



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Public Audit Committee

**Thursday 26 May 2022**

**Session 6**



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**PUBLIC AUDIT COMMITTEE**  
**16<sup>th</sup> Meeting 2022, Session 6**

**CONVENER**

\*Richard Leonard (Central Scotland) (Lab)

**DEPUTY CONVENER**

\*Sharon Dowey (South Scotland) (Con)

**COMMITTEE MEMBERS**

\*Colin Beattie (Midlothian North and Musselburgh) (SNP)

\*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)

\*Craig Hoy (South Scotland) (Con)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Roy Brannen (Scottish Government)

Hugh Gillies (Transport Scotland)

Fran Pacitti (Transport Scotland)

Dermot Rhatigan (Scottish Government)

Mo Rooney (Scottish Government)

**CLERK TO THE COMMITTEE**

Lynn Russell

**LOCATION**

The James Clerk Maxwell Room (CR4)



**Scottish Parliament**  
**Public Audit Committee**

*Thursday 26 May 2022*

*[The Convener opened the meeting at 09:00]*

**Decision on Taking Business in Private**

**The Convener (Richard Leonard):** Good morning. I welcome everyone to the 16th meeting of the Public Audit Committee in 2022. The first item of business is for members of the committee to consider whether to take agenda items 3, 4 and 5 in private. Do members agree to take those items in private?

**Members** *indicated agreement.*

**Section 23 Report:**  
**“New vessels for the Clyde and Hebrides: Arrangements to deliver vessels 801 and 802”**

09:00

**The Convener:** The principal item of business on our agenda is to take evidence from representatives of the civil service in the Scottish Government about the procurement and arrangements for the delivery of vessels 801 and 802, which have been the subject of a detailed section 23 report by the Auditor General for Scotland.

I welcome our witnesses this morning. I begin by welcoming Mo Rooney, who joins us online. Mo is deputy director for strategic commercial interventions at the Scottish Government. If you wish to come in, Mo, please indicate using the chat function, and we will do our best to bring you in. You may also be delegated responsibility by other members of the panel to answer questions.

I also welcome Roy Brannen, the interim director general net zero at the Scottish Government; and Colin Cook, the director of economic development. We are also joined by Dermot Rhatigan, the deputy director for manufacturing and industries at the Scottish Government; Hugh Gillies, interim chief executive of Transport Scotland; Fran Pacitti, Transport Scotland’s director of aviation, maritime, freight and canals; and Chris Wilcock, head of the ferries unit at Transport Scotland. You are all welcome.

To begin with, I ask Roy Brannen to give us an opening statement. Members of the committee will then wish to put some questions to you.

**Roy Brannen (Scottish Government):** Good morning, convener and committee members. Thank you for the invitation to provide evidence this morning. I recognise that the decisions around vessels 801 and 802 and the Scottish Government’s support for Ferguson’s are areas of significant interest. My colleagues and I welcome the opportunity to support the committee by answering any questions that you may have.

As is clear from the scope and the detail in the Auditor General’s report, the issues here are complex and cover a period of several years. I begin by recording my thanks to staff at Audit Scotland for the very measured and professional way in which they engaged in the preparation of their report, and I acknowledge the significant effort of my colleagues across Transport Scotland and the Scottish Government in seeking to engage openly and constructively throughout Audit Scotland’s work.

We are here in number today, and that reflects the range of issues that are addressed in the Audit Scotland report and our desire to ensure that you have access to the right people and the information that you need. It goes without saying that people have moved on in their careers since the project began in 2014. Some have gone to other roles in the Government, and some have left the Government entirely. We have brought witnesses to the inquiry with the best knowledge of events, either through their direct experience in current or previous roles or, where that has not been possible, through an understanding of issues in their current roles.

We were in touch with your clerks in advance of this evidence session to map out our respective areas of involvement. Alongside me today I have Colin Cook, Mo Rooney and Dermot Rhatigan from the directorate general for economy, who will be able to speak to issues around nationalisation of the yard, on-going progress with the vessels and loan funding to Ferguson Marine Engineering Ltd. I, along with Hugh Gillies, Fran Pacitti and Chris Wilcock from Transport Scotland, will be able to cover the other matters relating to initial delivery of the vessels and to contract issues. I will try to direct questions across the panel of witnesses accordingly.

We have accepted all of the recommendations in the Audit Scotland report, and we of course accept that the outcome in relation to vessels 801 and 802 is not that for which we had hoped at the point of contract award. We do not take that lightly.

This is still a live project, with much work to be done. However, as ever, we will endeavour to answer as many questions as we can to the best of our ability.

**The Convener:** I begin by putting a question to Roy Brannen and Hugh Gillies, but I will take you first, Mr Brannen. You mentioned current and previous roles. You have both held the post of designated accountable officer for Transport Scotland, so can you outline what is required in that role in providing formal advice to ministers and recording decisions, particularly where significant concerns or risks are involved?

**Roy Brannen:** I took up the role as designated accountable officer of Transport Scotland as chief executive officer in November 2015. It is fair to say that, as it is an executive agency, there is a well-defined structure of accountability in Transport Scotland. The Scottish public finance manual and the Public Finance and Accountability (Scotland) Act 2000 set out what that responsibility is for an accountable officer. First and foremost, it is signing the accounts for expenditure and income; secondly, it is overseeing the regulatory and proprietary issues of the finance that is at your disposal; and thirdly, it is using resources as

economically, effectively and efficiently as possible in undertaking all the work of the agency. The agency's work encompasses policy, operations and delivery.

In relation to how we engage with ministers on that, ministers set strategic direction, policy and the budget, and the job of the CEO and the accountable officer is to set the governance structure and internal arrangements in the organisation to deliver on ministers' wishes, and that is how we go about our business.

We have an investment decision committee that is chaired by the chief executive of Transport Scotland. That committee looks at the business cases for investments prior to that decision going forward to ministers. 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. I will pause there, because that was a long answer.

**The Convener:** Hugh Gillies, do you want to add anything to that?

**Hugh Gillies (Transport Scotland):** I came into post in November last year and, as Roy Brannen set out, I inherited the responsibilities of Transport Scotland accountable officer and all the responsibilities that go with that in relation to the SPFM and the civil service code. One of the first things that came across my desk, as Roy intimated, was an IDM in relation to the Islay ferries contract. I was very much aware of the history of vessels 801 and 802, so one of the first things that I did when that IDM paper came across my desk was to turn to Fran Pacitti, my director of aviation, maritime, freight and canals, and Chris Wilcock, my head of ferries. I had discussions with Fran and Chris going into the IDM process for the Islay ferries to make sure that all the requirements, propriety, value for money and so on were included in the process. We can talk about that at length later, if you wish.

**The Convener:** I will take you back to some evidence that we heard from the Auditor General about correspondence on 8 and 9 October 2015 that took place between your predecessor as chief executive of Transport Scotland and Government ministers. An email from Transport Scotland reflected Caledonian Maritime Assets Ltd's concerns about the award of the contract to Ferguson Marine Engineering Ltd. The board of CMAL went so far as to say:

"The Board feel it is their absolute duty to point out the risk to their shareholder and in that respect would expect approval, should SG wish this project to proceed, and to receive direction to that effect".

The next day, a reply was submitted to Erik Østergaard from the director of aviation, maritime, freight and canals—your predecessor, Fran Pacitti. Transport Scotland used the word “authorised” in relation to CMAL being able

“to enter into the Contracts and any associated documentation.”

At the bottom of that letter, it says:

“I confirm that the Scottish Ministers have considered and approved the contents of this letter.”

One of the issues that are at stake is whether written authority from ministers was sought and secured but not recorded or whether the correspondence does not constitute that at all. Mr Brannen, will you address that point?

**Roy Brannen:** I have reviewed the correspondence that has come forward. From what I can see, the director of aviation, maritime, freight and canals at that point presented all the evidence, risks and consideration to ministers in seeking the approval to allow CMAL to award the contract. I know that you have written to Mr Middleton to seek his view, but I do not know what consideration he made as the accountable officer of whether written authority was required.

