of bringing the yard into public ownership.²⁰

441. The Committee asked the former Cabinet Secretary for Finance, Economy and Fair Work during evidence why a full due diligence exercise was not conducted before the decision was made to nationalise the yard. He responded—

” As much due diligence as could be carried out was carried out at the time. Clearly, we would not have had access to absolutely everything, but we had enough information. I certainly had enough information to judge that nationalisation was the right thing to do for many, many reasons. The foremost three objectives were to complete the vessels, safeguard the jobs and give the yard a future. In the end, it appeared to be the case that that was the right intervention at the time, and I still believe that it was. That is why we took that decision.¹⁶

442. We asked the First Minister during oral evidence whether there was a clear point at which nationalisation became the preferred option for Scottish Ministers. She responded—

” ...had we not nationalised, in my view, the yard would have closed, and the vessels would never have been completed. Every decision that a Government takes on any issue involves a balance of risk. Clearly, in the period before we took public ownership in December 2019, there was a whole process of exploring and considering all the issues around nationalisation and alternatives to it but, by the time that we got to that point, it was not just the preferred option; it was the only viable option that was available.¹⁸

Arrangements after nationalisation

443. The AGS's report stated that on 2 December 2019, “the Scottish Government completed a commercial transaction to bring the shipyard into public ownership and created a new organisation, FMPG to complete the vessels”.¹

444. The AGS's report also confirmed that when FMEL was nationalised, “most of the senior management team left the organisation and the Turnaround Director subsequently recruited new senior staff”.¹

445. During oral evidence, the former director of FMEL commented on the departure of senior FMEL staff, stating that the Turnaround Director—

” ...immediately dismissed most of the senior management team, and many of the key managers below that level left. They were wiped out.⁶

446. The former director stated during the same meeting that FMEL's systems were also “wiped out”. The impact of these changes, according to the former director, was explained to the Committee—

” What was wiped out was all the people who knew what was going on, all the systems that controlled it and the design people who were behind it. There was a black hole there, and for six months nobody knew what was going on in the yard. A new design team was then brought in, and I think that it has been changed twice since then.⁶

447. The Committee notes that after FMPG was established, CMAL transferred the existing vessel contract from FMEL to FMPG. The AGS also explained that in

March 2021, new funding and management arrangements were put in place by the Scottish Government. The AGS went on to state that “this included replacing the existing fixed-price contract between CMAL and FMPG with a new contract (for each vessel) between itself and FMPG”.¹

448. The Committee notes a particular line in the AGS’s report in relation to these new arrangements—

” The Scottish Government is committed to paying the additional vessel costs, regardless of the final price.¹

449. Recognising that this new arrangement could be interpreted as the Scottish Government giving FMPG a “blank cheque” to complete the project, we explored this line of questioning with Scottish Government officials. The Deputy Director Strategic Commercial Interventions, Scottish Government responded—

” Ministers have been really clear with the board, the management team and the workforce that these vessels need to be delivered within the budget that has been allocated. Each organisation—Ferguson’s and CMAL—and each part of the Scottish Government that is involved in this all share the obligation to deliver as efficiently as possible, with an eye to value for money. There is no blank cheque.²⁰

450. The Committee notes that in December 2022, the Scottish Government announced that it would allocate a further £15 million^{xxxviii} in 2022/23 and £57 million in 2023/24 to FMPG to support the completion of vessels 801 and 802.

451. We also sought to establish what would happen should the project require further significant funding to complete the vessels during oral evidence. The Director of Economic Development, Scottish Government responded on the basis that he was the “accountable officer when the report came in, in March^{xxxix}”, that the cost of the vessels would increase”. He stated—

” At that stage, a process takes place and the accountable officer applies the accountable officer tests. Considerations that I would have had—and the accountable officer in any future iterations around the cost of the vessels would have— include whether the contract continues to represent best value, whether it is still the best opportunity to get the ferries delivered to a reasonable timetable, and whether it continues to deliver value for money compared with the alternative, which would be to stop and reprocur, with all the timetable increases and issues for the yard and workforce that that would bring.

Those decisions are looked at and taken very seriously. We do not write blank cheques with public money.²⁰

452. The AGS’s report stated that the new funding arrangements that were put in place

xxxviii The total FMPG capital budget for 2022/23 was £61.1 million as set out in [The 2021/22 audit of Ferguson Marine Port Glasgow \(Holdings\) Limited](#).

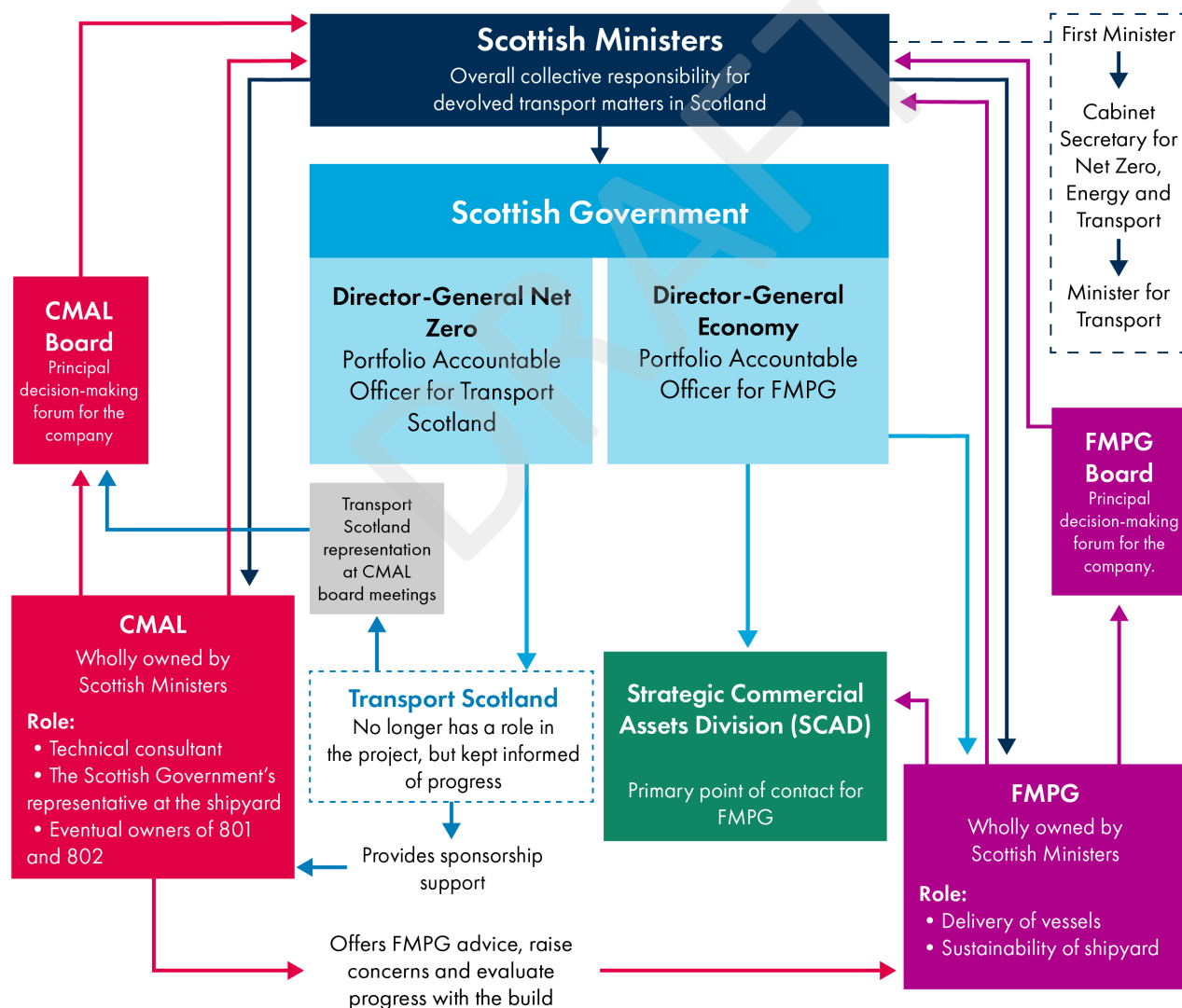
xxxix This refers to a report provided by the Chief Executive Officer of FMPG to the Scottish Government in March 2022, which sets out that the vessel completion costs had risen from £110.3-£114.3million to £119-£122 million.

required changes to the governance of the project. This involved the Scottish Government taking over responsibility as—

- **Contract owner** (previously CMAL's responsibility).
- **FMPG's sponsor** (previously Transport Scotland's responsibility).¹

453. We set out the current governance arrangements for the project to deliver vessels 801 and 802 at Exhibit 2.

Exhibit 2: Current governance arrangements to deliver vessels 801 and 802



Source: The Scottish Parliament

454. The AGS stated that under the new governance arrangements, CMAL was appointed as the Scottish Government's technical consultant.
455. We asked Scottish Government officials during oral evidence whether there was any conflict of interest in terms of CMAL's revised role. The Deputy Director Strategic Commercial Interventions, Scottish Government responded—

” I do not. That was considered as part of our consideration of the best approach to structuring the arrangements going forward, and no material risk of conflict was identified.²⁰

456. During the evidence session with Scottish Government officials, we asked if follow up documentary evidence could be provided to the Committee to demonstrate the considerations that took place regarding CMAL's revised role in the project.

457. The Committee subsequently received follow-up correspondence from the Director of Economic Development, Scottish Government which included an extract of the assessment that was made regarding any potential conflict of interest in relation to the new contractual arrangements—

” **Conflicts of interest**

The financial arrangements outlined in Option 4 are considered low risk in terms of presenting any additional conflicts of interest between relevant bodies. The relationship between the Scottish Government and Ferguson Marine is already widely recognised. The financial arrangements outlined under this option would only act to formalise this relationship into a contract.

