



Law Society
of Scotland

Written Evidence

Inquiry into construction and procurement of ferry
vessels in Scotland

February 2020



Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

Our Competition Law and Marine Law sub-committees welcome the opportunity to consider and respond to the Scottish Parliament Rural Economy and Connectivity Committee's *Inquiry into construction and procurement of ferry vessels in Scotland*¹. We have the following comments to put forward for consideration.

General Comments

Ferry contracts in Scotland

There are 2 main ferry contracts in Scotland: the Clyde & Hebrides and the Northern Isles.

Originally, ferry services in the Clyde & Hebrides were operated by the Caledonian Steam Packet Company and David MacBrayne. In 1973 these merged to form Caledonian MacBrayne Limited, a public corporation wholly owned by the Scottish Ministers.

In 2007, in order to comply with EU rules around maritime cabotage, Scottish Ministers created two new organisations and split the responsibilities of Caledonian MacBrayne Limited between them. Both of these organisations are wholly owned by Scottish Ministers:

- David MacBrayne Limited, a holding company which wholly owns CalMac Ferries Limited (CalMac). CalMac is the entity which bids for and operates ferry services; and
- Caledonian Maritime Assets Ltd. (CMAL), which owns the vessels used for the Clyde & Hebrides ferry services as well as most of the associated harbour infrastructure.

¹ <https://www.parliament.scot/parliamentarybusiness/CurrentCommittees/113986.aspx>

The Gourock – Dunoon route now forms part of the Clyde & Hebrides network and is operated by Calmac. Prior to 2019 (when it transferred to CalMac) it was operated under a separate contract by Argyll Ferries Limited, a subsidiary of David MacBrayne Limited which was created in 2011 to bid for this contract.

The Northern Isles ferry services were operated by Serco Northlink Ferries in the period from 2014 – 2019. A fresh public procurement for these services was completed in 2019 which resulted in Serco Northlink Ferries being announced as the successful bidder. CalMac has subsequently raised a procurement challenge in respect of this.

Vessel procurement

CMAL, being the party responsible for the provision of vessels for the Scottish ferries networks, has since its creation entered into various contracts with shipyards throughout Europe. Most recently, CMAL has placed several shipbuilding contracts with Ferguson Marine Engineering Ltd including those for the MV Glen Sannox and vessel currently known as Hull 802.

Background

CalMac is a public undertaking “*entrusted with [a] service of general economic interest and [which] receives public service compensation...in relation to that service*”. Both CMAL and CalMac fall under The Financial Transparency (EC Directive) Regulations 2009² which now implement Directive 2006/111/EC on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings³. This codified and replaced earlier Directives.

Ferguson Marine Engineering Ltd⁴ is in administration (FMEL) (privately owned, see Ferguson Marine Engineering (Holdings) Ltd, Clyde Blowers Capital Fund III LP, Hammonia Fund SICAV Hammonia Private Asset Fund).

Ferguson Marine (Port Glasgow) Ltd⁵ (FMPG), incorporated as Macrocom 1067 Ltd (and referred to by that earlier name in the Committee Report), is owned by Scottish Ministers to whom a standard security over Newark Works, but no floating charge, is granted.

We note that issues relative to the procurement of maritime cabotage services are set out in the *Scottish Government Ferry Services Procurement Policy Review Interim Report - Emerging Findings 20 December 2017*⁶ (The Interim Policy Review). The Interim Policy Review was about obtaining the services of a maritime cabotage public service concessionaire. The Interim Policy Review was not about the status in procurement and state aid law of CMAL, the entity purchasing the vessels as a customer, nor was the review about the status in procurement and state aid law of CalMac.

² <http://www.legislation.gov.uk/ukxi/2009/2331/contents>

³ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32006L0111>.

⁴ Company Number SC485060

⁵ Company number SC638457

⁶ https://www.transport.gov.scot/media/41273/ferry-services-procurement-interim-report_2nd-go.pdf

It should also be noted that because CMAL is a company wholly-owned by The Scottish Ministers, any funds or benefit that it might make available to another party are “*through state resources*” are capable in principle of amounting to state aid to the recipient.

As a general point of state aid law, it should be noted that any unlawfully-provided state aid must be clawed back and that the clawback payment obligation transmits to a successor company unless the original recipient is not merely insolvent but actually undergoes an insolvency process that results in the realisation of its assets at fair market value.

Questions

1. What are your views on the conclusions and recommendations of the programme review board with respect to delivering the most effective delivery programme for the completion of the two vessels, MV Glen Sannox (vessel 801) and vessel 802?

The ‘known knowns’ relate to the actual state of partially completed vessels and of the current state of the designs.

The ‘known unknowns’ include:

- whether, by when, and at what cost it will be possible to be in possession of full finalised designs on which to base a specification (see answer to question 4),
- whether, by when, and at what cost the necessary specification can be drawn up and embodied in a form of contract,
- whether, by when, and at what vessels can be completed conform to the necessary specification,
- the value, on a willing seller, willing buyer basis of:
 - the designs in their current state,
 - the vessels in their current state at their current locations,
 - the undertaking of FMEL, and
 - the other assets of FMEL (including whether any of the assets might possibly have a negative value and if so, how that might affect a state aids analysis).

New ‘unknown unknowns’ may become known as time passes.