I refer to the points that I made on the SPFM. The last part of the SPFM says that, if you are asked to do something that is not, in normal circumstances, related to the proper performance of your duties, you should seek written authority. In the case of the ferries contract, there was no need to do that. As the Auditor General said in his report, no authority was sought and no direction was given.

**The Convener:** Okay, but in light of the view of CMAL, which also reports directly to the ministerial team, why do you not think that it was asking for written authority?

**Roy Brannen:** I think that the first part of the sentence said that CMAL was looking for approval to award the contract. I do not know whether the language that it used was specific—it could have been clearer—but it was certainly looking for approval from ministers to award the contract. In the normal course of events, that would be the case. If we were investing in a major project, once it had passed our IDM processes, we would seek ministerial approval to continue with whatever the next stage of the process would be.

**The Convener:** Who would ministerial approval be sought from?

**Roy Brannen:** It would depend on the issue at hand. If it was a transport project, it would be the transport minister. If it was entirely within their portfolio, it would be a decision entirely for the minister. If it was a wider issue, such as bringing ScotRail into public ownership, it might be

considered to need wider approval than from a single minister because it would need a wider-Scotland approach.

**The Convener:** When you say that it is a decision entirely for the minister, the finance secretary does not have a role in that.

**Roy Brannen:** No. 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.

**The Convener:** Would it not go to a Cabinet meeting, for example?

**Roy Brannen:** No, not necessarily. 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.

**The Convener:** Even though the First Minister had been to the yard to announce that the contract had been awarded before the negotiations were concluded.

**Roy Brannen:** The contractor was announced as the preferred bidder not as the successful contractor. That is an important distinction. There is a period of time between preferred bidder announcement and contract signing. The contract was signed in, I think, the middle of October in the end.

**The Convener:** The First Minister stands up in Parliament and says that, in the end, she is responsible but she was not involved in the decision. Is that what you are saying?

**Roy Brannen:** That is correct. As the paper trail demonstrates, the decision was taken directly on the information provided by the director at the time up to the transport minister, who considered it and responded accordingly.

The First Minister has said in Parliament that ministers have collective responsibility for all decisions. That is correct. If the decision is taken by the transport minister, everybody is collectively locked into it.

09:15

**The Convener:** You mentioned paper trails. One of the big concerns that are expressed in the Auditor General's report is about the lack of paper trails—the lack of paperwork—to cover the implications of the decision to award the contract under the circumstances that it was awarded under and the risks that that entailed. What is your reflection on that?

**Roy Brannen:** It was regrettable that we could not identify that exchange. It was covered in the exchange that Mr Nicolls put back to CMAL, but with further investigation by Fran Pacitti and the records team it turned up. It confirmed that the minister had indeed considered the evidence that had been put in front of him, made a decision and responded accordingly. Since 2015, more than 210 documents have been publicly available. Those cover a wide range of exchanges with cabinet secretaries and ministers on various issues as we went through the process of trying to get these vessels into the water and into the hands of the community.

I accept that, on that occasion, that one bit of paper was not easy to find, but we did find it. 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.

**The Convener:** I am sorry, Mr Brannen—I will come to the recent correspondence between the permanent secretary and the Finance and Public Administration Committee of this Parliament—but you just said that the piece of paper had been found. That is not the view of Audit Scotland, is it? Its view is that the piece of paper that was found and presented to Parliament a couple of weeks ago represented more information on who. Now, you have said that it was entirely the then minister for transport. That seemed to suggest that, actually, the then finance secretary was involved in the process. However, the piece of paper that was presented does not fill the gap identified by the Auditor General, which is that there is no substantial recording of the considerations of ministers and their response to the risks that were clearly identified by CMAL in presenting the contract to Ferguson Marine.

**Roy Brannen:** I do not accept that. On the information that was put forward by Transport Scotland, as referenced by the Auditor General in the report, we put forward the entire case of the risks associated with the contract award. The consideration of that is for the minister. How the minister chooses to respond to that is entirely up to him. In this case, I cannot remember the exact words, but he responded that he was content for the contract to be awarded. However, he had in

front of him everything that he needed to make that decision. On other occasions that we provide advice to ministers, they might ask further questions on a particular issue. In this case, as far as I can see from the paperwork, there was no exchange of that nature.

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. As I understand it, that is what the exchange between the chief financial officer, Gordon Wales, and the DFM was.

**The Convener:** Okay. You say that it is the responsibility of the minister, but it is the responsibility of the civil service to give the minister advice on issues around the value for money, propriety and regularity of the contract that is about to be entered into. Under some circumstances, if it is believed that the deal runs contrary to those values, it would be expected that written authority would need to be given.

**Roy Brannen:** That is correct. However, as I said, in this case, I suspect that, although you could argue that it could have been laid out differently, all the key considerations were included in the exchange that went up from the director. What you will no doubt wish to ask Mr Middleton is what consideration he gave, on the basis of that information, to whether it departed from the duties of the accountable officer. As I said, there is nothing in there that suggests to me that that was something that he considered to be required.

**The Convener:** We are limited for time, so I have just one other question before I bring in Willie Coffey. You alluded to the permanent secretary, who, in correspondence with the Finance and Public Administration Committee, recently said:

“there is no overarching statutory duty to record all decisions in a particular way”.

Do you consider that the lack of such a statutory duty contributed to the failure to record the important decision by the Scottish ministers on 9 October 2015 to award the contract?

**Roy Brannen:** No. There is no statutory duty, but there is a duty under the civil service code, in which there is a requirement for us as officers to use evidence in our deliberations and to record the advice that goes to ministers. In this case, as I have said, I believe that John Nicholls, the director, has done that. He recorded that exchange. Now that we have the bit of paper that explains that the minister accepted that, that is the totality of that exchange.

**The Convener:** We may well return to that.

**Willie Coffey (Kilmarnock and Irvine Valley) (SNP):** I have a supplementary question on the convener's line of questioning, Mr Brannen. Is the extent to which some parties are placing an emphasis on paper trails and the recording of decisions a fair reflection of how the Government works in practice? Are we dealing with the unmet expectations of some people or with failures to deliver on requirements? Which side of that line are we on? The issue has been a recurring one for the committee, and others, for some time.

**Roy Brannen:** If it would be helpful, you could see the exchange that occurred about the Islay vessels, for instance, which demonstrates the process of approvals being cleared through the IDM and ministers deliberating on the decisions. All investment is done in that way: with a paper trail, advice going up and recommendations that seek ministerial approval.

There are also good examples within the audit trail paperwork in relation to the latter part of 2019 that is available online, when Clyde Blowers Capital suggested a different approach to nationalisation. You will see in there a fairly detailed response from Liz Ditchburn, the director general at the time, and me, on the accountable officer considerations of that proposition. It clearly sets out that, in terms of propriety, regulatory requirements and value for money, the recommendation could not be taken forward.

There is therefore good evidence that decisions are recorded properly by the civil service. Admittedly, it could be argued that, in this case, that could have been demonstrated differently, but all the right evidence was there. Everything that was in front of Mr Nicholls was presented to the minister for his consideration.

**The Convener:** In your opening remarks, you said that you accept in full all the recommendations of the Audit Scotland report. However, you do not seem to accept the recommendation that says that there was a huge gap in the supporting paperwork—which required to be logged—that lay behind the decision to award the contract to FMEL.

**Roy Brannen:** I would need to check what that recommendation was, but I think that it would have been made on the basis that that concluding piece of information was not available at that time. Subsequent to the production of the report, that piece of information is available.

**The Convener:** Maybe it was more a conclusion than a recommendation.

**Sharon Dowey (South Scotland) (Con):** Good morning. I have some supplementary questions based on those that the convener has asked.

Under the Public Records (Scotland) Act 2011, records must be kept, and someone is responsible for that. Why was that not complied with? The biggest issue seems to be the fact that we do not have enough records to show the decisions that were made.

**Roy Brannen:** As I said—I am repeating myself—the record is there, has been kept and is public.

**Sharon Dowey:** Right.

In an evidence session that we had with the Auditor General for Scotland, he confirmed that

“In the absence of formal written authority under the terms of the Scottish public finance manual in Scotland ... If an accountable officer does not request such written authority, the accountability for the decision rests with the accountable officer.”—[*Official Report, Public Audit Committee*, 28 April 2022; c 28-29.]