As the vessels will be transferred to CMAL upon completion, it would also be considered appropriate for CMAL to retain its current involvement of providing technical feedback, without this giving rise to any perceived conflict of interest.³⁸

458. Under the new governance arrangements, the AGS stated—

” Transport Scotland is kept informed of progress, but it no longer has a role in the project.¹

459. An additional governance measure put in place by the Scottish Government was the appointment of the FMPG Board in June 2020. The AGS stated in his report that FMPG is aware of the need for improvements at the shipyard. The Committee notes that a new FMPG chairman came into post on 1 December 2022.

460. In terms of the overall leadership of the yard, the AGS reported that the Scottish Government originally employed the Turnaround Director on a short-term contract, with the option to roll it forward on a monthly basis. The AGS further highlighted in his report that in August 2020, the FMPG Board took on responsibility for the Turnaround Director's contract, extending it until February 2022.

461. A new Chief Executive Officer (CEO) of FMPG came into post in February 2022. The AGS stated in his report that both the FMPG Board and the Scottish Government are of the view that this permanent appointment will “enhance the stability of the yard”. The AGS also reported that “the new CEO has stated that FMPG and CMAL will work more collaboratively in future” and that the FMPG board was seeking to strengthen its shipbuilding and legal expertise through a board recruitment exercise.

462. The Committee notes however that the AGS highlighted in his report that—

- ” While these developments can be considered as a positive for the shipyard, there is a risk that significant changes to its leadership results in a loss of knowledge and may create a period of uncertainty amongst the workforce. ¹

Following the money

463. The AGS reported that at the point at which FMEL entered administration in August 2019, CMAL and the Scottish Government had paid FMEL a total of £128.25 million. However, the vessels were largely incomplete.
464. The AGS also reported that the total cost of the vessels project was now estimated to be at least £240 million; more than double the original contract value. The AGS provided a breakdown of the £240 million as follows—
- £83.25 million – paid by CMAL to FMEL under the original contract (£82.5 million in milestone payments and £0.75 million for agreed contract variations)
 - £45 million – in Scottish Government loans
 - £110.3 million to £114.3 million – costs to complete the vessels under FMPG.
465. The AGS’s report provided a breakdown of other project costs—
- The Scottish Government’s £6 million cost of running the shipyard during administration. This was offset by the £6.5 million that it received from the administration process
 - the Scottish Government’s £7.5 million cost of purchasing FMEL’s assets. This was offset against FMEL’s outstanding loan
 - FMPG’s £4.3 million costs related to Covid-19. This was treated as an exceptional item
 - CMAL’s project management costs, which total £1.49 million (between October 2015 and February 2022).
466. Throughout our scrutiny of the AGS’s report, we sought to establish how the significant amount of public money paid to FMEL could be accounted for. We asked the AGS this question during oral evidence. He responded—
- ” We included the amounts paid to the contractor and the loans that the Scottish Government provided to it, some of which it was able to recover through the administration process and the valuation of the assets that were in the yard at the time of nationalisation. However, it is clear that the scale of money that was invested did not bear any resemblance to what was initially anticipated would be delivered for such a size of public sector investment. ²²
467. An Audit Manager at Audit Scotland provided some further detailed analysis in relation to the money paid by CMAL to FMEL. For example, in relation to the restructuring of the milestone schedule, to accelerate £14.55 million of payments to FMEL, as referred to in this report at paragraph 315, she stated—

” FMEL had to submit all the invoices related to the project, and CMAL would review them and ensure that all the money that it was accelerating to FMEL was being spent on the suppliers, equipment for the vessels and so on. Our understanding is that some invoices were submitted by FMEL that were not directly linked, but CMAL refused them, so none of the £14.5 million was given to FMEL to spend on anything else.²²

468. Regarding the £83.25 million paid by CMAL to FMEL, the Audit Manager stated that Audit Scotland asked “several times” where the money went. She reinforced the point made in the AGS’s report that—

” CMAL was legally required to make the payments, but the fact that the milestones were not clearly defined was what caused the issues to arise. The money was being paid out, but the vessels were not being constructed as we would have expected.²²

469. The Audit Manager also provided some context about the Scottish Government loans made to FMEL, confirming that “the first loan of £15 million, which was made specifically on the basis of vessel progress, was very quickly drawn down by FMEL”. Regarding the second loan of £30 million, the Audit Manager stated—

” ...although PricewaterhouseCoopers was providing the Scottish Government with reports on FMEL spending, they did not go into detail on where the money went, so we were unable to trace exactly how that money was spent and what progress was made on the vessels as a result. However, we were told that suppliers and the workforce were paid, which stopped legal action against FMEL and allowed progress to continue on the vessels.²²

470. We asked the former director of FMEL during oral evidence how the £128.25 million had been spent by FMEL. The former director stated—

” Every penny that was forwarded went into those ships. The ownership transferred to CMAL....changes were made, which led to further costs and delays. If there is a six-month delay, the workforce that has been built up will be needed for another six months, so there will be costs. The costs were running way ahead, but all those costs were to do with the ships.⁶

471. Asked how the Committee can identify that the money was absorbed by these changes, the former director responded—

” It can do that because they have all been audited. Ask for the PwC audits and look at the accounts—the invoices are there. The time that people spent on the ships is there. That is what the costs went on. It is self-evident that that is what it cost. The process whereby £45 million was put in—£15 million and then £30 million—was very strictly controlled. Before that money was released, PwC and Luke van Beek^{xi} had to sign off and say, “Yes, that work was done and that’s what it cost.” The process was well documented and controlled by the Government.⁶

^{xi} Luke van Beek was the independent operational expert appointed by the Scottish Government to provide the Scottish Government with a brief assurance report each time

472. During oral evidence, the Chief Executive Officer of CMAL provided examples of how FMEL approached the construction of the vessels and how this impacted on FMEL's costs—

” If you build something undercover, it might cost one unit of price; when you do that in the open air to join the vessel up, it costs two units of price; and when you do that when the vessel is afloat, it will cost four units of price. Basically, we saw units being built at risk, not signed off by us and not signed off by Lloyds^{xli}. What that meant is that, when they were inspected, there were many, many mistakes.⁷

473. As we have already highlighted, FMPG workforce representatives raised concerns in relation to a range of FMEL management and build errors, which all appear to have had cost implications. The Committee was also told by workforce representatives about the perceived level of wastage at the yard, with items left unidentified and/or sent to scrap. Workforce representatives stated that they “could see the money getting wasted”. For example, on one occasion, it was explained that an item of scrap worth approximately £5,000 which belonged to CMAL had been identified. This was later removed from scrapping and made use of.

474. Workforce representatives also provided their experiences and reflections of working at the shipyard when the Turnaround Director was responsible for its oversight. Representatives stated that a significant number of additional management staff were brought in by the Turnaround Director. Representatives also raised concerns that the approach of employing people without the appropriate skills, introduced by the Turnaround Director, often resulted in the existing workforce having to re-do sub-standard work.²⁹

475. The Committee was also told by workforce representatives that the Trade Union had communicated a vote of no confidence in the Board of Directors and the Senior Management Team to the Cabinet Secretary for Finance and the Economy towards the end of 2021. The representatives stated that they regretted not doing this sooner.²⁹

476. The Committee notes that the Turnaround Director was in post between August 2019 and February 2022. The Committee further notes that details of his appointment have been made publicly available by the Scottish Government through a [Freedom of Information request](#) (FOI). The FOI confirmed that the Turnaround Director was expected to be paid £1.98 million for 595 days work.

477. During oral evidence, we asked the Scottish Government if this appointment represented good value for money. The Deputy Director Strategic Commercial Interventions, Scottish Government responded—

FMEL requested to draw down part of the loan. We refer to the independent operational expert in paragraphs 347-350 of this report.

^{xli} The AGS's report explained that Lloyds Register was contracted by the shipyard to ensure the vessel complies with its rules and regulations. It approves vessel plans and inspects the vessel during construction to ensure it is structurally sound.

” It was a challenging role in a very challenging context. It is important not to understate the depth and scale of the turnaround that was required in the business.²⁰

478. The Deputy Director went on to describe the “successes” of the Turnaround Director in the time he was in post—

” Smaller vessels were delivered out of the yard, and he put in place a strong senior team that had a gender balance, which is incredibly uncommon in the sector. He improved processes.²⁰

479. To further assist its understanding of how the money could have been spent by FMEL, the Committee wrote to the Chief Executive Officer of FMPG, recognising his wealth of experience in the construction and marine manufacturing industries, as well as being in post at FMPG for almost a year. The response stated—

” The build programme is still coping with legacy issues embedded by decisions made in 2015 onwards by FMEL, as well as factors from the past few years and this has led to the overall increase from £97million to £227 million.^{xlii 39}

480. The Chief Executive Officer of FMPG also provided his own view as to the reasons for the significant increase in costs to deliver vessels 801 and 802—

” **Time** – an increase of ~£50m in overheads relates to the simple fact that the two ferries will have carried the costs of the shipyard for ~9 years by the time of delivery of 802 in '24.

Pricing – if FMPG had bid for the two ferries in the near past for delivery in '23 & '24 as now planned, I estimate we would have priced the ships at ~£140m. Hence inflation and better knowledge of the complexities of these ships would have created an increase of ~£40m.

Management & Build errors – the balance, an increase of ~90m^{xliii}, is a function of mistakes and other factors, e.g., recovery from administration through the pandemic etc, over the whole period since the contracts were placed in 2015.³⁹

481. With regard to the management and build errors, the Chief Executive Officer categorised two of the five main issues, as relating to decisions taken by FMEL—

^{xlii} The CEO explains that this figure is comprised of £83 million, originally paid by CMAL to FMEL (vs. FMEL estimate, June '19 of £123 million incurred by them), the FMPG budget of £122 million and £72 million of additional budget that was subject to due diligence by the Scottish Government at the time the correspondence was received. It does not include details on the £45million loan.