In the circumstances, policymakers may wish to consider, among other things:

- whether constant redesign might result in the delivery of a vessel that would be the engineering equivalent of a legacy IT system kept in service by frequent patches,
- whether the “sunk cost fallacy” may be of relevance, and
- the implications (including the legal implications) of starting again from scratch.

2. What has been the impact of the repeated delays to completion of the contract to construct two hybrid ferries on the specific routes and island communities awaiting delivery and entry into service of these two vessels?

We have no comment on this question.

3. What actions can be taken, in particular with respect to improved contract management processes, to ensure future contracts of this type are delivered a) on time; and b) on budget?

We consider that any future contracts (or, as the case may be, interdepartmental financial memoranda) should be consistent with our answer to question 4. The way in which a contract is intended to be managed should be taken into account at the stage of preparation of a preliminary or pre-qualification questionnaire and drafting the financial memorandum or contract.

We recognise that if CMAL and FMEL had been fully arms-length commercial entities, the pre-contract-award negotiations and the arising disputes may have been handled differently. For example, it is likely that there would have been a full Refund Guarantee in place from a third-party lender to protect CMAL's financial position and this could have been relied upon to ensure (or compel) prompt performance of the yard's obligations.

4. What key challenges need to be addressed in procuring new vessels to support Scotland's ferry network and how might these be overcome?

Apart from procurement and state aid issues, the main element of an answer to this question is that the following should be part of the process:

- a clear outline design brief,
- a contract and process for customer and designer to collaborate on the development of detailed integrated designs for the entire project,
- a specification embodying the finalised designs,
- a contract and process for building a vessel to the specification,
- a system for continuous monitoring of progress,
- a clear basis for identifying and authorising "changes" and any consequent additional payments, and
- a clear process for testing and checking the conformity to specification of the delivered vessel.

A contract needs to make it possible for a customer to say: 'this is what you promised, and these are the consequences of failure to deliver in full and on time.'

The Scottish Government's wider obligations should be borne in mind, albeit these may be seen as applying at a stage earlier than procurement – for example, obligations in relation to climate change and biodiversity, and those arising under the Islands (Scotland) Act 2018. It is important that the focus is not only on financial and commercial matters but takes full account of other relevant considerations.

5. How might the experience of the procurement and fulfilment of the current hybrid ferries contract inform the development of an updated Ferries Plan?

Regarding procurement (apart from the dimension of procurement law and state aid), the issues addressed in the answer to question 4 should be taken into account. The lessons from the experience of fulfilment can only be considered if and after fulfilment occurs.

6. What are the likely implications of the Scottish Government’s decision to take Ferguson Marine Engineering Ltd. into public ownership for the fulfilment of the current contract and the award of future contracts for the construction of new ferries?

As a company under Scottish Ministers’ ownership, FMEL will:

- be subject to the accounting disciplines of The Financial Transparency (EC Directive) Regulations 2009,
- be under scrutiny to see that it is not a recipient of unlawful state aid,
- be under scrutiny to see that it is not a donor of unlawful state aid, and
- itself be a “contracting authority”.

Procurement law would be relevant to the obtaining by CMAL of a vessel as though CMAL were a “contracting authority”⁷. If a vessel is to be procured this would mean that FMEL would need to obtain any future contract by winning in a procurement competition and that any amendments to the specification following procurement would be subject to the rules in procurement law about the limited situations in which changes can be made without starting a fresh procurement process.

Stakeholders should be mindful of the tensions inherent in a situation where one government-owned entity is procuring shipbuilding works, and there exists another government-owned entity, a public undertaking, which has specifically been acquired to maintain the tradition of Scottish shipbuilding. Robust governance and clear separation of roles would be required to ensure compliance with procurement law by all concerned.

The feasibility and risks of any scheme could only be assessed after appropriate legal advice and consultation, as well as consideration of taxation and other matters.

⁷ See C-567/15 *UAB LitSpecMet v UAB Vilniaus*

7. What impact is the United Kingdom's departure from the European Union likely to have on the future award of new ferry construction contracts, in particular as regards ongoing compliance with applicable rules on state aid and competitive tendering?

The EU is likely in trade negotiations to seek the continuation in the UK of substantially similar rules on state aid and competitive tendering with an alteration in emphasis from “*trade between member states*” to trade between the UK and EU. It should be kept in mind that much of EU law is the EU's collective uniform embodiment and enhancement of obligations that exist in some form in public international law anyway, through organisations such as the World Trade Organization, The World Intellectual Property Organization, The Organisation for Economic Co-operation and Development, the United Nations Economic Commission for Europe, the Council of Europe and others. The World Trade Organization's rules on Government procurement are in the Revised Agreement on Government Procurement⁸ and the rules on state subsidies are in the Agreement on Subsidies and Countervailing Measures.⁹

As the UK is already a member of the WTO in its own right, it will remain bound by its WTO obligations as a matter of public international law. However, there may be scope to implement those obligations in a different way, outside the EU framework. At the same time, if and to the extent that future UK divergence from EU norms might be compatible with a future UK/EU Agreement, it does not follow that such divergence will necessarily occur, bearing in mind possible consequences for UK trade of dramatic divergence.

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⁸ See https://www.wto.org/english/tratop_e/qproc_e/memobs_e.htm

⁹ See https://www.wto.org/english/tratop_e/scm_e/subs_e.htm