Why would the accountable officer not have obtained that, and why would it not have been stored safely? My question is due to the number of issues that have been raised throughout.

**Roy Brannen:** I come back to what I said originally about the SPFM and the Public Finance and Accountability (Scotland) Act 2000. The SPFM highlights three points that an AO has to consider: signing accounts for expenditure and income; proprietary and regulatory issues around finance; and the efficient, effective and economic use of finance. The next part says that if an accountable officer is asked to do something that he considers would not be part of the normal performance of the duties listed above, he should seek “written authority”.

All that I can say is that the accountable officer at the time, Mr Middleton, must have engaged in that consideration. It is entirely appropriate for individual accountable officers to consider whether to seek authority. In this case, no written authority was sought or given, as the Auditor General states in his report.

**Sharon Dowey:** How long was Mr Middleton in that role?

**Roy Brannen:** He left at the end of October and I took up post at the beginning of November. I think that David Middleton was in post for longer than me, heading towards seven years. I was there for six years, so I think that he was still the longest-serving CEO of TS.

**Sharon Dowey:** He was experienced in his role, then.

**Roy Brannen:** Yes.

**Sharon Dowey:** Was there a reason that he left? Was it for another job? What was the reason for his leaving so soon after the contract was signed?

**Roy Brannen:** He was moving on to become chief exec of Historic Environment Scotland, and subsequent to that he retired—he is of that age.

**Sharon Dowey:** He moved on to another Government position.

**Roy Brannen:** Correct.

**Sharon Dowey:** The accountabilities include ensuring that risks are managed effectively and that procurement guidelines are met, and the requirement to seek written authority from ministers if any action is inconsistent with proper performance of the accountable officer's functions.

You commented earlier that the job is to deliver on ministers' wishes. Why would somebody with seven years' experience not put all that into practice? Numerous concerns have been raised around the contracts. Why would somebody with that amount of experience not get written confirmation from a minister of the decisions that were made?

**Roy Brannen:** Again, I think that they did. John Nicholls, the director of aviation, put forward all the considerations in relation to the contract award and sought ministerial approval on the back of that. That is the paperwork that I have in front of me; I am reviewing the same paperwork that the committee has.

I have not spoken to John Nicholls or to Mr Middleton. I know that the committee has written to both, or at least one, of them to get written evidence. I am not sure that I can add anything further to that.

**Sharon Dowey:** I find it hard to believe that he did not get that confirmation.

In a letter to the Cabinet Secretary for Infrastructure, Investment and Cities dated 20 August 2015, various issues are raised. Ministerial approval was "sought by ... 27 August", which is just seven days after the letter was received, because the minister was on holiday. The letter states that the date had

"already been extended for 2 months"

—that was for signing the contracts.

Paragraph 8 states:

"CalMac will not be in a position to fully endorse the shipbuilding documentation by the required deadline"

and that

"further efforts will be undertaken during the detailed design of the vessel by FMEL to address any outstanding points."

It goes on to highlight issues concerning

"the access of the vessels to the various ports they may serve"

and the

"requirement for modifications at some ports."

It notes that the vessels are dual fuel, and that

"LNG brings some logistics challenges ... and may require some additional fuelling infrastructure."

A lot of issues, including infrastructure issues, were being raised, other than just the ferries. Why was there such a last-minute rush to get that signed off? It had already been extended by two months—the minister went on holiday, and it was then given to the cabinet secretary to sign off. Why was there such a last-minute rush? Was it because of the number of issues in the contract?

**Roy Brannen:** No—well, I will bring in Fran Pacitti here, but I do not think that there was a rush to sign it off. I think that CMAL, in negotiating with the bidder and trying to get to a point at which it could sign the contract, took a period of more than two months, from preferred bidder to contract award, to get those final issues resolved. I do not think that that was a rushed procedure by CMAL as the procuring authority, bearing in mind that Transport Scotland did not have a role in the contract—it was between CMAL as the buyer and FMEL as the builder. CMAL had to satisfy itself that it was able to enter into that contract and resolve whatever issues were apparent.

Is there anything that you would like to add, Fran?

**Fran Pacitti (Transport Scotland):** I do not think that there is anything to add to that, Roy.

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.

09:30

**Sharon Dowey:** Was there a communication issue, then? Referring to the minister who you are saying is responsible for signing off the project, you are saying that it would only have been Derek Mackay, who was the minister at the time. There would not have been any other involvement; he had the authority to sign it off. Would there not have been communication between him, Transport Scotland, CMAL and others to get the contract signed? Derek Mackay just goes on holiday, and the project is then passed to Keith Brown to sign off. You are saying that he would not have had

any knowledge of that in advance, as it would only have been Derek Mackay who was signing it off.

**Roy Brannen:** 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.

I was not party to those discussions or exchanges at the time, but I know that you have written to former colleagues to seek their evidence on that.

**The Convener:** Just for the record, we have not written to them yet. We have indicated that we are going to write to them, but the letters have not dropped through their letter boxes yet.

**Roy Brannen:** My apologies.

**The Convener:** That is fine.

I will now bring in Craig Hoy; I can come back to Sharon Dowey shortly.

**Craig Hoy (South Scotland) (Con):** I will start with a question for clarification, just to get it on the record. In your view, which minister took the final decision to proceed with the contract?

**Roy Brannen:** The minister for transport.

**Craig Hoy:** That would be Derek Mackay.

**Roy Brannen:** Correct.

**Craig Hoy:** He took the final decision.

**Roy Brannen:** Correct.

**Craig Hoy:** Which minister signed the contract?

**Roy Brannen:** The procuring authority was between CMAL, as the buyer, and FMEL, as the builder, so no minister signed the contract.

**Craig Hoy:** Okay. No minister signed the contract. CMAL had significant concerns, and it raised them with ministers, then it signed the contract. Was CMAL overruled, or were its views ignored?

**Roy Brannen:** No. Its views were put entirely to the minister. The minister considered those views, responded accordingly to the officials who were engaged as the sponsor body of CMAL, and reported back to CMAL. As I understand it—and I know that you will be speaking to CMAL—the CMAL board were comfortable with that and subsequently awarded the contract.

**Craig Hoy:** If I advise you not to do something in pretty strong terms and you then proceed to do it, I am either being ignored or overruled, am I not?

**Roy Brannen:** Are you referring to the letter from the chair at the end of September and to the subsequent exchanges that went to the minister? 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, CMAL was responded to, and the board accepted that and then signed the contract on 19 October, I think it was—or thereabouts, Fran?

**Fran Pacitti:** Thereabouts, yes.

**Craig Hoy:** I am looking at exhibit 1 in the Auditor General's report. In September 2015:

"CMAL advises Transport Scotland of the significant risks of awarding the contract to FMEL, and states its preference is to start the procurement process again".

In October:

"Transport Scotland advises CMAL that Scottish ministers are aware of the risks and are content for CMAL to award the contract to FMEL".

It is quite clear that either CMAL's wishes were ignored or they were overruled.

**Roy Brannen:** That comes back to my answer that the concerns that CMAL had raised were presented to ministers in totality, with the advice that had gone forward from the director. Ministers considered that advice and then responded accordingly to approve CMAL to award the contract, which it did.

**Craig Hoy:** Okay. We have clearly touched on who took the decision—although I still have real concerns about that—but we do not understand why. When are we going to get to the why, and what changed materially to allow CMAL to set aside all its very significant concerns—so much so that it wanted to reopen the procurement process? Where is the documentary evidence that the Auditor General requested to say why the final decision was taken? Significant concerns were raised in September 2015, but we do not know what changed between September and October. Surely, with all the research that you must have done for coming before us today, you must have a greater understanding of what changed.

**Roy Brannen:** Again, that comes back to the documentation that went from John Nicholls, director of aviation, to the minister. That contained all the considerations, including the mitigations that CMAL had managed to negotiate with the builder to make itself comfortable that it was able to award the contract.

If you read the exchanges, they explain that, at the initial stage, the no refund guarantee was too far adrift from where they needed to be. They also explain that, at the point at which the advice went up to ministers, CMAL had managed to negotiate a position where it had both a refund guarantee for 25 per cent and a final payment of 25 per cent. It had therefore reduced the risk, which was now, in its view, manageable.