^{xliii} “Perhaps £40m more if the £45m loan was attributed in some way to the difference between the £123m claimed as incurred by FMEL and £83m paid to them by CMAL”.

” a. Decisions by FMEL to run concurrent design and engineering, starting construction of the hull and superstructures before the design was complete – this always, in my experience, adds significant costs, and embeds design gaps and future re-work.

b. Decisions by FMEL not to follow conventional shipbuilding practices and to build ‘a largely empty ship’ – i.e., not to outfit units and modules in the sheds (fit windows) prior to assembly on the slipway – this decision alone could have doubled the subcontractor and direct labour manhours, resulting in outfitting materials – pipes, racks, etc., – being lifted onto the ship (801 afloat since 2017) by crane or carried up gangways. For example, the number of pipe-spools and end fittings probably doubled through this decision because each spool had to be smaller and more portable.³⁹

482. The remaining issues included the termination of the overall electrical and power management contracts, just prior to administration; the need for significant changes to the design contracts and key engineering partners after administration; and challenges associated with rebuilding engineering team after administration and nationalisation and the managing labour and contractors through this as well as the Covid-19 pandemic.

483. Reflecting on the oral evidence provided by the Chief Executive Officer of CMAL, the Committee refers to his conclusion of how the money was spent by FMEL—

” If you want to follow the money and see where the money has gone, I can tell you that, effectively, the money was wasted.⁷

FMEL’s financial records

484. In follow-up written evidence to the Committee, the AGS confirmed that “FMEL’s spending was outwith the scope of the audit as my remit does not include private sector organisations”. The AGS also confirmed what happened to FMEL’s financial records after the shipyard was nationalised in December 2019. The AGS stated—

” Ferguson Marine Port Glasgow (FMPG) has advised us that it holds FMEL’s records, as required by the Sale and Purchase Agreement between the two bodies. FMPG advise that these records exist in both digital and hard copy forms, but they are not organised or categorised. The Sale and Purchase Agreement does not require FMPG to review these records and FMPG has informed us that it has no plans to do so. FMPG is therefore not aware of what information exists and indeed whether this information will explain how FMEL spent the £128.25 million.⁴⁰

485. The AGS also confirmed—

” As part of the new contract arrangements, CMAL transferred ownership of the vessel assets to the Scottish Government at market value. The effective date of the transfer was 1 April 2020, and the market value of the vessel assets was £74.8 million⁴⁰

486. The response also clarified the separate value of FMEL's assets—

” When the Scottish Government brought the shipyard into public ownership in December 2019, it paid £7.5 million for FMEL's assets (offset against the loan debt owed by FMEL). These assets included owned property, intellectual property, equipment, and stock. ⁴⁰

Progress with the vessels

487. The AGS reported that the turnaround of FMPG is “extremely challenging and is taking longer than expected”. The report goes on to explain that initial progress with the vessels was delayed due to—

” FMPG focus[sing] its efforts on completing three smaller vessels that were then under construction at the shipyard and making operational changes to support the build of vessels 801 and 802. ¹

488. The AGS also highlighted that just four months after the shipyard was nationalised, “the Covid-19 pandemic caused significant disruption to the turnaround of the business and to vessel progress.” ¹

489. The AGS explained in his report that the significant operational failures identified by the Turnaround Director still need to be resolved. In December 2021, and at the request of FMPG, CMAL advised FMPG of its main points of concern. These included—

- FMPG's ability to resolve OORs
- Poor quality pipework
- Incomplete structural works. ¹

490. The AGS's report went on to state—

” ...unless it provided safe access to valves, pumps, and auxiliary equipment on vessel 801 for operation and maintenance, there was a risk that it might not obtain its passenger safety certificate. ¹

Problems with cable installation on vessel 801

491. The Committee pursued the serious problems identified by the Turnaround Director regarding cable installation on vessel 801 which would further delay the delivery of both vessels. Indeed, the AGS highlighted that in February 2022, the Turnaround Director notified the Scottish Parliament that the majority of the 1,400 cables that FMEL had installed on vessel 801 in late 2018 would need to be removed and replaced. The AGS reported the impact of this discovery by the Turnaround Director—

” This additional unexpected work will result in delays to the installation of the remaining 8,400 cables on vessel 801 and the commissioning process. It will also have an impact on the programme for vessel 802. Crucially, it means that FMPG will not meet its previously reported delivery dates for either vessel.¹

492. We asked a number of witnesses how these problems could have arisen during oral evidence. The Deputy Director Strategic Commercial Interventions, Scottish Government stated—

” We do not know what happened with the cables in the first instance. They were installed prior to Ferguson coming into public ownership. We understand that it is standard practice that, when those cables are fitted, they are left with a bit of excess. They were fitted by reputable contractors, so it was assumed that the coils that were rolled up included the length of cable that was required.

I understand that that issue was not discovered until an inspection at the tail end of December, when the cables were unrolled and measured. We do not know how that came about but, as I said, the cables were installed by reputable contractors, and assumptions were made on that basis.¹⁵

493. The former director of FMEL offered an alternative position, stating that this serious problem arose due to the way the project was managed after nationalisation. The former director went on to state—

” The cables were installed by Kongsberg earlier on. It is a very professional outfit. It had the design-and-install contract to put the cables in based on the design that we had for where equipment was and where the control panels were, and that is what it did. These are not people who make such mistakes.⁶

494. The former director also confirmed that in his view the cables were—

” ...not short for the design and the placing that we had for the control panels and other equipment. We know that equipment has been moved about and we know that control panels have been moved.⁶

495. We also pursued the problems identified with the cables with CMAL during oral evidence. The Chief Executive Officer of CMAL stated—

” Very simply, two things happened. Some of the cables that were installed were simply too short to reach the equipment that they were supposed to be connected to. That is part 1 of the story. Part 2 of the story is that the original installer did not come back to site after administration, so there was a change from a company called Kongsberg to one called Wärtsilä. The systems and control panels that Wärtsilä has in some instances—only a few—had to be in different compartments, because they were configured differently. There were short cables—full-stop— and there was some moving of equipment.⁷

496. As we have already set out in our report, FMPG provides quarterly updates on progress on the vessels to the Scottish Parliament. These updates are required in response to a recommendation the REC Committee made in its report.

497. The updates are currently provided to the NZET Committee. The most recent

update was received on [22 December 2022](#) and confirms that the target date for completion of 801 Glen Sannox (GS) is the end May 2023. For vessel 802, the target date for completion is the end March 2024^{xliv}.

498. During our meeting with FMPG workforce representatives, the Committee notes that concerns were raised about the possibility of further delays with the delivery of vessel 801. For example, some items that have been purchased for the vessels have been lying around the yard for a considerable amount of time and may therefore be out of warranty.²⁹
499. Concerns were also expressed during the meeting with FMPG workforce representatives that there remains a risk that the vessels may not be considered fit for purpose once they are completed. The importance of senior managers facing up to these risks was highlighted during the meeting.²⁹

Performance reporting to the Scottish Parliament

500. In addition to FMPG's quarterly updates of progress to the NZET Committee, the Scottish Government also provides Scottish Ministers with a separate monthly update on progress, which the AGS highlighted in his report "clearly set out CMAL's concerns with the build". The AGS's report goes on to highlight that—

” The updates provided to the Scottish Parliament tend to provide a more positive view of progress than those provided to Scottish ministers.¹

501. The AGS stated in his report that the different views of progress is understandable to some extent given that the Scottish Government, CMAL and FMPG all have a different focus with respect to the project—

” The Scottish Government, as the customer for the vessels, is focused on risks to delivery, the potential for delay and the impact of this on users of ferry services. CMAL, as the Scottish Government's advisers, therefore emphasise the problems and risks and the work being done to mitigate these. As the eventual owners of vessels 801 and 802, CMAL's focus is on ensuring that the vessels will be fit for purpose throughout the anticipated 30-year lifespan. Conversely, FMPG as vessel supplier is focused on action taken to achieve or improve delivery.¹

502. While noting the different focuses for all organisations, the AGS states that there is—

^{xliv} The Committee agreed its report on the morning of 16 March 2023. Later that same day, the Deputy First Minister [advised Parliament of further delays in the delivery of the ferries](#). In his statement, he advised that vessel 801 is now scheduled for autumn 2023 with a contract backstop of no later than the end of December 2023. Vessel 802 is to be handed over in autumn 2024, with a contract backstop of no later than the end of December 2024.

” ... an opportunity to consider how all parties could contribute to greater openness and transparency through more balanced public reporting on progress and problems with the project.¹

503. The AGS highlighted in his report that the Scottish Government, “as FMPG’s sponsors, has an important role in ensuring that the Scottish Parliament receives a full account of progress on the vessels and the associated challenges”.

Future of the yard

504. The Committee’s scrutiny focussed on the events that took place to procure and deliver vessels 801 and 802, as set out in the AGS report. While it is not the role of this Committee to determine or assess the merits regarding the viability of the shipyard in the future, we do highlight here some of the evidence we received in relation to this issue which may be of interest to the NZET Committee in its current work.

505. For example, when we met with FMPG workforce representatives, some signs of optimism were expressed. Indeed, it was highlighted to us that the current Chief Executive Officer of FMPG was the first senior manager of the yard “to talk about the possibility of the shipyard turning a profit.”²⁹

506. The Committee notes that the AGS highlighted in his report that—

” FMPG is actively pursuing new opportunities and bidding for new contracts, and its board has plans which would allow the shipyard to be more efficient and competitive in a commercial environment. The new FMPG CEO will be expected to play an important role in developing FMPG’s future strategy and supporting the sustainability of the shipyard.¹

507. It is clear that the deteriorating and subsequent breakdown in the relationship between CMAL and FMEL significantly impacted on the project. The Committee notes that following nationalisation, the AGS reported that “working relationships between FMPG and CMAL have been good, although some frustrations have emerged”. The AGS went on to state that—

” Initial working relationships between CMAL and FMPG were very productive, and both agree that there is a good working relationship between senior staff. There is also a good working relationship between CMAL’s onsite team and FMPG management, with weekly meetings taking place to discuss CMAL’s OORs.¹

508. During our meeting with workforce representatives at FMPG, it was explained that under the new arrangements, if CMAL ask for something to be fixed, it is fixed. There was also a recognition that both CMAL and FMPG are now part of the public sector, and therefore share the same objectives.

