

Report to Partnership Meeting 2 February 2018

RESEARCH AND STRATEGY DELIVERY

Scottish Government Review of Ferry Procurement

PURPOSE OF REPORT

The purpose of this report is to update Members on the progress of the review being undertaken into procurement processes and state aid requirements for the future funding of Scottish Government ferry services following publication of an Interim Report in December.

Background to Scottish Government Ferry Service Responsibilities

The Scottish Government currently supports the operation of three ferry service contracts. These are:

- Northern Isles Ferry Service Contract (NIFS)
- Clyde and Hebrides Ferry Service Contract (CHFS)
- Gourock to Dunoon Town Centre to Town Centre

The Ministerial portfolio also includes the ownership of David MacBrayne Group Ltd (DML) in which Scottish Ministers are sole shareholder. The DML group of companies include CalMac Ferries Ltd who were recently re-awarded the CHFS contract for an 8-year period commencing 1 October 2016 and Argyll Ferries who operate the Gourock to Dunoon Town Centre to Town Centre contract. The current Gourock - Dunoon ferry contract was due for renewal by end of June 2017.

Before the procurement of the first CHFS contract state owned Caledonian MacBrayne Ltd provided the majority of Clyde and Hebrides ferry services and owned the associated vessels and a number of the harbour facilities. The company was wholly owned by Scottish Ministers with these services requiring an annual revenue deficit grant from the Scottish Executive to maintain lifeline service levels. In order to comply with European guidelines on State Aids in Maritime Transport, an open public tender was deemed necessary in respect of these ferry services. The then Scottish Executive tendered the Clyde and Hebrides Ferry Services (CHFS) as a single bundle, with the exception of the Gourock-Dunoon service. In recognition of the uniqueness of the fleet and in order to ensure a level playing field for all bidders, on 1 October 2006 Caledonian MacBrayne Ltd was split into two companies. The operating company CalMac Ferries Limited and an asset owning company Caledonian Maritime Assets Limited (CMAL). CMAL continues to own the vessels and land-based assets (ports, harbours, etc) and makes them available to an operator through the tendering process. The CHFS operator is bound to use the CMAL vessels and infrastructure under the terms of the CHFS contract.

Since the commencement of tendering of Scottish Government ferry services there has been vocal support that the requirement to tender be challenged. Initially this focused on the Altmark case in Germany and in recent years the Teckal exemption that allows for public contracts to be awarded to in-house companies under strict conditions relating to the parent authority's control

and the functions performed has been promoted as the most appropriate vehicle to enable state aid compliant operation of these services by a state owned operator without the requirement to tender.

Announcement of Procurement Review

A policy review into future tendering for Scottish Government ferry contracts was launched by the Minister for Transport and the Islands Humza Yousaf on 2nd February 2017.

It follows correspondence from the European Commission on the Teckal Exemption, prompted by a joint approach from the Scottish Government and the RMT union. The response indicates that, in certain circumstances, public ferry services could be awarded to an “in house” operator without the need for tendering.

The review looks in detail at the implications of the Commission’s response on future tendering, the Teckal exemption and State aid rules. Key stakeholders are being engaged during the process.

To enable the review to progress the tendering processes for two contracts was paused. These being Gourock – Dunoon town centre to town centre services and the Northern Isles Ferry Services contract.

Interim Report

The Scottish Government published an interim report on the future approach to the procurement of ferry services in December 2017. This report describes the legal, policy and financial implications that have been considered to date. It sets out the information gathered from stakeholder engagement across the CHFS and NIFS networks and in Dunoon. The Interim Report outlines the emerging findings and the actions that will be taken in the short to medium term as a result of the Review. These are set out below under relevant sub headings.

The full report can be downloaded at – https://www.transport.gov.scot/media/41273/ferry-services-procurement-interim-report_2nd-go.pdf

Legal Framework

- A Teckal compliant award under the procurement regime would be compatible with the Maritime Cabotage Regulation, subject to meeting the strict functions, control and private capital participation tests of the Teckal doctrine.
- A Scottish Minister owned company, as currently constituted, would meet the requirements of the Teckal functions and private capital participation tests.
- Further consideration is required on the governance of a Scottish Minister owned company, as currently constituted, in order to ensure full compliance with the Teckal control test.
- The provision of ferry services, whether undertaken “in house” or not, is an economic activity for the purposes of the State aid rules.
- In order to satisfy the State aid rules, it will be necessary to demonstrate full compliance with the four Altmark criteria.
- The fourth Altmark criterion is particularly challenging. It can be satisfied by means of a public procurement procedure, as highlighted in the European Commission’s letter of 22 September 2016. An alternative would be to undertake detailed benchmarking against typical, well-run and adequately equipped undertakings in the ferry sector.

Clearly in terms of the Legal Framework there is more work that needs to be undertaken if the Minister's stated preference of public sector operation is to be achieved. The questions around governance would appear to relate to how control is exercised by Scottish Ministers and will require considerations on the implications on the current model of state ownership through standalone companies, namely David MacBrayne Group Ltd and Caledonian Maritime Assets Limited.

The fourth Altmark criterion is identified as particularly challenging and in overcoming this there would appear to be an opportunity to retain a positive aspect of the more recent experience of procurement whereby stakeholders and communities have an opportunity to provide meaningful input on the specification of these lifeline services. Having this type of engagement embedded within any detailed benchmarking of on ferry service provision could provide space to ensure there was benchmarking against how well routes serve the social and economic wellbeing of their local communities.