Again, I am probably speaking on behalf of others who the committee is about to see, including CMAL, which will wish to present its own evidence on that. Nonetheless, from my reading of the paperwork, that is where it got to in terms of the ministerial decision.

**Craig Hoy:** You are absolutely certain that nobody was overruled and that there was no threat to overrule anyone.

**Roy Brannen:** No.

**Craig Hoy:** Completely certain.

**Roy Brannen:** Yes.

**Craig Hoy:** You can be certain about that, but you are not certain about what those discussions were, because you were not there.

**Roy Brannen:** I am certain on the basis of the information that was presented to the minister and what I have been able to review. The advice that Mr Nicholls put up to the minister included the exchange between the chairman of CMAL and John Nicholls in September; the further consideration of the CMAL executives on the negotiations of the contract; and the draft voted loan letter that was to go back out from officials to CMAL that clearly set out the risks. It was for the minister to consider all that evidence and opine on whether he was content to approve the award of the contract. That is what I have in front of me.

**Craig Hoy:** I will ask about the culture around the way in which Government works. Obviously, there are formal channels and then there are back channels. For example, when did you last speak to the First Minister?

**Roy Brannen:** When did I last speak to the First Minister? I cannot recall. Not any time recently. I suspect that it might have been—in fact, it was probably one month ago when she came out to speak to the executive team in an informal environment.

**Craig Hoy:** Did she discuss ferries?

**Roy Brannen:** No.

**Craig Hoy:** Nonetheless, you would accept the principle that when you have discussions with ministers, they can be minuted, but there can also be water cooler moments where discussions are had. Are you certain that everything that needed to

be recorded around that time, principally during those critical 24 hours in October, was recorded?

**Roy Brannen:** There is always regular dialogue with ministers, which I think is what Mr Hoy is alluding to. That is the case in relation to regular daily business. However, when it comes to important decisions, such as decisions on investment or policy, those discussions are recorded. That is the distinction. In this case, I have in front of me the paperwork trail that records that particular decision on the award.

**Craig Hoy:** The Auditor General does not think that that paper trail is sufficient.

**Roy Brannen:** Again, it depends on what the Auditor General feels should be the response that comes back from private offices and ministers. That can vary. A response that comes back on a particular issue can set out verbatim the recommendations on the advice that went up. That is, if policy officials put up a piece of advice that says, “We recommend that you do A, B, C and D”, on some occasions, private office will come back to say that the minister has considered the advice that has gone forward and reflect back those recommendations. On other occasions, the response can be as simple as one line that says, “The minister has fully considered the advice and is content.” On other occasions still, the response could say that the minister has further questions to ask in response to the advice and would welcome a meeting or further exchanges on it.

In this case, the response that came back was as documented in the information that the committee has.

**Craig Hoy:** You are saying that the Auditor General got it wrong.

**Roy Brannen:** I am not saying that he got it wrong; I am saying that that is my interpretation of the documentation that I have. The information that went forward was full and the response that came back was the minister’s own view—there is no set template on how the minister should come back. In that response, he opines that he has considered the information and is content for the contract to be awarded.

**Craig Hoy:** I want to come back in later, but I have one final question for now.

You mentioned the investment decision committee. Did it consider the ferries in 2015? If not, who did?

**Roy Brannen:** No. I will also bring Fran Pacitti and Hugh Gillies in here. At that point, the IDM was principally concerned with major investments and projects of the scale of the Queensferry crossing, for example. It did not look at port infrastructure, vessels or other investment across TS. That subsequently changed. As we moved

forward, those big decisions that involved smaller amounts of money but were still unique in their nature, came forward through the IDM process.

Therefore, such decisions go through formal business cases, different stages and gateway reviews and are then cleared by the IDM challenge session. At that point, the advice would go to the minister to say, "We have completed the IDM, we have the business case, we have the gateway review findings, and our recommendation is to do A, B or C."

**Fran Pacitti:** 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.

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. During my time in post, I have found it beneficial to take significant projects to the IDM to benefit from that challenge, to assist with the assurance process, and support the chief executive in their AO function.

**Hugh Gillies:** It is now my responsibility to chair those IDMs. I take the same view as Fran on their benefits, and to be fair, when Roy Brannen was chief executive, he did the same.

The IDMs are very much for the directors of Transport Scotland. They get the papers in advance and they are expected to read them thoroughly. If need be, we get a project team to come in and do a presentation. I then open up the discussion and invite every director to offer comment, and we reach a view.

Sometimes we send the project team away because we are not satisfied with its responses to some of the challenges. It is certainly not a tick-box exercise; I assure the committee of that. It can be quite uncomfortable for some directors, and they get quite heated and disappointed when they are sent away. However, the serious point is that the challenge function is there—and rightly so. My responsibilities under the SPFM and the civil service code are very much at the heart of that.

**Craig Hoy:** I have a final question for Mr Brannen. You said that you were aware that we had written out to future potential witnesses but that you had not spoken to Mr Middleton. How

were you aware that we had written out if you have not spoken to anybody?

**Roy Brannen:** I think that it was through the clerk. In fact, it was through social media. The committee tweeted out that it was going to seek evidence from Mr Middleton and other employees. That is where I saw that.

**The Convener:** I will bring in Willie Coffey, who has been itching to come in.

**Willie Coffey:** I have a supplementary to my colleague, Craig Hoy's, question.

Mr Brannen, you have heard the convener raising issues about the decision-making process and record keeping. You have also heard Craig Hoy highlighting proper consideration of risk, which is central to some of the issues that we are facing. In your view, were the issues that have been raised about those two areas sufficient to have invited the Government to reach a different decision about procurement of the vessels?

**Roy Brannen:** The singular piece of evidence to rely on—or, at least, to consider—is the written advice from the CMAL executive to Mr Nicholls and, subsequently, that from Mr Nicholls up to the minister. That talks about the management of risk in terms of the refund guarantee changing, the mitigations that were put in place, and the residual risk. I do not have the paperwork in front of me; however, from recollection, I think that it talks about a medium level of risk remaining in relation to delivery of the vessels.

The advice then goes on to explain a number of scenarios that might or might not happen—for example, that in the event of insolvency, the title to all the different parts is secured on behalf of the buyer. The advice lays out the level of risk that, in CMAL's mind, remained at that point, having negotiated a different set of outcomes with the builder.

09:45

**Willie Coffey:** Had the Government not proceeded with the procurement of the vessels, what would have been the impact and outcome?

**Roy Brannen:** If the procurement had not gone ahead, there would have had to be a retendering exercise and we would have had to start from scratch. That would have meant a delay to the introduction of the vessels to service, which would have had an impact on communities.

**The Convener:** Fran Pacitti made an extremely important point about the role of challenge in making decisions. The cost was going to be £97 million of public money. In the end, it has ended up being considerably more than that. The role of challenge in such decisions is primary. As the

Public Audit Committee of the Parliament, we would expect challenge.

Will you explain a bit more about the relationship that ought to exist between the portfolio accountable officer and the decision maker? Will you also explain whether there is a role in the process for the director general of finance? Is part of their role not to challenge investment decisions that are taken at portfolio level to see whether they pass the tests that are set out in the public finance manual?

**Roy Brannen:** The accountable officer for the executive agency is the chief executive. It is entirely right that they are the officer responsible for investment decisions and challenge function. The investment decision maker approach is a mechanism for ensuring that, before the advice goes up to ministers and decisions made, options are thoroughly tested in terms of value for money and whether they still address the policy outcomes that we seek.

As Hugh Gillies explained, previously and during my tenure, there were a number of occasions when particular initiatives were not developed enough or did not demonstrate that they would produce a positive benefit to cost ratio, so the teams were sent away to consider how best we could deliver the same policy outcome with a different option.

That kind of approach to major projects is the one that we are applying to all our infrastructure projects now, including ports and harbours and how they join up with vessel replacement. Some of the lessons that have come out have meant that Fran Pacitti and the team are now required to consider not only the vessel replacement but the port infrastructure that is required to support that vessel replacement, and to bring those two things together to the IDM in business-case format to ensure that proposals are thoroughly tested and challenged before CMAL is allowed to award contracts.