509. In relation to these shared objectives, the Committee notes that the AGS’s reported—

” While FMPG and CMAL share a common goal to deliver the vessels and regular discussions about progress are taking place, there have been times when some frustrations have emerged between the bodies. These mainly centre on CMAL being the Scottish Government’s representative at the shipyard, which involves it inspecting and reporting on FMPG’s activities and progress.¹

510. The AGS’s report also stated—

” FMPG’s workforce representatives advised us that the workforce values CMAL’s opinions but the shipyard could do more to draw on its expertise”. The extent to which FMPG is acting on CMAL’s advice and implementing changes is unclear.¹

511. The report also stated that since August 2021, “the Scottish Government has facilitated meetings between CMAL and FMPG to support greater information sharing at the strategic level”. It also explained that a joint CMAL board and FMPG board meeting took place in February 2022 “to discuss how the two bodies could work better together”. The report confirmed that this was a positive meeting and that it was agreed that “the organisations will work collaboratively to support vessel progress”. The boards have agreed to meet at least twice a year going forward.¹

512. The AGS stated in his report that the appointment of the new CEO of FMPG provide “further opportunities for closer working”.¹ As we have already noted, the new CEO has stated that FMPG and CMAL will work more collaboratively in future. The Committee is encouraged by this commitment to continue to improve relations between the two organisations.

513. The AGS’s report stated that prior to nationalisation, “PwC advised the Scottish Government that it should consider its exit strategy”. The report went on to state—

” The Scottish Government advised Scottish Ministers that it was not appropriate to do so at that time, that the immediate priority was delivering the vessels, and that the future of the shipyard would be considered at a later stage.¹

514. The AGS’s report clarified that the Scottish Government will—

” ...support FMPG to a position where it can compete for contracts, as it considers this is the best way to secure its future. It is also exploring the possibility of it awarding contracts directly to FMPG without the need to go through an open procurement exercise.¹

515. The AGS’s report further stated—

” The Scottish Government reports that it has not made any strategic decisions on the long-term future of the shipyard, including whether it should be publicly or privately owned, as this will depend on many factors, including FMPG’s future pipeline of work.¹

516. Asked whether it was the Scottish Government’s intention to keep the shipyard under public ownership, the First Minister stated during oral evidence—

” ...ultimately, we want all the commercial assets that we have taken ownership of to be back in the private sector, but we will have to make decisions about the point at which that becomes viable. We have not reached the point of decision on Ferguson’s.¹⁸

517. The Committee accepts that time was of the essence if the Scottish Government was to save the shipyard and the jobs. The Committee notes that, as part of Project Kildonan, PwC was appointed to consider potential options and provide commercial advice regarding the future of the vessels and shipyard. The Scottish Government separately assessed a further option put forward by CBC. There would have been clear merit in PwC considering all possible options, to ensure a consistent assessment of each was put forward to inform final decisions.
518. Differing legal opinions exist regarding the proposal put forward by CBC, and whether it would have broken State aid rules. Both CBC and the Scottish Government were entitled to seek legal advice to inform their decision making. However, the Committee notes that the Scottish Government confirmed it had followed its own legal advice. These legal opinions were never tested in court. We are therefore not in a position to adjudicate on the merits of the different legal opinions that were provided on compliance with State aid rules.
519. The Committee accepts that the Programme Review Board may not have had a role in scrutinising the assessment of the revised costs provided by the Turnaround Director. Nonetheless, given his costs were significantly higher than CMAL’s estimate, it was incumbent on the Scottish Government and Transport Scotland to do everything they could to seek assurances that these estimates were accurate and robust. However, the AGS confirmed in his report that there was no evidence that the updated costs or new timescales for the vessels were scrutinised by the Scottish Government or Transport Scotland. This is a matter of concern.
520. It is of particular note to the Committee that under the new governance arrangements, Transport Scotland no longer has a formal role in the project. This calls into question the effectiveness of Transport Scotland during the project and whether it sufficiently fulfilled its original role, that is, to report progress to internal and external stakeholders, act as the conduit between CMAL and Scottish Ministers and provide CMAL with advice and guidance. We further note that while Transport Scotland continues to fulfil its role as CMAL’s sponsor, there is a lack of clarity regarding the role it now plays in the vessels project.
521. The Scottish Government commissioned PwC to monitor and report FMEL’s delivery against the progress of the vessels as part of the conditions of the loans. However, we received evidence from Audit Scotland that the reports did not go into detail on where the money went, so it is not possible to establish how the money was spent by FMEL and what progress was made on the vessels. The Committee concludes that more robust reporting arrangements should have been put in place to monitor spending more

closely. The Committee asks the Scottish Government to consider how more robust reporting processes can be put in place for similar future projects.

522. The Committee accepts that it is not possible to say at this stage whether the FMEL financial records held by FMPG will explain exactly how the £128.25 million was spent. Despite this being a key focus of our scrutiny, it has not been possible for the Committee to establish where this money has gone in any detail. The Committee therefore strongly encourages the AGS to use his powers to undertake a forensic analysis of this information to shed more light on how this money was spent by FMEL.
523. The Committee received consistent evidence to suggest that decisions made by FMEL regarding the management of the project and the building of the vessels contributed to the serious problems highlighted by the AGS. It is clear that what appear to the Committee to be serious contract breaches took place at the yard under FMEL's watch. This contributed to significant sums of public money allocated to build these essential vessels being mismanaged in the process.
524. We consider that the serious problems identified with the cable installation on vessel 801 is representative of wider problems that existed at the yard from the outset. Indeed, insufficient investment and effort in the design process by FMEL during the early stages of the project limited the success of the project from the very beginning. This set of circumstances will have inevitably contributed to the substantial cost overruns and delays to the delivery of the vessels.
525. Serious challenges still require to be overcome by FMPG before the vessels can be delivered. The Committee encourages the new chairman of FMPG to work with senior managers at the yard to address these challenges as a matter of urgency.
526. In December 2022, the Scottish Government announced that it would allocate a further £15 million in 2022/23 and £57 million in the next financial year to support the completion of vessels 801 and 802 at Ferguson Marine (Port Glasgow) Ltd. This represents a further significant cost to the public purse to deliver vessels 801 and 802. The AGS's report stated that "The Scottish Government is committed to paying the additional vessel costs, regardless of the final price". Evidence from Scottish Government representatives challenge this assertion, stating that the vessels need to be delivered within the budget that has been allocated. Nonetheless, the Committee remains concerned regarding the ongoing significant risk that costs will continue to rise.
527. The Committee notes that FMPG provides quarterly updates to the NZET Committee. It is essential that these updates to the Scottish Parliament provide good quality, balanced and transparent information about the progress of the vessels, particularly in light of the further public expenditure required to deliver the vessels. The Committee echoes the

AGS's views that the Scottish Government ensures the Scottish Parliament receives a full account of progress, including any challenges that emerge in future updates.

- 528. The Committee recognises that significant events have taken place at the yard since 2019. This includes FMEL entering into administration, the nationalisation of the yard, the Covid-19 pandemic and the change of leadership during 2022. Cumulatively, these events will unquestionably have had a substantial impact on FMPG's workforce. Despite this unsettling sequence of events, the Committee heard first-hand how committed the workforce is to protect the quality of shipbuilding at the yard. The Committee commends the workforce for its resilience in the most exceptional set of circumstances. The Committee also considers that senior management at FMEL should have paid much greater attention to the experienced voice of the workforce from the very start.**
- 529. The Committee wishes to see a positive future for FMPG and is therefore encouraged that there appear to be signs of more constructive relations between the new management and the workforce, and between FMPG and CMAL.**

Lessons learned from the project

Changes implemented for future vessel projects

530. The AGS's report stated that there is no evidence of a formal project review exercise having been undertaken by the Scottish Government, Transport Scotland or CMAL after the original contract failed. He explained that "they have, however, reflected on the 801/802 project and made some improvements" which we have set out below.¹

CMAL changes

531. The AGS reported improvements made by CMAL in relation to the re-design of its tender process, commissioning support for concept designs and technical assessments during the vessel procurement process. The AGS also stated that CMAL will consider "the scheduling and frequency of milestone payments as part of future vessel tendering exercises".¹
532. The AGS also reported that CMAL will—
- ” ... ensure that only shipbuilders who agree to provide a full refund guarantee can qualify as a preferred bidder. In addition, if a preferred bidder subsequently retracts the offer of a full refund guarantee, CMAL states that it will not award it the contract, regardless of the views of Scottish ministers.¹
533. In written evidence to the Committee, and as referred to at paragraph 307 of this report, CMAL set out the approach it took to the recent procurement of the Islay vessels. This included seeking a full BRG from the shipyard; milestone payments being signed off by the vessel's Classification Society and the shipbuilder obtaining the necessary Class approval of all the design drawings before a milestone payment is made.¹²

Transport Scotland changes

534. The AGS also highlighted in his report that Transport Scotland will take steps to enhance how it resources ferry capital projects and has—
- committed resources to help better understand the decisions that were made throughout the 801/802 project. This includes sharing lessons learned around risk
 - begun the process of strengthening its project governance. This has included clarifying roles and responsibilities, ensuring that it adheres to project management principles, embedding more rigid project documentation, assessing its internal review processes, and embedding gateway reviews at key stages of major ferry infrastructure projects.
535. During oral evidence, the Interim Director-General Net Zero provided information

about Transport Scotland's investment decision committee, chaired by the Chief Executive of Transport Scotland. He explained that the purpose of that committee is to consider business cases for investments, prior to that decision going forward to Scottish Ministers. The Interim Director-General went on to explain how these arrangements have changed since the project to deliver vessels 801 and 802 commenced. He stated—