Stakeholder Engagement

- Local communities and stakeholders in the area currently served by CalMac Ferries Limited in fulfillment of the Clyde and Hebrides ferry services contract expressed a general preference for a direct award to an in-house operator for those services.
- There was a general preference for a direct award to an in-house operator for the Gourock-Dunoon town-centre ferry service. If this cannot include provision for the transport of vehicles, the general preference from the local community was that the service should be tendered to allow the possibility of a vehicle-carrying service being returned to the route.
- Shetland communities and stakeholders adopted a more neutral stance on whether the Northern Isles services should be awarded to an in-house operator or tendered, with many expressing a preference for tendering.
- In Orkney, the community and stakeholders expressed a clear preference for tendering.
- Further engagement with the local community and stakeholders will be undertaken to inform the final decision on the future approach to the procurement of the Northern Isles and in due course the Clyde and Hebrides ferry services, if required.

With regards to the final bullet point above HITRANS will engage with Transport Scotland to understand how we can help facilitate this engagement through the Ferry Stakeholder Groups and potentially via Community Planning Partnerships. This is similarly picked up as an issue that should be addressed under the next section on *Value for Money*.

Value for Money

- There is some evidence that tendering can present different creative and innovative service solutions. Any direct award to an in-house company would need to include mechanisms to deliver similar levels of continuous innovation and service delivery improvement.
- A direct award to an in-house operator, in full compliance with the Teckal doctrine and the State aid rules, is capable of providing similar levels of efficiency and service delivery to that which might otherwise be obtained from tendering.
- A direct award to an in-house operator would avoid the high costs of tendering, allowing savings from the tendering process and operator returns to be reinvested in public services.
- A direct award would also allow longer-term investment planning.

The point around long term investment planning is welcome. It is important that processes for this are robust and transparent. This is an area that HITRANS would value consideration be given to irrespective of the final outcome of the procurement review to ensure that investment in our ferry services delivers the right outcomes for the communities served.

Future Operating Models for Ferry Companies Owned by the Scottish Ministers

- The immediate focus is on the changes required to the current corporate company framework for David MacBrayne Limited and its operating companies in order to satisfy the Teckal control test.
- Further consideration can be given to alternative operating models, such as the creation of a new public sector body, or transfer to an Agency of the Scottish Government, once the immediate question of changes required to the current corporate company framework to satisfy the Teckal control test has been addressed.
- The costs of any significant restructuring of current company structures, including potential tax liabilities, will have to be assessed against value for money. Further specialist analysis on potential tax implications will inform the costs associated with required changes to the current operating model and any future alternative models.

The future operating models of companies owned by Scottish Ministers seem to be a critical factor in achieving the Minister's ambitions around direct award to publicly owned operations. These are technical governance issues that sit in legal frameworks but this is crucial in state aid terms. From the service user perspective little would change as indeed little changed in the move to tendering with the identify of the ferry services remaining broadly the same – the Caledonian MacBrayne brand lives on as the identity for CHFS and the Northlink identity remained for NIFS despite the change of operator.

Implications for Ferry Services - Clyde and Hebrides

- The Clyde and Hebrides ferry services are already provided by a wholly state-owned operator until 2024.
- There is no immediate time pressure in which to consider the full implications of Teckal and the State aid rules in relation to the future approach to be taken to the procurement of the Clyde and Hebrides ferry services.
- Scottish Government will build a case for making a direct award to an in-house operator for the Clyde and Hebrides services in line with the requirements of Teckal and the State aid rules, particularly the four Altmark criteria.
- A decision on the future approach to procuring the Clyde and Hebrides ferry services will be taken ahead of the current contract ending in 2024.

Implications for Ferry Services – Northern Isles

- Arrangements are in hand to extend the term of the current Northern Isles ferry services contract until October 2019.
- A decision on whether to make a direct award or continue tendering the Northern Isles ferry services will be taken in the Spring of 2018.
- The decision to be taken in the Spring of 2018 will consider progress made on the further analysis of the Teckal exemption and the State aid rules. It will also take account of local community views and the remaining timeline in which to complete a competitive tender, should that be required.

Implications for Ferry Services – Gourock - Dunoon

- The current Gourock-Dunoon ferry service contract will be extended to December 2018.
- A direct award for the Gourock-Dunoon service, assuming that such an award could be achieved by reference to the Teckal doctrine and the Altmark criteria, could only be applied to the transport of foot passengers under the terms of the public service obligation.
- Tendering the Gourock-Dunoon ferry service could potentially realise the return of a vehicle-carrying service on the town-centre route.
- The currently paused tender exercise for the Gourock-Dunoon ferry service will therefore be restarted as soon as practicably possible.

RISK REGISTER

RTS Delivery

Impact - Neutral

Comment – While the Review could have far reaching consequences on the operation of our ferry services it is to be assumed that the objectives and strategy that drive the development of these services will retain a similar emphasis to that already outlined in the Scottish Ferries Plan and which will be subject to development in line with future refresh of this and that it would recognise RTS priorities.

Policy

Impact - Neutral

Financial

Impact – Neutral.

Equality

Impact – neutral.

RECOMMENDATIONS

1. Members are asked to note the report.

Report by: Ranald Robertson
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Date: 23rd January 2018