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Director-General Economy
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By email [REDACTED]

25 June 2019

Dear [REDACTED]

Thank you for taking the time to meet with our respective teams yesterday to discuss CBC's proposal aimed at resolving ongoing issues with Fergusons in light of the independent view of FMEL's claim against CMAL. The discussions took place in the context of meeting Ministers stated aims of completion of 801 and 802, securing employment of the workforce and sustaining the future of the site.

We refer to your proposal of 24 June (**Proposal**) which, as indicated, we will consider alongside continuing to look at all available options in the circumstances.

However, as we explained yesterday, for several months we have been giving detailed thought to options for an appropriate and acceptable way forward, including from the standpoint of State Aid and procurement compliance.

It is worth noting that CBC outlined two possible scenarios in the meeting yesterday, one where CMAL amend the contract by less than 50% in reliance on unforeseen circumstances and another (where the first is not possible) where SG invests £48m of equity in a nationalised FMEL.

For completeness this response addresses these alternatives, as you outlined at the meeting yesterday.

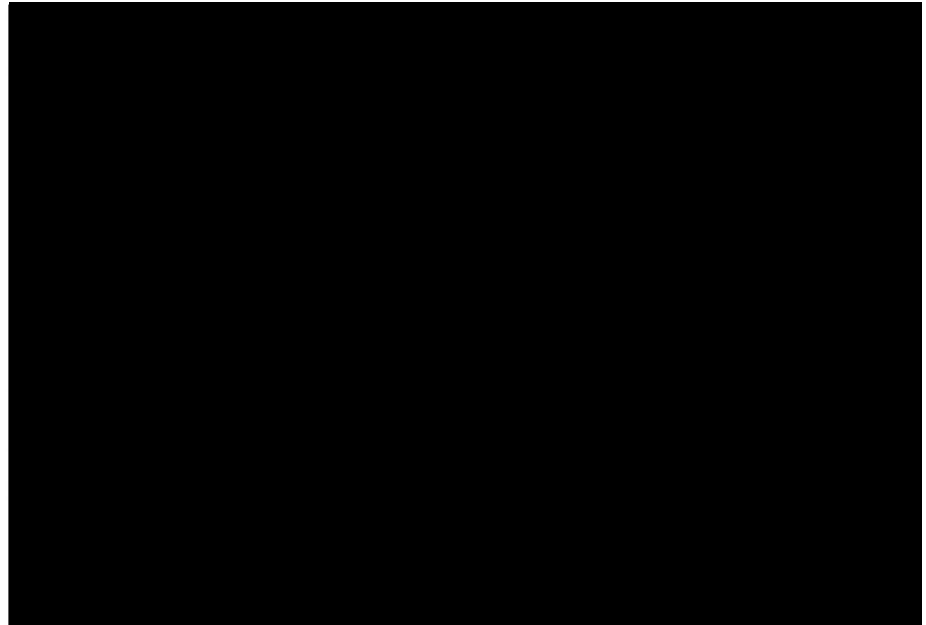
As discussed, we thought it would be useful to share these with you now, so that you can consider how your proposal addresses these points. We have set this out in significant detail, reflecting the scope of the challenges arising from our consideration and previous detailed analysis we have undertaken on similar options.

Current Context

We note the position that you outlined in your presentation to us yesterday, along with points 1 to 4 in the opening sections of your written Proposal. However, whilst we acknowledge that this may be the CBC view of how we reached the current situation, it is important to clarify that the Scottish Government does not agree. Neither do we agree with your assessment that neither party could have reasonably known the costs at the outset of the contract – particularly given the fixed price nature of this and the fact that the contract was awarded following a competitive procurement process where comparable bids were also considered. For completeness, it is also worth highlighting that PWC prepared their analysis of the costs incurred to support the loans based on the information provided by FMEL and CBC. This was never intended to represent an independent analysis of quantum.

In addition there are two key elements of current context to be aware of in considering the Proposal, as follows.