” In 2015, that investment decision management—IDM—approach was principally concerned with major projects such as the Queensferry crossing, the A9 and M8-M73- M74 improvements, but one change that has been made since the report came out is that all port, harbour and ferry infrastructure projects also now go through the IDM approach. ¹⁵

536. The Director of Aviation, Maritime, Freight and Canals, Transport Scotland explained what the IDM approach involves—

” The investment decision-making board of Transport Scotland is a piece of governance in the agency that is designed to support the chief executive in his role as accountable officer. It is designed to be a challenge function at strategic business case stage or subsequent stages in a project before any significant decisions are taken. It supplements the gateway review processes and other assurance and governance arrangements that the committee would expect to see in place. ²⁰

537. Asked why vessels 801 and 802 were not considered as part of this process, the Director of Aviation, Maritime, Freight and Canals responded—

” Vessels 801 and 802 were not taken to the investment decision board, but I cannot speak to the reasons for that. The threshold and range of projects that come forward to the investment decision board have changed over time as that governance has evolved and continues to evolve. ¹⁵

538. During a separate evidence session, we asked Transport Scotland what improvements it had made to ensure the process for future vessels is much more tightly controlled and managed, and that the governance issues do not recur. The Director of Aviation, Maritime, Freight and Canals, Transport Scotland again highlighted the investment decision board, responding—

” We have enhanced the project groups for defined projects and programmes going forward. We have increased the emphasis on the discipline around recording all decisions, particularly our approach to recording risks. We now take all projects to the investment decision-making board at Transport Scotland, as discussed in the previous session, which provides the additional challenge function and the additional assurance for the accountable officer in taking investment decisions on how to proceed. In all our projects, we have introduced greater use of gateway review at appropriate stages in project development, and we also have clearer mechanisms for reporting to ministers with project status updates throughout the life of any project. ²⁰

539. The Committee notes that Transport Scotland planned to replace its 2012 Ferries Plan with an Islands Connectivity Plan (ICP) by the end of 2022, subject to available resources. The ICP will be broader in scope, taking account of aviation, ferries and

fixed links, and onward and connecting travel. It will be developed within the context of the second National Transport Strategy and the National Islands Plan and be informed by the outcomes of the Strategic Transport Projects Review 2. The Committee further notes that the ICP will include a “long-term plan and investment programme for ferries”, intended to replace the current Vessel Replacement and Deployment Plan.¹

540. [Transport Scotland's website](#) confirms that work on the ICP is underway, with priority being given to a draft Long-Term Plan for Vessels and Ports, which was published on 30 December 2022. This will be subject to public consultation in the early part of 2023. Transport Scotland also confirms that “work on the other elements of the ICP will follow, with a view to further engagement, consultation and publications in 2023”.⁴¹

Changes made by the Scottish Government

541. During oral evidence, the Committee asked the First Minister what lessons had been learned to ensure that the events that took place for vessels 801 and 802 do not happen again. The First Minister responded—

” Reflecting on lessons learned will, obviously, be an on-going process as we complete the vessels. I am absolutely determined that the Government properly and fully learns all lessons that are appropriate.¹⁸

542. We also asked the First Minister who in her view, was responsible for the failures that took place during the project. She responded that each party involved should learn lessons—

” We all—the Scottish Government; CMAL; to a lesser extent, to be fair, but nevertheless, I include CalMac; and Transport Scotland, which is an agency of the Scottish Government—have to reflect on all aspects, recognise whether decisions that we have taken could and should have been taken differently, and learn lessons from that. I do not shy away from that.¹⁸

543. While accepting that there are lessons for the Scottish Government and its agencies, the First Minister also referred to the responsibility of the former organisation FMEL, stating—

” It contracted to do a job that has not been done. Therefore, in my view, a significant degree of responsibility has to rest with FMEL and FMEL's management at the time—not sole responsibility, and I am not saying that none of its concerns are legitimate, but it has to be part of this, too.¹⁸

544. Referring to action the Scottish Government has taken since, the First Minister drew the Committee's attention to the publication of its business investment framework in March 2022 (referred to at paragraphs 359 and 360 of this report) intended to “strengthen [the Scottish Government's] approach in general terms to any strategic interventions that it makes in commercial assets”.¹⁸

545. The Committee notes that in his report, the AGS made recommendations to the

Scottish Government in relation to the [business investment framework](#) and its future investment in private businesses as follows—

” The Scottish Government should:

- in line with its new framework for investing in private businesses, improve the transparency of its investment decisions
- be clear about the specific outcomes it expects to achieve from investing in private businesses and put appropriate measures in place to assess and report value for money. This includes setting clear conditions for its investment, ensuring that these are adhered to, and monitoring risks.¹

546. In December 2022, the AGS published his report, [The 2021/22 audit of the Scottish Government Consolidated Accounts](#). While welcoming the publication of the framework, the AGS stated in his report—

” There is scope to further develop the framework by, for example, strengthening financial control over interventions and expanding commercial outcomes to include impact on the public such as jobs and future growth opportunities. The framework should also make a direct link between risk tolerance and risk appetite for investment considering the financial capacity of the Scottish Government. There is also scope to strengthen the guidance by removing some of the flexibilities in the application of the principles.³⁷

547. In January 2023, the Committee took oral evidence from the AGS on the 2021/22 audit of the Scottish Government Consolidated Accounts report. During the evidence session, we asked the AGS whether the framework was sufficiently robust to inform decision making in this area. He responded—

” I think that we can define our response as a qualified welcome. It is important that the framework is in place, but we think that there is opportunity for Government to do more to satisfy itself that that provides it with the framework for its investments. Bear in mind that the investments that the Government is likely to make will be higher risk. They are likely to be opportunities that will come its way when companies have exhausted other opportunities, whether through private finance or other public sector support through enterprise companies. Therefore, it matters that the framework is tight and that all the risks and opportunities are properly weighed up. There are a couple of final steps that the Government can take to make sure that that is rounded off in respect of its management of risk.⁴²

Alternatives to builder's refund guarantees

548. As we have already set out in our report (paragraph 91), different interpretations existed between CMAL and the former director of FMEL as to what was required by way of a builder's refund guarantee (BRG).

549. The Committee notes that during oral evidence, the former director of FMEL made reference to exploring with the Scottish Government whether it was possible to adopt arrangements used in other European countries rather than the shipbuilder

providing a BRG. He explained—

” In Germany, the national investment bank put up the bonds for the Flensburg shipyard. In Poland, shipyards get backed. In Finland and in Holland, and in most European countries, the burden is not put on the company that receives the order—the Government stands behind it. My first approach to the Government was to ask whether it could stand behind the bond in the same way as Governments overseas do, and its response was that it could not as it was the buyer as well, so there was a conflict.⁶

Future transport ferries governance arrangements

550. The Committee notes that the REC Committee explored the decision-making structure for the procurement and construction of new vessels to serve the Clyde and Hebrides ferries network as part of its inquiry work. Based on the evidence the REC Committee gathered, it concluded that there was a cluttered decision-making landscape that lacked transparency”. The REC Committee went on to conclude that the contract to deliver vessels 801 and 802—

” ...exposed serious failures in the current tripartite decision-making structure. The Committee therefore concludes that a root and branch overhaul of current decision-making structures is urgently needed and that this should consider the relative roles and responsibilities of all bodies involved in decision making around the procurement of new vessels and should also include an appraisal of whether each of these bodies should continue to exist or whether there is scope to streamline and simplify decision-making structures by merging or abolishing certain of them.²⁸

551. During oral evidence, the former Minister for Transport and Islands provided his views on the governance arrangements that were in place when he was in Government, referring directly to the REC Committee’s findings. He stated—

” A personal view is that transport governance as it stands is not perfect, and it was not perfect when I was transport minister. In its recommendations, the REC Committee makes the point that there is definitely room for improvement in transport governance—the agencies, the structures and so on. Of course, there is the potential to restructure things in such a fashion as to remove that competitive, contractual, conflicting and ultimately hostile relationship that we got into between the contractor and the contracting body, with the Government into the bargain.¹⁶

552. We asked the former Minister for Transport and Islands whether he considered those governance arrangements to be a barrier to resolving the dispute between CMAL and FMEL^{xiv}. He responded—

^{xiv} By this stage, the former Minister for Transport and Islands was the Cabinet Secretary for Finance and the Constitution.

” When I was transport minister, I felt that there was an issue with CMAL as an agency, with Transport Scotland and with the contractual arrangements as they were. When problems emerged, I was being advised—for good reason— by a multitude of people, and I felt that transport governance was quite a cluttered landscape at that point.