**The Convener:** For the avoidance of doubt, Fran Pacitti said that that did not happen in the case of vessels 801 and 802.

**Roy Brannen:** That is correct. Back in 2015—as a result, I suspect, of how the IDM approach was focused at the time—the approach principally related to our major projects, such as the £1.35 billion Queensferry crossing and the Aberdeen western peripheral route. The process was focused on large-scale substantial investment decisions. Smaller amounts of investment did not flow through it; unique projects flowed through it. For instance, a unique information technology project would have been expected to go through the IDM process. The approach has subsequently

changed to include a much wider range of investment.

**The Convener:** I am not sure that I got an answer to my question about the challenge function and the role of the director general of finance. “Transport Scotland Framework Document”, which was published in 2012—it was applicable at the time of awarding the contract—says clearly that one of the roles of the portfolio accountable officer within the directorate general is to challenge.

Roy, you are now the DG in the relevant department—albeit that it has changed its name—and, formerly, you were the chief executive of Transport Scotland. Do you not see that there should have been a role for the DG accountable officer to challenge? Was there such a role?

**Roy Brannen:** As I said, I cannot recollect the matter entirely, but I do not think that the DG had much of a role in challenging the investment decisions at that point. Those decisions were made directly between the chief executive officer and ministers.

In my current role, Hugh Gillies might raise with me an issue that has been through the IDM process, and I am copied in to all the various correspondence that goes up to ministers, so I will pick up from those exchanges what there is for me to be involved in, and decide whether I need to see more information about a particular issue—for example, bringing ScotRail into public ownership.

**The Convener:** However, from what we have heard this morning, the lines of challenge that we would expect to be in place for a contract of that size appear not to have been in place or to have operated or worked, and the framework document appears to be a piece of paper rather than a living document. It was a framework document that gathered dust, rather than leading to the correct challenges being made to those decisions.

**Roy Brannen:** I do not accept that. I suspect that David Middleton, as the accountable officer at that time, in his regular discussions with Graeme Dickson, who was the DG, would have been apprising him of all the work that was under way within TS at that time. As I said, the paperwork—whether it was on the ferries project, the Queensferry crossing or new trains—would have been seen by the DG as it went forward to cabinet secretaries and ministers for consideration. As well as the final decision, the gestation of policy up to implementation would have been exchanged between all the parties. If a particular issue had to be raised, it would have been entirely appropriate for the DG and the CEO to sit down and consider it.

**The Convener:** Our view is that the concerns that were raised by CMAL extend beyond the

description “a particular issue”. There were pretty comprehensive concerns about the risks involved in placing the orders.

For the third and final time, was there a role in that process for the director general of finance?

**Roy Brannen:** I do not believe so. Again, I point out that the DG of finance would not ordinarily have been involved in that. I guess that the chief financial officer would have been involved from a budget and financial perspective; you can clearly see from the exchange that he was. However, ordinarily, the DG of finance would have been satisfied with the support structures that the chief executive and the DG responsible for the portfolio put in place for management of resources and budget, and for effective delivery of the minister’s programme of works. That is the position.

**The Convener:** Okay. We do not know whether they were satisfied or not and, with hindsight of what happened to the project, we can speculate about whether “satisfied” comes anywhere close to it.

I invite Colin Beattie to come in with questions on his area of inquiry.

**Colin Beattie (Midlothian North and Musselburgh) (SNP):** Before I do so, I would like to get a small clarification from the witnesses. In connection with the builders refund guarantee, paragraph 21 of the Auditor General’s report says:

“During the negotiations, and contrary to what was included in its bid”.

As I understand it, it was mandatory that a builder’s refund guarantee be provided as part of the bid but, subsequently, FMEL came back and said that it could not provide that. The implication in the Auditor General’s report is that, in the original bid, FMEL had accepted that the BRG was mandatory, but that, subsequently, FMEL said that it could not fulfil that part of the bid. Elsewhere in the report, there is reference to the fact that, when FMEL completed its bid, it was silent on the subject of the BRG, so there was an assumption that FMEL had accepted that. Can you clarify that? Did FMEL actually accept the BRG or was it assumed, because FMEL did not challenge it, that it was accepted?

**Roy Brannen:** I will bring Fran Pacitti in. You might want to check that with reference to the committee’s evidence session with CMAL, but my understanding was that FMEL raised no issues in the tender process in relation to areas including a BRG. FMEL submitted its tender accordingly. By its nature, anybody that does that is accepting the terms and conditions of the tender, as described in the invitation to tender.

**Fran Pacitti:** That is correct. At the point of submitting bids, all parties that had been invited to

tender were invited to comment on the terms and conditions that were set out in the standard Baltic and International Maritime Council contract, which was clear on the requirement for guarantees. As I understand the matter, Ferguson’s did not make any comment in relation to that so, in line with the standard procurement process, it was assumed that, because of its failure to raise it at that point, Ferguson’s accepted that requirement.

**Colin Beattie:** Is that in line with other bids? Would there be the same approach?

**Fran Pacitti:** Yes.

**Colin Beattie:** It was not something different.

**Fran Pacitti:** No.

**Colin Beattie:** Therefore, at that point, there was every reason to believe that FMEL was going to—

**Fran Pacitti:** I would defer to CMAL on the specific terms of the invitation to tender, but it is my understanding that it is common practice in procurement to invite comments and for silence to be taken as tacit acceptance. That is reflected in the Auditor General’s report.

**Colin Beattie:** Okay. Thank you for that clarification.

I turn to something other than chasing pieces of paper. I would like to chase the money. An awful lot of money has gone into FMEL, and I will go through that in more detail in a second. FMEL received more than £128 million of public money. What attempts have been made to identify what it was spent on? When the company was nationalised, there was only about £8 million in total assets in the company, yet substantial loans and payments of tens of millions had been made. What attempts were made to find out whether the money was spent appropriately?

**Roy Brannen:** I will bring Dermot Rhatigan in to comment on the loans and tracking where the money was being invested.

With regard to the contract, the 15 milestone payments that were set in the contract, as well as CMAL’s requirement under the contract as the buyer, required that the builder submit to the buyer evidence to suggest that the milestones had been reached, and that the buyer be satisfied that a milestone payment could be made.

**Colin Beattie:** In the Rural Economy and Connectivity Committee report from December 2020, it is clear that milestones were fabricated, and there is reference to that not being unusual in the industry. To me, that is extraordinary.

**Roy Brannen:** Again, that is a matter on which you will, no doubt, wish to seek advice from CMAL as the procuring authority. However, as I

understand it, in the negotiation with FMEL, the procuring authority agreed what the milestone payments schedule should be. The milestone payments schedule was tied to deliverables, whether of equipment or levels of fabrication. I accept that there is, in the Auditor General's report, a question about the definition of "level of fabrication".

CMAL has worked hard to tighten up what those milestones should be and how they can be tied to quality in future contracts. However, we cannot get away from the fact that the BIMCO new-build contract is a fairly standard shipbuilding contract, which is unchanged and includes the same terminology and language as you have seen in this contract. It includes up-front payment for acquiring various bits of equipment and, thereafter, various stage payments for build-out of the ship.

**Colin Beattie:** [*Inaudible.*—a quarter of the money put up front, to enable them to purchase materials?

**Roy Brannen:** Again, that was in the negotiation between CMAL and FMEL.

**Colin Beattie:** When I get the chance, I will ask questions of CMAL, but Transport Scotland had a responsibility in this, as well.

**Roy Brannen:** I am sorry, but we did not. We were not a party to procurement of the contract.

**Colin Beattie:** Were you not the sponsor?

**Roy Brannen:** We were the sponsor body for CMAL, in ensuring that CMAL, as our expert in shipbuilding, was undertaking the procurement and work that it does in running CMAL appropriately. That was the role of TS in that.

**Colin Beattie:** Were you not concerned that tens of millions of pounds were being flushed down the toilet, with no way to ascertain what was happening to the money?

**Roy Brannen:** The contract was set by the builder and the buyer, with expert opinion on what the milestones should be. It was then a case of the payments being made under the contract.