1. MEOP - Right to Purchase Holdings



2. Independent View



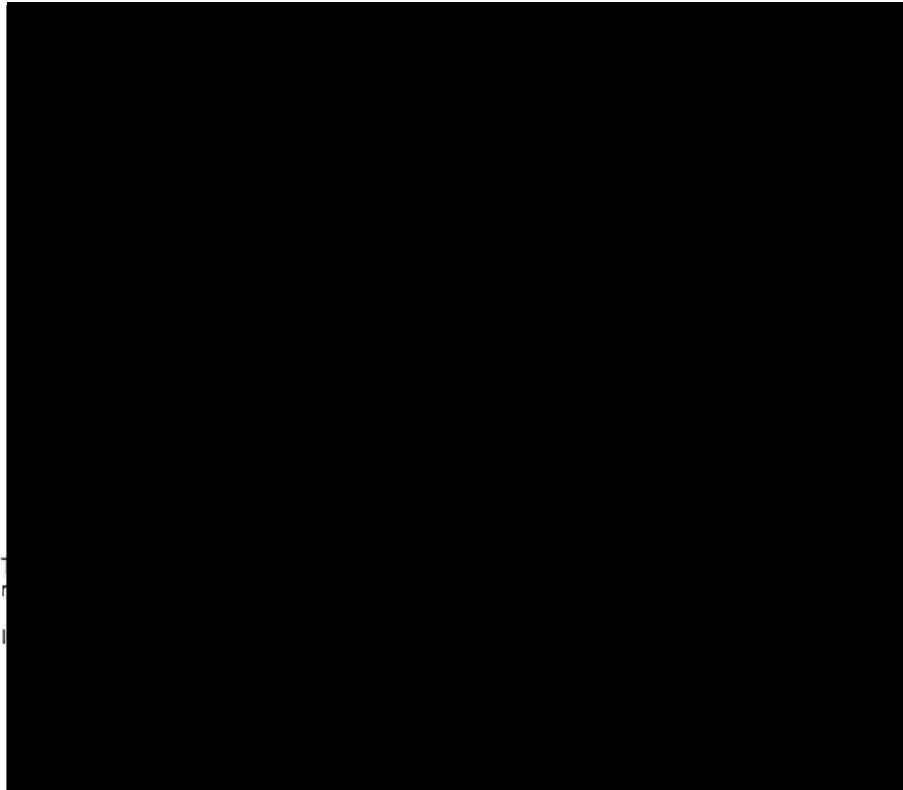
The Proposal

For clarity, we note these elements of the Proposals:

Stage One

1. Holdings would set up a Newco, Ferguson Marine Engineering Technology Company Limited (**Newco**).
2. FMEL transfers all of its assets and liabilities (other than the contracts for 801 and 802) to Newco. FMEL's business is limited to delivery of the Vessels i.e. it becomes '801/2 FMEL' (**801/2 FMEL**).
3. Newco would hold all FMEL's business assets such as trading contracts and tendering opportunities, staff, plant, equipment and supplies, and
4. With the consent of CMAL, 801/2 FMEL would enter into a subcontract with Newco to complete the Vessels at a fixed price of £63.2m. This amount comprises £48m as an agreed/settled cost for completion of the Vessels, plus £15.2m of payments you indicate still are due under the original contracts. These amounts would need to be verified.

Stage Two



In addition, in the Proposal you also indicate:

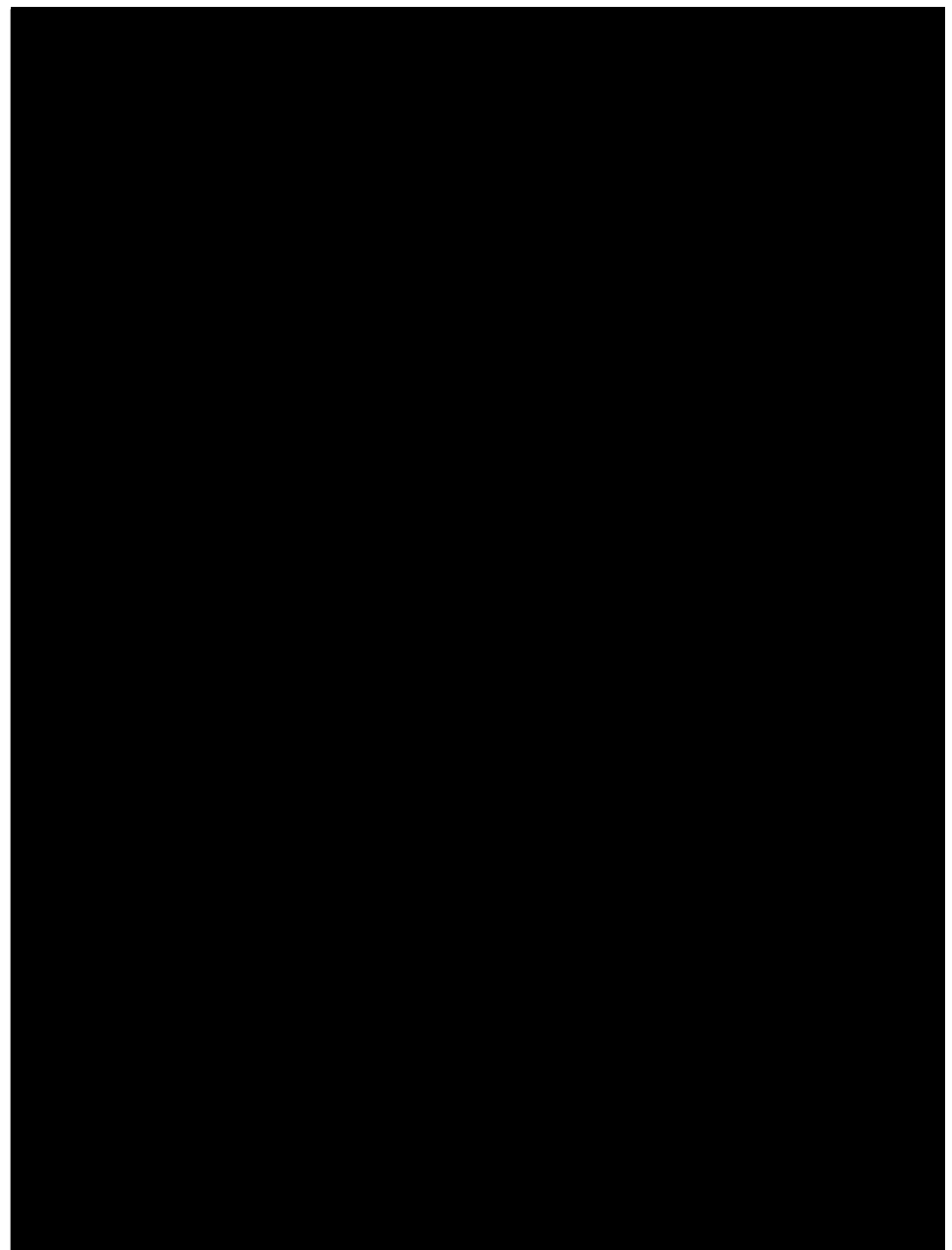
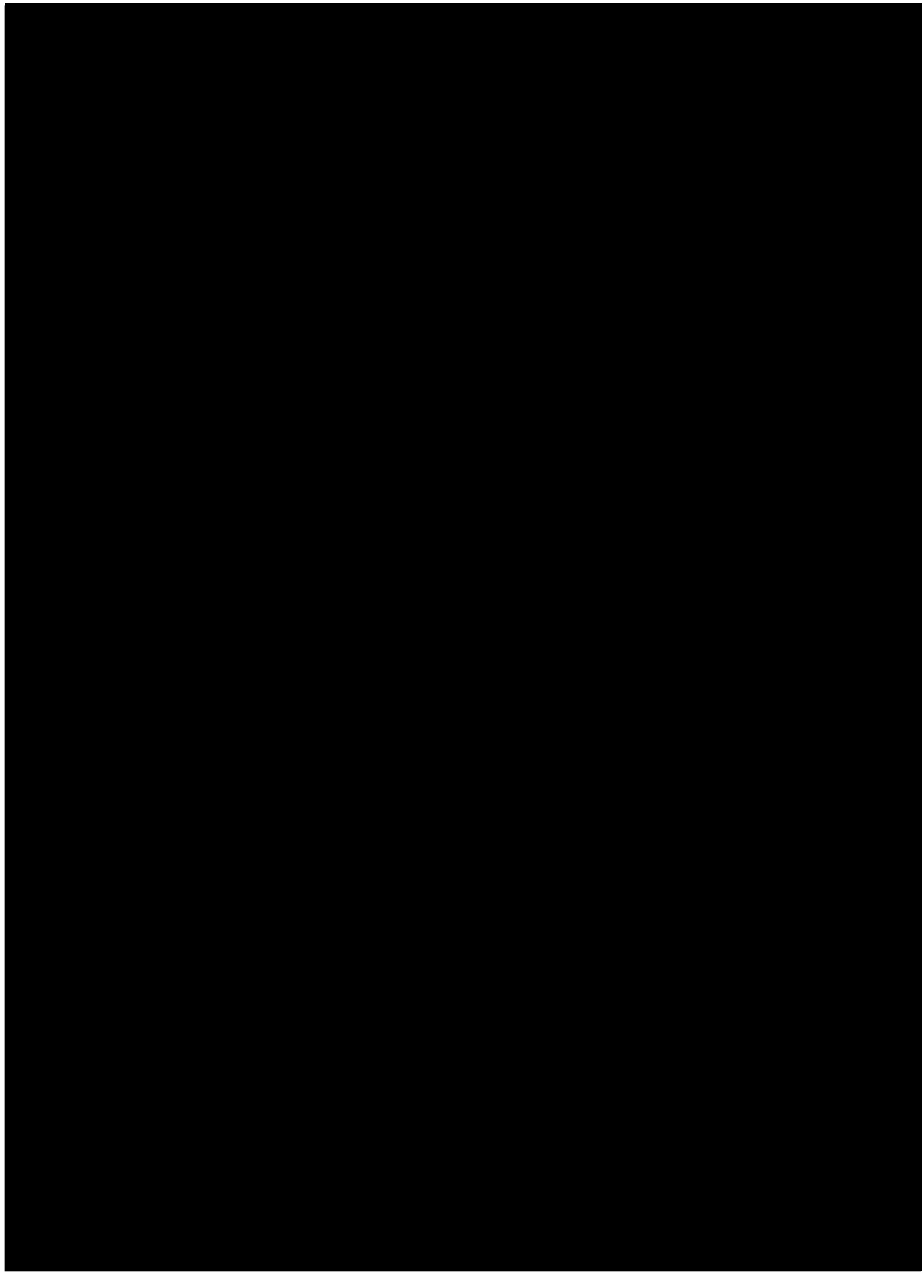
"It provides the best possible chance of recovery of the £30m loan. Without the involvement of CBC and the current senior management team, which would not continue in the event that SG took 100% ownership in FMEL, SG as owner and operator of the business is unlikely to be able to exploit the current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

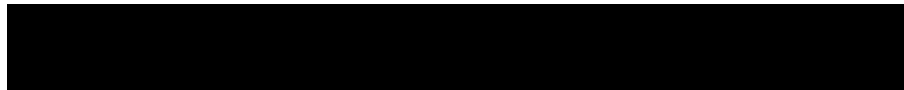
It would not be straightforward for Scottish Ministers to accept this justification for the Proposal, in the absence of evidence that there would be greater risks of non-repayment as you suggest.

Initial Structural Questions

At this stage we see serious structural difficulties with the Proposal. We do not believe that all of the following concerns could be addressed adequately, but we would invite you to consider and confirm that you would agree with our understanding.







We realise in light of the comments above you may want to provide further detail or clarification in response. We will give prioritisation to considering these further as soon as they are received.

Given the timescales, it is imperative that we receive a response as soon as possible - ideally by close of business tomorrow 26th June. Once we have had an opportunity to consider any responses that you may provide, it may be useful to hold a further meeting. We will be in touch in due course to make the necessary arrangements, should such a meeting be necessary.

Yours sincerely



LIZ DITCHBURN