Of course, when you are, as the transport minister, dealing with the daily issues, you do not necessarily want to embark on structural reform.¹⁶

553. The AGS’s report stated that in March 2021, Transport Scotland commissioned consultants to conduct a review of [the governance arrangements for ferries](#), including the roles of Transport Scotland, CMAL, and CalMac, to assess whether they are fit for purpose. The AGS’s report further stated—

” The consultant’s initial reports on the review (known as Project Neptune), prepared in November 2021, identify several areas for improvement, including insufficient clarity on responsibilities, and a lack of oversight, and present several options for structural reform. Transport Scotland reports that it is beginning to make improvements in relation to transparency and accountability but recognises that further work is required. In February 2022, Scottish ministers received the final Project Neptune reports for consideration.¹

554. In follow-up written evidence provided by the First Minister, reference is made to a number of changes Transport Scotland have made to the governance around new build vessels, which we have set out above. In this written evidence, the First Minister stated that—

” Transport Scotland accept there is still further work to be done in terms of a strategic framework for the three organisations – Transport Scotland, CMAL and CalMac – which will help further define roles and responsibilities. This will be progressed as part of Project Neptune.¹⁹

555. On [8 September 2022](#), the current Minister for Transport made a statement to the Scottish Parliament confirming that the final Project Neptune report had been published. The report is structured into two parts as follows—

- [Part 1: CHFS Network: Governance, Internal Controls and Value for Money \(VfM\)](#)
- [Part 2: Project Neptune: Future Options](#)

556. During her statement, the Minister set out some of the key findings of Project Neptune. She explained—

” The tripartite structure of CalMac, Caledonian Maritime Assets Ltd and Transport Scotland was brought in by the then Scottish Executive to comply with European Union law. Not unhelpfully, project Neptune evidences what that can sometimes mean in practice—when, for example, the members of the tripartite do not agree. The report notes challenges in holding the tripartite to account because of confusion over roles and responsibilities. It also points to a lack of a formalised process for ministers to engage with the tripartite. That needs to change.⁴³

557. The Minister for Transport also highlighted that part 2 of the Project Neptune report evaluated “different approaches to bringing together organisations that deliver ferry services”. During the statement, the Minister referred to the introduction of a ferries commissioner as one possible option included in the report. However, she highlighted that the report recognises that this could bring “another stakeholder into an already crowded sector”.⁴³
558. The Minister also confirmed in her statement that the Scottish Government will directly consult with island communities on the next steps, following the publication of Project Neptune. The Chair of the Ferries Community Board^{xlvi} will lead this work.
43

559. **The Committee welcomes the improvements made by CMAL and Transport Scotland in response to the significant failures associated with this project. Nevertheless, we support the AGS’s recommendation that upon completion of vessels 801 and 802, Transport Scotland and CMAL should undertake a formal project review to learn vital lessons for future vessel projects. The Committee considers that this review would benefit from the involvement of independent maritime expertise, to restore public confidence in future maritime procurement exercises.**
560. **The Committee notes the action taken by the Scottish Government to publish a business investment framework to strengthen its approach to investment in private businesses. Based on the evidence we have received, particularly in the case of bringing Ferguson Marine shipyard into public ownership, more work is required to ensure the framework is sufficiently robust and transparent and is underpinned by a clear strategy. We therefore take this opportunity to reassert our earlier conclusion that the Scottish Government needs to strengthen its framework for its investment in private businesses to better outline intentions over risk tolerance, risk appetite and the expected public benefit of future interventions.**
561. **The Scottish Government should also consider how more information can be routinely shared with Parliament and published about its decisions to invest in private companies. While we recognise that some of this information will at times be commercially sensitive, we believe there is a public interest in providing information on these investment decisions, to provide the transparency necessary for public scrutiny, including the determination of whether the intended objectives have been met and that value has been provided for the taxpayer.**
562. **During oral evidence, the former director of FMEL stated that in some other European countries, the government provides the financial security for a shipbuilding contract, rather than there being a requirement for the shipbuilder to provide a full BRG. If it has not already done so, we ask the Scottish Government to consider whether any learning can be taken from this approach for the procurement of future vessels in Scotland, as well as from the UK Government’s proposal to develop a model for a Home**

xlvi The Ferries Community Board is facilitated by CalMac Ferries Limited. Its primary purpose is to be the voice of the communities and provide the community view to CalMac.

Shipbuilding Credit Guarantee Scheme, intended to "level the playing field for domestic shipbuilders". The Committee also asks the Scottish Government to explore how this can be addressed, including whether there is a role for the Scottish National Investment Bank.

563. **The Committee agrees with the REC Committee that the decision-making structure for the procurement and construction of new vessels to serve the Clyde and Hebrides ferries network is cluttered and lacks transparency. The Committee therefore welcomes the publication of the Project Neptune governance review in September 2022. The Committee considers it vital that local community voices are considered at various stages of the procurement process. The work that is currently underway to consult with island communities on its next steps and how best to implement the future new vessels programme is therefore also welcome.**
564. **The Committee is firmly of the view that stronger governance arrangements from the outset to the conclusion of a project is required, not least to ensure that the capability of a bidding yard undergoes full and proper assessment prior to the awarding of a contract. We note that Project Neptune provides the opportunity for much needed reform of the governance arrangements for ferries. However, it should not be seen as a silver bullet in preventing a similar situation from occurring again. We reiterate our view that a formal review of the project upon completion of the vessels is essential in learning lessons for the future.**
565. **We recognise that the findings of the CMAL investigation in response to the BBC Disclosure investigation have not yet concluded. However, we expect that these findings, alongside the NZET Committee's own conclusions regarding the current tri-partite arrangement for managing ferry service provision provide an opportunity for the Scottish Government, and its agencies, to learn fundamental lessons that improve procurement processes and ensure that ferries are delivered on time and on budget in the future.**

Annexe A: Key decision makers and accountable officers

Scottish Ministers responsible for the portfolios covering transport and finance

Covering the period between when the procurement process for the vessels was launched in October 2014 and the dissolution of Parliament in May 2021.



Transport

Cabinet Secretaries

Infrastructure, Capital Investment and Cities Sep 2012 – Nov 2014	Infrastructure, Investment & Cities Nov 2014 – May 2016	Rural Economy and Connectivity May 2016 – Jun 2018	Transport, Infrastructure and Connectivity Jun 2018 – May 2021
Nicola Sturgeon MSP	Keith Brown MSP	Fergus Ewing MSP	Michael Matheson MSP

Ministers

Transport and Veterans Sep 2012 – Nov 2014	Transport and Islands Nov 2014 – May 2016	Transport and the Islands May 2016 – Jun 2018	Transport, Infrastructure and Connectivity Jun 2018 – May 2021
Keith Brown MSP	Derek McKay	Humza Yousaf MSP	Paul Wheelhouse



Finance

Cabinet Secretaries

Finance, Employment and Sustainable Growth May 2011 – Nov 2014	Deputy First Minister and Cabinet Secretary for Finance, Constitution & Economy Nov 2014 – May 2016	Finance and the Constitution May 2016 – Jun 2018	Finance, Economy and Fair Work and the Constitution Jun 2018 – May 2020	Finance May 2020 – May 2021
John Swinney MSP		Derek McKay		Kate Forbes MSP



Oct 2014
Minister for Transport and Veterans launched the procurement process to build and design two new ferries for the Clyde and Hebrides Ferry Services network



Aug 2015
Preferred bidder announced.
Oct 2015
Contract awarded.



Feb 2017
Ministers formally informed of vessel delays.
May 17
CMAL accelerate £14.55 million of payments to FMEL.
Sep 17
SG provide FMEL with a £15 million loan.



Jun 2018
SG provide FMEL with a £30 million loan.



Aug 2019
FMEL enter administration
Dec 2019
Shipyard brought into public ownership.

Scottish Ministers responsible for the portfolios covering transport and finance (continued)

Covering the period from May 2021 until present day.



Transport

Cabinet Secretaries

Net Zero, Energy and Transport May 2021 – present
Michael Matheson MSP

Ministers

Transport May 2021 – Jan 2022	Transport Jan 2022 - present
Graeme Dey MSP	Jenny Gilruth MSP



Finance

Cabinet Secretaries

Finance and the Economy May 2021 - July 2022 (currently on maternity leave)	The Deputy First Minister and Cabinet Secretary for Covid Recovery July 2022 - present (responsible while Kate Forbes MSP is on maternity leave)
Kate Forbes MSP	John Swinney MSP

Source: The Scottish Parliament

Scottish Government, Transport Scotland and CMAL representatives

Covering the period between when the procurement process for the vessels was launched in October 2014 until present day.

Scottish Government

Portfolio Accountable Officer for Transport

Director-General Enterprise, Environment & Innovation Dec 2011 - May 2016	Director-General Enterprise, Environment & Innovation May 2016 – Nov 2021	Director-General Net Zero Nov 2021 – Present
Graeme Dickson	Liz Ditchburn	Roy Brannen

Transport Scotland

Chief Executive / Accountable Officer

Feb 2009 - Nov 2015	May 2015 – Nov 2021	Dec 21 - Aug 22	Aug 22 - present
David Middleton	Roy Brannen	Hugh Gilles	Michelle Quinn

CMAL

Chair of the Board

Mar 2014 - Jan 2022	Jan 2022 – present
Erik Østergaard	Morag McNeill*

Chief Executive Officer

Apr 2014- Apr 2016	Apr 2016 – present
Tom Docherty	Kevin Hobbs



Oct 2014
Minister for Transport and Veterans launched the procurement process to build and design two new ferries for the Clyde and Hebrides Ferry Services network



Aug 2015
Preferred bidder announced.

Oct 2015
Contract awarded.



Feb 2017
Ministers formally informed of vessel delays.

May 17
CMAL accelerate £14.55 million of payments to FMEL.

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Jun 2018
SG provide FMEL with a £30 million loan.



Aug 2019
FMEL enter administration

Dec 2019
Shipyard brought into public ownership.

*Interim - Jan 2022 Perm - Sep 2022

Source: The Scottish Parliament

Annexe B: Timeline of key events

This timeline covers the period between the launch of the procurement process in October 2014 and the point at which the shipyard was nationalised in December 2019.

2014

October 2014

Minister for Transport and Veterans launches the procurement process to build and design two new ferries for the Clyde and Hebrides Ferry Services network

December 2014

MSP for Greenock and Inverclyde writes to the Cabinet Secretary for Finance, Constitution and Economy asking if SG could introduce a more flexible bonding arrangement to reduce FMEL's "large upfront costs".

2015

February 2015

Minister for Transport and Islands responds explaining that while CMAL has a preference for refund guarantees, it has on occasion taken alternative approaches.

21 August 2015

Cabinet Secretary for Infrastructure, Investment & Cities approves decision for CMAL to award FMEL preferred bidder status for the contract.

31 August 2015

First Minister announces the preferred bidder decision.