Once such a contract starts, it is very difficult to stop. There are, in such contracts, some suspension and termination rights that are basically around lack of work for 14 days, at which point the buyer would be able to stop the contract and say that it looks as though no more progress will be made. Once it starts, it is in both parties' interest to conclude the contract.

10:00

**Colin Beattie:** At what point did you become aware that relationships between CMAL and FMEL had broken down?

**Roy Brannen:** Throughout 2016, CMAL reported to Transport Scotland on recoverable delays—I will bring in Fran Pacitti on that reporting mechanism—and towards the end of 2016, I as CEO became more aware that there was a greater risk that the delay would go beyond that first date for delivery. In early 2017, we reported that fact to Scottish ministers.

From recollection, the minister visited the yard in 2016. I think that there is an exchange in the public record where the issue of delay was put to Jim McColl directly, and his response was that he was astounded that somebody was questioning whether the vessels were going to be delayed or not. At that point, you could start to see the relationships between both parties drifting, and for the next 18 months, I, Transport Scotland and the DG finance attempted to broker a more harmonious relationship between the two parties and get to a point where we could resolve the differences of opinion.

You have seen from the response that Mr McColl sent to the committee that those differences of opinion on events remain, and I suspect that, when you speak to CMAL, that will remain the case.

**Colin Beattie:** Just to clarify in my mind, I recognise that CMAL granted the contract, signed it off, managed it and so on, but what reporting to Transport Scotland did it undertake on the progress of the contract and the issues that arose in it?

**Roy Brannen:** I will bring in Fran Pacitti on this point. I am sorry, Fran; I forgot to bring you in. The voted loan documentation explains the requirement for CMAL to update Transport Scotland and ministers on a regular basis, and there is a template in there that sets out what needed to be put forward.

**Fran Pacitti:** The voted loan involved a requirement for monthly reporting from CMAL to Transport Scotland in its role as the creditor under the voted loan agreements, which had a requirement for updates on progress. In addition, CMAL would also report to the programme steering group, which 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.

**Colin Beattie:** Is monthly reporting normal?

**Fran Pacitti:** It was quarterly reporting—forgive me if I said that it was monthly—under the voted loan for vessels 801 and 802. In subsequent voted loans, that requirement has changed to monthly reporting and, yes, that is standard. The point is that there is active and regular discussion about risks and governance. In addition to that formal written report, there would have been regular dialogue between the parties. There were short lines of communication, so people would have been aware of progress and issues in real time.

**Colin Beattie:** At what point did Transport Scotland become concerned at the tenor of the reports that were going in, and what did Transport Scotland do?

**Fran Pacitti:** Again, I was not present at the time, but my understanding, based on the documents and discussion with other members of the team, is that individual aspects of the programme had slipped from early in the contract. Around December 2016 or thereabouts, it was reported to Transport Scotland that some of the delays to individual programme lines were likely to be irrecoverable, leading to changes in delivery dates under the contract, and at that point we notified Scottish ministers of those concerns.

**Colin Beattie:** When was that, approximately?

**Fran Pacitti:** Forgive me—it was maybe January or February 2017.

**Roy Brannen:** In the contract, there is an allowance for delays. It is an acceptance that there could be overruns. I think that, in December 2016, CMAL reported that, in its view as our professional experts—the yard's view was entirely different—it could not see how the first boat could be delivered to the original date plus the allowance for delay. At that point the May 2017 date moved to August 2017—so three months—but CMAL could not see how that could be done.

**Colin Beattie:** My impression is that CMAL fairly consistently raised concerns for an extended period. What was done about that? What intervention was made to try to get the project back on schedule? The awareness that CMAL's relationship with FMEL had broken down should have created additional concern. On top of that, my understanding from the documents that we have is that CMAL wanted to stop the payments and took legal advice, which said that it had to continue them. Did all that not raise concerns about what was happening?

**Roy Brannen:** Yes, it did. During 2016, CMAL reported its view on how the project was performing. FMEL had a different opinion on that. The builder is a private organisation, and it is for that organisation to build the boats—it is a design

and build contract. The builder is in control of the build and the programme, and its view was different from CMAL's. At that point, the delays that were being reported were recoverable. It was still early on in the gestation of the project.

That is not unusual for major infrastructure. Take the Queensferry crossing, for instance. Over a six-year contract, we were only 10 weeks late, but we would not have been concerned about some of the delay early on in the gestation of the project. It was similar with the ferries until CMAL got to the point at which it could not see how the original delivery date for vessel 801 would be achieved.

I have to say that CMAL worked incredibly hard throughout the process to try to resolve the matter and work constructively to make the contractor a success. Nobody wants a failed supplier. Everybody wants the outcome to be good on both sides—the buyer and the builder—and CMAL went a considerable way to try to assist the builder not only with his cash flow issues and the design development, which he was stuck with, but with variations. There were some variations that, as has been mentioned quite a bit in other reports, were to the yard's benefit and should have speeded up the process. CMAL could not have done any more as a buyer to try to keep the contract in place and moving forward.

**Colin Beattie:** However, we ended up with a failed supplier.

I will take a slightly different angle on the money. A good chunk of the money was paid out. FMEL got most of the value of the vessels paid to it, actually. However, it also got loan support. As I understand it, that was not visible to CMAL because of commercial issues around it.

What was the rationale for that decision? Who made the decision to give those loans and, basically, provide working capital? What were the loan conditions and were they adhered to?

**Roy Brannen:** I will bring in Dermot Rhatigan on that.

The DG economy, Liz Ditchburn, was responsible for oversight of the assistance to the economic asset that was the yard. 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.

That moved the matter out of the territory of the contract into the yard as an economic asset needing support. That is where Dermot Rhatigan, the team and Liz Ditchburn looked into loans. It was important to keep those two issues separate.

You mentioned supplier failure. That area was touched on in the REC Committee report and in the Audit Scotland report, but what I have seen through the programme turnaround work, the work that Tim Hair did and the assessment of work that is still required on vessel 801 is that there is a fundamental issue about the builder understanding the simple terms of the contract, which were for a 100m boat to go at 16.5 knots and carry 1,000 people, and for that to be delivered for the price of £97 million. How it went about building that is an issue that you will no doubt wish to ask CMAL questions about.

**Dermot Rhatigan (Scottish Government):** You asked about the purpose of the loan and who signed it off. Roy Brannen covered the putting up of the advice, which came from DG economy initially, on the first loan, and then from the director of economic development, Colin Cook's predecessor, on the second loan. The loans were approved by the cabinet secretary, Derek Mackay.

On the purpose of the loan, as Roy said, there are two types of contract. There was a contract for the build, which was a procurement. The loans were not a procurement; they were an investment into the business, so the purpose—

**Colin Beattie:** Was the purpose of the investment the purchase of share stock?

**Dermot Rhatigan:** No. Initially, it was debt. We reviewed the business case of the business. Essentially, when the business was taking on debt, we wanted to understand whether, through its business plan, it would be able to repay that debt, with the Government earning a commercial return.

**Colin Beattie:** Did CBC put any money into that?

**Dermot Rhatigan:** CBC had initially capitalised the business, so we—

**Colin Beattie:** How much was that?

**Dermot Rhatigan:** The figure that I have heard CBC talk about is around £25 million. I think that that was understood to be its initial capitalisation of the business. We then negotiated the second loan, and under its terms CBC was due to put £8.5 million into the business.

**Colin Beattie:** Did it do so?

**Dermot Rhatigan:** No. It did not put in the £8.5 million. In the end, it put in £3 million-worth of money, which went in as debt rather than as equity, which was the original agreement.

**Colin Beattie:** So, actually, the terms of the loan were not fulfilled by the supplier.

**Dermot Rhatigan:** 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. However, that debt was to rank behind the Scottish Government's debt.

**Colin Beattie:** We are talking about loans here, but was there ever a prospect that they were going to be repaid? We had a business that was clearly suffering from lack of liquidity and that needed all sorts of concessions on its contract in order to get payments to keep it ticking over, yet we were giving it loans. On what rational financial basis was that done?