October 2015

Minister for Transport and Islands approves the decision for CMAL to award the contract to FMEL

2016

December 2016

Transport Scotland prepares a briefing for the Minister for Transport and the Islands notifying them of the risk FMEL would not recover vessel delays

2017

February 2017

Transport Scotland officially informs Scottish Ministers of the probability that the vessels would be late

May 2017

CMAL accelerate £14.55m of milestone payments to FMEL

July 2017

CMAL disputes £17.5m claim submitted by FMEL for additional costs.

September 2017

SG provides FMEL with a £15m loan.

2018

February 2018

CMAL and FMEL abandon mediation attempts.

April 2018

FMEL advises CMAL its claim has increased to £27.4m.

June 2018

CMAL allows FMEL to extend the vessel delivery dates. SG provides FMEL with a further £30m loan.

December 2018

FMEL submits a new claim to CMAL for £65.8m.

2019

February 2019

Project Kildonan initiated.

March 2019

CMAL refute FMEL's revised claim.

May 2019

SG commission independent view of FMEL's claim.

June 2019

SG advise there is no legal basis for CMAL to pay more than the fixed price of the contract.

August 2019

FMEL enter administration. SG appoint a Turnaround Director.

December 2019

SG complete a commercial transaction bringing shipyard into public ownership and create FMPG

Source: The Scottish Parliament

Annexe C: Extracts from minutes

Extracts from the minutes of meetings of the Public Audit Committee

12th Meeting, Thursday 21 April 2022

3 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee took evidence on the section 23 report from—

Stephen Boyle, Auditor General for Scotland;

Antony Clark, Interim Director of Performance Audit and Best Value, Angela Canning, Audit Director and Gill Miller, Audit Manager, Performance Audit and Best Value, Audit Scotland.

4 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered the evidence heard at agenda item 3 and took further evidence from—

Stephen Boyle, Auditor General for Scotland;

Antony Clark, Interim Director of Performance Audit and Best Value, Angela Canning, Audit Director and Gill Miller, Audit Manager, Performance Audit and Best Value, Audit Scotland.

The Committee agreed to take further evidence from the Auditor General for Scotland at a future meeting.

13th meeting, Thursday 28 April 2022

3 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee took evidence from— Stephen Boyle, Auditor General for Scotland; Antony Clark, Interim Director of Performance Audit and Best Value and Angela Canning, Audit Director, Audit Scotland.

4 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered the evidence heard at agenda item 3 and took further evidence from—

Stephen Boyle, Auditor General for Scotland;

Antony Clark, Interim Director of Performance Audit and Best Value and Angela Canning, Audit Director, Audit Scotland.

The Committee agreed to invite the Scottish Government and Transport Scotland to give

oral evidence at a future meeting.

15th meeting, Thursday 19 May 2022

2 Work programme (In Private):

The Committee considered its work programme.

In relation to its scrutiny of the report: New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802, the Committee agreed to invite the current Chief Executive and former Chair of Caledonian Maritime Assets Limited to give oral evidence at a future meeting. It also agreed to invite the Director and Chief Executive of Fergusson Marine Engineering Limited to give oral evidence, on a separate panel, at a future meeting.

The Committee agreed to seek written evidence from the former Chief Executive of Transport Scotland, the former Director-General for Enterprise, Environment and Innovation and the former Minister for Transport and Islands, Scottish Government.

16th meeting, Thursday 26 May 2022

2 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee took evidence on the section 23 report from—

Roy Brannen, Interim Director-General Net Zero, Colin Cook, Director of Economic Development, Dermot Rhatigan, Deputy Director Manufacturing and Industries and Mo Rooney, Deputy Director Strategic Commercial Interventions, Scottish Government;

Hugh Gillies, Interim Chief Executive, Fran Pacitti, Director of Aviation, Maritime, Freight and Canals and Chris Wilcock, Head of Ferries Unit, Transport Scotland.

3 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered the evidence heard at agenda item 2 and took further evidence from—

Stephen Boyle, Auditor General for Scotland;

Angela Canning, Audit Director and Gill Miller, Audit Manager, Performance Audit and Best Value, Audit Scotland.

The Committee agreed to invite the Scottish Government and Transport Scotland to give further oral evidence at a future meeting.

17th meeting, Thursday 9 June 2022

2 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee took evidence on the section 23 report from—

Colin Cook, Director of Economic Development , Dermot Rhatigan, Deputy Director Manufacturing and Industries and Mo Rooney, Deputy Director Strategic Commercial Interventions, Scottish Government ;

Fran Pacitti, Director of Aviation, Maritime, Freight and Canals, Chris Wilcock, Head of Ferries Unit and Hugh Gillies, Interim Chief Executive, Transport Scotland.

3 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered the evidence heard at agenda item 2 and took further evidence from—

Stephen Boyle, Auditor General for Scotland;

Angela Canning, Audit Director, Audit Scotland.

18th meeting, Thursday 16 June 2022

2 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee took evidence on the section 23 report from—

Jim McColl, Former Director, Ferguson Marine Engineering Limited.

3 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered the evidence heard and took further evidence from—

Stephen Boyle, Auditor General for Scotland;

Angela Canning, Audit Director, Audit Scotland.

20th meeting, Thursday 30 June 2022

2 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee took evidence on the section 23 report from—

Kevin Hobbs, Chief Executive Officer, Morag McNeill, Interim Chair and Erik Østergaard, Former Chair, Caledonian Maritime Assets Limited.

5 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered the evidence heard at agenda item 2 and took further evidence from—

Stephen Boyle, Auditor General for Scotland;

Gill Miller, Audit Manager, Performance Audit and Best Value, Audit Scotland.

The Committee agreed to invite the former Chief Executive of Transport Scotland and the former Minister for Transport and Islands, Scottish Government, to give oral evidence at a future meeting.

21st meeting, Thursday 8 September 2022

2 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee took evidence on the section 23 report from— David Middleton, former Chief Executive, Transport Scotland;**and then from—** Derek Mackay, former Minister for Transport and Islands, Scottish Government.

3 New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee considered the evidence heard at agenda item 2 and took further evidence from— Stephen Boyle, Auditor General for Scotland; Angela Canning, Audit Director and Gill Miller, Audit Manager, Performance Audit and Best Value, Audit Scotland.

The Committee agreed to invite the First Minister to give evidence at a future meeting, and consider any further steps at its next meeting. The Committee also agreed to draft a report on the Auditor General for Scotland's section 23 report, New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802.

22nd meeting, Thursday 22 September 2022

4 Work programme:

The Committee agreed to write to Stuart McMillan MSP, Keith Brown MSP, Caledonian Maritime Assets Limited and Transport Scotland in relation to its scrutiny of the Auditor General for Scotland's report, New Vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802. The Committee also agreed to visit Ferguson Marine (Port Glasgow) Limited.

25th meeting, Thursday 3 November 2022

2 Work programme:

The Committee considered its work programme and noted correspondence received from Stuart McMillan MSP, Keith Brown MSP, Caledonian Maritime Assets Limited and Transport Scotland in relation to the Auditor General for Scotland's report, New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 and agreed to write to Keith Brown MSP and the Auditor General for Scotland.

26th meeting, Friday 4 November 2022

2 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802:

The Committee took evidence on the section 23 report from— Rt Hon. Nicola Sturgeon, First Minister, Scottish Government.

3 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and

802:

The Committee considered the evidence heard at agenda item 2 and took further evidence from—

Stephen Boyle, Auditor General for Scotland;

Antony Clark, Executive Director of Performance Audit and Best Value, Audit Scotland.

The Committee agreed to write to the First Minister on issues raised during the meeting and agreed to consider a draft report at a future meeting.

30th meeting, Thursday 8 December 2022**4 Work programme:**

The Committee agreed to write to the First Minister and Transport Scotland in relation to its scrutiny of New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802.

31st meeting, Thursday 15 December 2022**5 Work programme (In Private):**

The Committee considered its work programme and agreed to close the period for written submissions in relation to its scrutiny of the Auditor General for Scotland's report, New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802, as it moves into its report consideration phase. The Committee also agreed to seek information from Ferguson Marine (Port Glasgow).

1st meeting, Thursday 12 January 2023**1 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802(In Private):**

The Committee considered early sections of a draft report and will continue its consideration at a future meeting.

The Committee noted correspondence received from David Tydeman, Chief Executive Officer of Ferguson Marine (Port Glasgow), the Cabinet Secretary for Justice and Veterans and the First Minister.

The Committee also noted correspondence from the Deputy First Minister to the Convener of Net Zero, Energy and Transport Committee.

2nd meeting, Thursday 19 January 2023**5 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802(In Private):**

The Committee considered sections of a draft report.

3rd meeting, Thursday 26 January 2023

1 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered sections of a draft report.

4th meeting, Thursday 2 February 2023

4 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered sections of a draft report.

6th meeting, Thursday 23 February 2023

5 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (In Private):

The Committee considered its draft report and agreed a number of changes, some by division. The Committee agreed to continue consideration of the draft report at a future meeting.