**Dermot Rhatigan:** We studied the business plan of the business. For the second loan in particular, we were looking at a long-term plan over the next 10 years. It was clear, and the business was clear about this, that it did not anticipate making any margin at all on the contracts for vessels 801 and 802. Essentially, by taking on the debt from the Government, it was forgoing future profits, which would come back to the Government. The profits were to be earned on subsequent contracts. At that time, the business was bidding for quite a lot of work, and it did win some in that period. It won work on an air cushion barge and on two Inverlussa vessels, and it had some other fabrication work.

However, 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.

10:15

**Colin Beattie:** Did you believe in it?

**Dermot Rhatigan:** We sought advice from PwC, which reviewed the business plan for us. It said that there was a prospect of us getting a return on the money. Obviously, that has not proven to be the case. We have been able to recover some of the debt via the money that was offset against the loan for buying the business. An

amount of money has also come back via the administration.

**Colin Beattie:** PwC must have given a written opinion. Is it possible to see that?

**Dermot Rhatigan:** Yes. I think that the report from PwC is dated May 2018, although it may have been April 2018. It is referred to in the advice that Colin Cook's predecessor, Mary McAllan, put to ministers recommending the second loan.

**Colin Beattie:** It would be interesting to see that recommendation as well.

**Dermot Rhatigan:** Do you mean the recommendation from civil servants?

**Colin Beattie:** The letter.

**Dermot Rhatigan:** Yes. It is all put down in Mary McAllan's submission. I think that the letter was of April 2018. That is on the public record, as are the FMEL documents that we have published.

**The Convener:** I am conscious of the time, Colin. I am keen to bring in two members of the committee before we finish up.

**Willie Coffey:** I will raise again the issue of the application of quality standards, which Colin Beattie led on a moment ago.

In his key messages, the Auditor General told us that some of the project milestones were not clearly defined and that there was no linkage to any quality standards that may be an accepted part of that particular industry.

Roy, do you have a view on why we were not insisting on a connection between the milestones in the project and the quality standards that should have been applicable at each point?

**Roy Brannen:** Again, my background is civil engineering, highways and transport. However, as I understand the standard shipbuilding contract, there is a clear clause at the start that talks about standard shipbuilding conditions; that is, the building of ships as you would expect to see ships built by competent yards. I suspect that a lot of that rests within the contracts and the way that those contracts are held between the buyer and the builder.

The Auditor General picked up on the point that there is surely an opportunity to review and strengthen that standard BIMCO—Baltic and International Maritime Council—contract. I know that CMAL has looked at that. I will bring Fran in again on the Islay vessels to see what more has been done.

However, as we saw through the turnaround director's report, it is evident that a substantial amount of work was not done in that kind of sequence or in the generalised way that you would

have put the boat together. That is no reflection on the workforce at the yard; they built what they were asked to build. I suspect that it is more about how it was planned and project managed through that period.

The contract is silent on that. It does not allow CMAL, as the buyer, to interfere in the builder's approach to building. CMAL is allowed, within the contract, to ask for variations, and the builder is entirely entitled to refuse those variations or to continue on if he feels that those variations will impact on the contract itself. There is also a dispute mechanism in the contract.

In my parallel world of civil and transport projects, there is a very similar approach to how you deal with disputes, variations and costings and their payment, but nothing that would allow the buyer to intervene in quality control per se.

**Fran Pacitti:** As you would expect, there has been a significant degree of reflection on what could be done better or lessons that might be learned from vessels 801 and 802. Again, I defer to CMAL on the detailed specification but we have reflected collectively on how we tie quality to milestone events.

As part of that reflection, we discussed whether it would be prudent to modify an internationally recognised BIMCO contract to be more explicit about quality standards. The feedback from CMAL as our industry expert is that that could have the unintended consequence of deterring bidders or distorting the contract price but that a different way to achieve the same outcome, which we now see in relation to the Islay vessels and will see in relation to future vessels, is to ensure that the milestone payment dates under the contract are explicitly linked to quality.

Future contract milestone events will rely on the builder preparing a certificate, which must be signed off by the attending classification society before payment is made. That might have been assumed, and it is typically the practice that would exist under BIMCO anyway through the general quality reference that Roy Brannen set out, but we can make that more explicit in relation to the milestone payments in future.

I am sure that CMAL will be able to speak to that more eloquently than I have done.

**Willie Coffey:** It is a recurring issue that, when the committee considers any project, it often finds that, if the project goes wrong at the beginning, it is unlikely to work at the end, as insufficient rigour was applied at the outset. Not applying quality standards to milestones seems to committee members to be a major issue.

Paragraph 138 of the Auditor General's report told us that

“some of the 1,400 cables”  
installed on the first boat  
“were too short”.

It is amazing to members of the committee and, perhaps, the public that that was not discovered and not reported to the Parliament until the turnaround director was involved in 2022. How on earth can something like that happen? How can cables that are too short go unseen and unnoticed for nearly four years and cause a significant delay? I connect that directly with the application of quality standards and inspection. Why was that missing in this case?

**Roy Brannen:** To comment more generally on the states of different types of contract, the BIMCO new-build contract is a design and build contract. Once the tenderer takes the concept design or outline design and signs the contract, he owns the design. His responsibility is to produce the outcomes that are set out on the front page of the contract and it is entirely up to him how he goes about that. The final payment is based on the end product. I think that I am correct in saying that there is no allowance for CMAL to judge how he goes about that as he delivers the final product because it is a complete design and build system.

You might argue that there would have been an opportunity to be in and about the yard, and there was. I think that the contract allows an individual to be in and about the yard to witness the build. CMAL can witness the build and was recording issues that were going on with it but, as far as I can see, there is no mechanism in the contract to halt it.

Triggers for suspension and termination are set out. I cannot remember quite what the clause is but it is clear about when the buyer is able to trigger a stop of the contract and the repayment of the fees. One trigger is a default of the refund guarantee and the second is a lack of work for more than 14 days. I have forgotten the third one, but the clause does not specifically talk about quality or specification as a trigger mechanism for halting the contract.

**Willie Coffey:** Should it not? It is ridiculous to be unable to challenge the fact that cables are too short on a boat and for that to remain the position for four years until somebody else—the turnaround director—comes on the scene to identify it. Surely, we must be considering that. I am aware that the observation reports were a mechanism to raise and highlight issues. In essence, they are change requests in the quality world, and the builder might or might not have carried them out. Surely to goodness that needs to be strengthened.

**Roy Brannen:** You are absolutely right. The owner observation reports are the mechanism by which the buyer is able to identify the issues that they are unhappy with and which need to be rectified before the boats are taken into ownership. That was fully documented. CMAL religiously identified what the issues in the OORs were and asked that the builder corrected them before the boats were handed over. Therefore, none of those issues would have materialised in the final boats. That is the mechanism. Whether the BIMCO contract needs to change to deal with that more explicitly is maybe a question you should ask our CMAL shipbuilding experts and speak to Kevin Hobbs and others about.

**Willie Coffey:** Do all parties accept the point that the Auditor General made about the cables being too short, or is there some dispute about that?

**Fran Pacitti:** I will defer to Mo Rooney on what the yard’s current position is on those cables. I think that CMAL understood and identified that the cables were too short and that that is accepted.

**Willie Coffey:** Did even the builder accept that they were too short?

**Fran Pacitti:** Forgive me, but I do not know whether that was accepted by the former management at FMEL when the cables were put in. However, I understand that that was certainly accepted by the current management team at the yard.

**Mo Rooney (Scottish Government):** 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.

**Willie Coffey:** Okay. We can probably investigate that further in the next session.

**The Convener:** Yes. We have only a couple of minutes left, and we want to address other large areas of the report—on nationalisation and the lead-up to it, for example. Colin Cook has been noticeably silent today. We may require a further session to complete the evidence gathering that we would like to get through.

I will conclude today's proceedings by inviting Sharon Dowey to ask any outstanding questions that she has.

**Sharon Dowey:** I have a wee question about the Erik Østergaard email that was sent on 26 September. He made it quite clear that the contract should not have gone ahead. In the evidence that you have given today, you have referred to CMAL as the expert in shipbuilding. Why would its recommendations have been ignored?

**Roy Brannen:** Again, I will go back to the timeline. I understand that, at that point, Erik Østergaard had reflected where things were with the negotiations. By the time that the advice got to ministers, those negotiations had moved on sufficiently enough that the CMAL executive and the board were content with what they had managed to negotiate with the builder at that time. To go back to some of the previous evidence, that seems to be the gestation of the movement from where the issue was to where it got to, before the advice went to the minister.

Does Fran Pacitti want to add anything to that?

**Fran Pacitti:** No—I think that that is a fair summary. At the point of the note that was referenced, the board was clear that it felt that the risks were unacceptable. That was followed by a period of negotiation in which mitigation in relation to alternative forms of guarantee was put in place, and there were modifications to the voted loan that provided CMAL with greater assurance. Those risks got to a position at which the board ultimately concluded that it was content with them. Risks remained, but the risks at that stage were acceptable, and the board was content to proceed. It was on that basis that Transport Scotland officials put advice to ministers. That was on 8 October and, ultimately, that advice was accepted.

**Sharon Dowey:** Was a meeting held involving CMAL, Transport Scotland and the ministers? Did they all come together in a meeting to discuss all the issues that they had?

**Roy Brannen:** Not that I can see from the paperwork that is in front of us.

**Fran Pacitti:** Again, I am not aware of that. My expectation would be that, had there been a meeting that engaged ministers and in which decisions were taken, that would have been minuted, but I have not seen any evidence of that. I expect, and I understand from the exchanges, that there would have been regular dialogue between CMAL and Ferguson. Transport Scotland would not have been privy to that, but there was regular engagement between Transport Scotland and CMAL. Ultimately, the output of that is all recorded in the submission of 8 October.

**Sharon Dowey:** So, even though all the issues were handed to the ministers, they did not have an in-person meeting to discuss it with the shipbuilding experts.

On 8 October 2015, an email was sent to Derek Mackay and Keith Brown. The sender's name is redacted, as is a list of other people who were copied into the correspondence. It states that the

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

It goes on to say:

"it is clear that the Board of CMAL are still concerned".

At the end, it asks for the minister's confirmation that he is aware of the issues and is

"content to give approval ... to proceed."

It also asks whether:

"the Minister wanted to speak to a representative of the CMAL Board".

Is it fair to say that it was the Deputy First Minister who was made fully aware of the financial implications prior to the announcement by the First Minister and that it was him who authorised the contract to go ahead?

**Roy Brannen:** No. I go back to my previous evidence: the DFM's role was in ensuring that finance was available to continue with the procurement.

**Sharon Dowey:** It looks as though the ministers were not happy with the financial implications, so they handed it over to the Deputy First Minister to give authorisation.

**Roy Brannen:** I do not have that bit of paper in front of me, but I do not see that as the right reading of it. As I have said, the DFM's role was to ensure that the finance and the budget was available for the procurement to continue. Whether there was the right authorising environment, by which I mean whether there was money available, to take forward the project was quite rightly an issue for the DFM, as the Cabinet Secretary for Finance, Constitution and Economy. However, the decision on whether to proceed with the procurement was for the ministers.

**Sharon Dowey:** Are you aware of whether the suggested meeting with CMAL was requested or took place?

**Roy Brannen:** We have no evidence that a meeting took place between ministers and CMAL.

**The Convener:** My final question, Roy Brannen, is to ask whether it was in your gift to advise ministers to terminate the contract. If it was, did it cross your mind to do that?

**Roy Brannen:** 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. It was an area that was considered; it was one of the 29 options that PwC put forward and it became one of three recommendations. However, it was discounted because of the impact that, at that time, that would have had on not just the vessels but the vessels, the yard and the jobs. Those three things were interlinked throughout the course of the project.

**The Convener:** You kind of recused Transport Scotland from that, but, as the accountable officer, you gave advice at the end of April 2017—it is among the 200-odd documents that are now in the public domain—in which you said that, if flexibility on the surety bond were to be introduced, you would require written authority for that.

**Roy Brannen:** Correct. I was pretty clear in that advice that there was no more flex in the contract and that CMAL had gone as far as it possibly could. I could not see how it could do anything more on that. If I had been required to ask CMAL to remove the surety bond, I would have sought written authorisation to do so.

Clearly, my recommendation was that that should not be touched. There was no issue with that; ministers did not ask me to do anything more with it—they accepted my recommendation. In that advice, I go on to say that I expected that there would need to be some other intervention or assistance to ensure a successful outcome. At that point, I was pretty clear that the contract had gone as far as it could.

**The Convener:** However, at that stage, there was a reprofiling, as you called it, or an acceleration, as many others would call it, of the payments to FMEL.

**Roy Brannen:** CMAL had made the proposal to bring forward some of the payments for additional milestones. That was strictly controlled by CMAL,

and clearance processes were put in place to ensure that the money was apportioned to whatever the titles were—it might have been parts or manufacturing—that were coming through the business. No new cash went into the business from the contract. There was the same contract value; there was just a reprofiling.

CMAL actually controlled that process very well. A couple of items came forward from the yard for work that was not connected to the milestones, and those payments were refused by CMAL.

In relation to my position on that approach and what I said to ministers, CMAL proposed the reprofiling as something that it could do to assist the builder to continue the work and deliver the vessels successfully. As the AO, I had to consider whether that approach was proportionate and manageable, and the balance of risks. Of all the proposals that came forward, the only one that I could say, hand on heart, would have assisted at that point was the reprofiling. The surety guarantee could not be touched.

**The Convener:** As part of that new arrangement, was a commitment given to CMAL that it would be compensated and that its budget would be increased to accommodate the change in the profiling of payments?

**Roy Brannen:** There was no new money. The totality of the voted loan was exactly the same. What would have been in the final payment was brought forward to an earlier part of the budget year. It was a reprofiling only of the totality of the voted loan. No new money went into the system.

**The Convener:** Audit Scotland's report notes that there were 15 intervals of payment rather than the typical five. For the record, can you tell us the reasons for that?

**Roy Brannen:** You would need to put that question to CMAL. It is normal practice for the buyer and builder to agree what the milestone payments should be, based on what the builder expects to have in place—that might relate to engines or equipment—or when he anticipates that he will need a flow of cash to allow things to be successfully built. Ships are expensive; they cost a lot of money. There are a lot of up-front costs, so it is entirely right that the builder and buyer agree what the milestone schedule should be. In this case, they agreed on 15 payments.

**The Convener:** One of the things that I have drawn from today's session is that a lot of responsibility and accountability seems to have been placed at the level of the builder and the buyer, but the whole apparatus of accountability in the civil service does not seem to have been applied.

**Roy Brannen:** Up to the point of the award, and once it becomes a contract, and this happens in all other cases—

**The Convener:** The cost has gone from £97 million to two and half times that much.

**Roy Brannen:** Indeed. The failure of the contract has been part of that process. In contracts that Scottish ministers and I have direct control over—the contract for the Queensferry crossing, for instance—we would act in exactly the same way as CMAL did on those issues. If the Queensferry crossing had involved a six-year contract and was 10 weeks late, as the buyer, I would have been dealing with those issues and delays and, as the builder, the Queensferry crossing contractor consortium would have been involved in the discussions about how we ensured that we maintained progress on the contract. Whether it involves TS or the SG, the civil service does not have a direct role in contracts that are procured by our agency, CMAL, and private organisations. We have oversight of the sponsor body, as is entirely appropriate, to ensure that it does not act inappropriately, so that it is not making payments that are not linked to progress or the contract.

**The Convener:** On that note—which is where we might pick things up again in the future—I thank Mr Brannen for his time and the evidence that he has given. I also thank all the members of the team who joined him, including Mo Rooney, who contributed towards the end of the session. As I said, there are whole areas of the report that we think it is important to interrogate. That is one of the reasons why Mr Cook was not called this morning. I am sure that we will get back in touch, Mr Brannen, to see whether we can arrange a follow-up session, because lots of important issues have been raised this morning but we did not quite get to some of the ground that we need to cover. Once again, I thank the witnesses for their time.

I close the public part of this morning's meeting.

10:40

*Meeting continued in private until 11:37.*



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