Record of division in private

Richard Leonard proposed the addition of the final sentence of paragraph 10. This proposal was agreed to by division: For 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Against 2 (Colin Beattie, Willie Coffey), Abstentions 0. Colin Beattie proposed alternative wording for this sentence as follows: "The delay in supplying the information requested was of concern to the Committee." The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Richard Leonard proposed that additional wording be added to paragraph 89 to refer to the poor judgement shown by the former Minister for Transport and Islands and, taking account of a suggestion from Craig Hoy, to reflect that the integrity of the procurement process had been compromised. This proposal was agreed to by division: For 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Against 2 (Colin Beattie, Willie Coffey), Abstentions 0. Colin Beattie proposed that the paragraph be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Craig Hoy proposed that the word "obstructed" be used in the final sentence of paragraph 99. This proposal was agreed to by division: For 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Against 2 (Colin Beattie, Willie Coffey), Abstentions 0. Colin Beattie proposed that the final sentence read as follows: "This lack of response is disappointing". The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Craig Hoy proposed that wording be added to paragraph 129 to reflect that the former Minister for Transport and Islands should have been aware of the preferred bidder status from the briefing received before he went on annual leave. This proposal was agreed to by division. For 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Against 2 (Colin Beattie, Willie Coffey), Abstentions 0. Colin Beattie proposed that the paragraph be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Colin Beattie proposed that paragraph 131 be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Richard Leonard proposed additional wording to paragraph 132 to reflect that CMAL's negotiating position was "almost certainly" weakened by the public announcement on the preferred bidder, and to question the involvement of the First Minister and related communications around the announcement. This proposal was agreed to by division. For 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Against 2 (Colin Beattie, Willie Coffey), Abstentions 0. Colin Beattie proposed that the paragraph be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Colin Beattie proposed alternative wording for paragraph 193 as follows: "In view of this submission raising contradictory views it might have been prudent if the Minister had been alerted to pursue further information regarding CMAL's position including taking up their offer to meet with a representative of the CMAL board". The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Colin Beattie proposed that paragraph 201 be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

7th meeting, Thursday 2 March 2023

6 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (Private)

The Committee considered its draft report and agreed a number of changes, some by division. The Committee agreed to continue consideration of the draft report at a future meeting.

Record of division in private

Richard Leonard proposed that the third sentence of paragraph 294 be deleted as follows: "On this basis, the Committee accepts that there may have been a case for the First Minister to launch vessel 801". The proposal was agreed to by division. For 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Against 2 (Colin Beattie, Willie Coffey), Abstentions 0.

Colin Beattie proposed that paragraph 409 be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Colin Beattie proposed that paragraph 410 be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Colin Beattie proposed that paragraph 413 be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

8th meeting, Thursday 9 March 2023

1 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802(In Private)

The Committee considered its draft report and agreed a number of changes. The Committee agreed to continue consideration of the draft report at a future meeting.

9th meeting, Thursday 16 March 2023

1 New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802 (Private)

The Committee considered and agreed a draft report and agreed a number of changes, some by division. The Committee agreed to delegate responsibility to the Convener for finalising the draft report for publication.

Record of division in private

Colin Beattie proposed that the final sentence of paragraph 42 be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Colin Beattie proposed that the final two sentences of paragraph 44 be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Colin Beattie proposed that the final two sentences of paragraph 47 be deleted. The proposal was disagreed to by division. For 2 (Colin Beattie, Willie Coffey), Against 3 (Sharon Dowey, Craig Hoy, Richard Leonard), Abstentions 0.

Annexe D: Written evidence and engagement

Written evidence received in relation to the Committee's scrutiny can be found [here](#).

The Committee also held an informal discussion with staff at FMPG on 31 October 2022. An anonymised note of that meeting can be found below.

FMPG Anonymised note

Attendees

- A small group of staff and Trade Union representatives
- Richard Leonard MSP, Convener
- Sharon Dowey MSP, Deputy Convener
- Willie Coffey MSP
- Craig Hoy MSP

Experiences and reflections of working at the shipyard when it was owned by the former organisation, Ferguson Marine Engineering Limited (FMEL)

It was explained to the Committee that soon after the yard went into administration in 2014, the former director of FMEL Jim McColl, explained to staff representatives that he would be buying the yard. This was considered to be a positive development as it was his intention to retain the workforce, in contrast to what was understood to be the case with other potential buyers.

The Committee heard that the former director of FMEL set out plans for a positive future for the shipyard. MV Catriona, the first contract won by FMEL and completed in 2016, was cited as an example of a ship that was “done well” and “kept the shipyard alive”.

Concerns were raised about the limited experience of FMEL staff employed to run the yard as well as the management style that was adopted. The Committee was told that staff regularly explained to managers that certain approaches or ideas wouldn't work, but they did not feel that they were listened to. It was explained to the Committee that the ambition the former director of FMEL had for the yard “was not informed by the people who had the experience”.

Concerns were raised about the way in which the shipyard was reconfigured, once FMEL had secured the contract to build vessels 801 and 802. It was explained that the approach was to “knock everything down” and construct new buildings which they felt had a negative impact on the operation of the yard. For example, the Committee heard that layout changes meant that unloading lorries could sometimes take 8 hours when it had previously taken only 20 minutes.

It was suggested that due to the size of the contract for vessels 801 and 802, the yard would never have been able to accommodate the two ferries at the same time. The Committee also heard that building the two ferries concurrently as well as making

significant changes to the layout of the yard all at the same time, would have made it impossible to meet the original timescales. It was commented that securing these contracts was the “demise” of the yard and that the events at the shipyard since the contracts were awarded to Ferguson Marine had led to the spirit of the yard being “broken” and that it had “destroyed our shipyard”.

The Committee heard that certain decisions taken by FMEL contributed to the significant increase in costs to construct the vessels. For example, purchasing a machine at £380k that was not fit-for-purpose. As there was no service contract for this machine, (which would have ensured it was subject to regular maintenance), staff had to wait for it to break down completely before it got fixed. It was explained that the machine would break down regularly, so production levels were often down at the yard while staff waited for the machine to be repaired.

Concerns were also raised about the protection of the vessels during their construction, explaining that they were never painted to protect them from rust. This was something staff were used to doing for previous vessels approximately every six-months.

The Committee also heard that a decision had been taken by FMEL to stop using a particular machine that was well used by staff. Despite staff challenging this decision, this machine stopped being used and was left out in adverse weather conditions. It was indicated that there had been plans to scrap the machine until management realised how useful it actually was.

The Committee was also told about the perceived level of wastage at the yard, with items left unidentified and/or sent to scrap. It was commented that staff “could see the money getting wasted”. On one occasion, it was explained that an item of scrap worth approximately £5k which belonged to Caledonian Maritime Assets Limited had been identified. This was later removed from scrapping and made use of.

It was indicated that the level of scrappage was “non-stop”. Concerns were also raised about the lack of local scrappage companies being used and questioned why this was the case.

Further concerns were raised about the level of work that was subcontracted to other companies. For example, much of the pipework was subcontracted as well as the burning of aluminium which was indicated to be an expensive task that could have been done at the shipyard.

The Committee also heard that a significant proportion of overseas workers were employed by FMEL via an agency. These workers were required to start earlier in the morning than existing staff. This meant that all the jobs and equipment for the day were usually taken by the time existing staff arrived for work. It was explained that existing platers and welders were placed in a smaller part of the yard from the agency workers and felt that they needed to “invent a job for ourselves”.

It was explained that while the former director of FMEL re-employed all existing staff, it became apparent that a significant number of managers were employed by FMEL, additional to what the previous owners had in place, and were paid very high wages.

It was also indicated that more senior staff were motivated by bonus payments and work on the yard was often prioritised to secure these payments. For example, it was explained that on one occasion, a funnel was built without any pipes, allowing some managers to receive a bonus, however, the work later had to be redone.

Regarding the relationship between the shipyard and CMAL, it was explained that many CMAL inspectors had previously worked for Ferguson Marine and therefore, there had been a long history of a supportive culture that existed between the yard and CMAL.

The Committee heard that quite early into the contract to deliver vessels 801 and 802, staff were told not to talk to the inspectors, which staff found very hard to do given the long-standing relationships they had developed with CMAL staff members, who were also former colleagues.

Experiences and reflections of working at the shipyard when the Scottish Government appointed Turnaround Director was responsible

A “culture of managers” was said to have continued when the turnaround director, Tim Hair was responsible for the yard, with lots of additional management staff being brought in by Mr Hair.

The Committee heard that one approach adopted was the use of a “weekend warrior allowance” to employ additional staff who “didn’t have the trade”. This approach often resulted in the existing workforce having to re-do sub-standard work.

It was explained that the Trade Union had communicated a vote of no confidence in the Board of Directors and the Senior Management Team to the Cabinet Secretary for Finance and the Economy towards the end of 2021 and that there was regret that this had not been done sooner.

Experiences and reflections of working at FMPG under current arrangements

Reflecting on the more recent changes at senior management level, the new Chief Executive, David Tydeman, was said to listen to staff concerns and “talks sense”. It was explained that the new Chief Executive had “parked his ego at the gate”, unlike previous senior management staff.

The Committee asked about the high level of owner observation reports referenced in the Auditor General for Scotland’s report.

A level of frustration was expressed about the number of units that had been completed for the vessels. For example, the Committee heard that the construction of MV Hebrides took 22 months to complete. In this same time period, only two units for vessel 802 had been constructed.

It was also explained that there is a recognition now that if CMAL ask for something to be fixed, it is fixed. There was also a recognition that both CMAL and FMPG are now part of the public sector, and therefore share the same objectives.

The Committee heard that there is always something in the news about Ferguson Marine being a “failed shipyard”. It was explained that vessel 801 is a “constant source of embarrassment” and that staff don’t tell people that they work for Ferguson Marine.

Concerns were raised about the possibility of further delays with the delivery of vessel 801. For example, some items that have been purchased for the vessels have been lying around the yard for a considerable amount of time and may therefore be out of warranty.

Concerns were also expressed that there remains a risk that the vessels may not be considered fit for purpose once they are completed. The importance of senior managers

facing up to these risks was highlighted during the meeting.

Future work for the shipyard

It was explained that the absence of an in-house design team meant that FMPG would not have the capacity to build two new ferries, the procurement process for which commenced in October 2022. Staff indicated that the shipyard had a key role to play in the small vessels programme, which is around one year down the line.

Staff explained that one positive legacy left by FMEL was the recruitment of apprentices. The challenge is retaining the workforce once the apprenticeship has ended, as other companies are often able to offer more money to staff than FMPG is able to.

It was stated that Mr Tydeman is the first senior manager of the yard to talk about the possibility of the shipyard turning a profit.

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