

Item:
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Report to Partnership Meeting 7 February 2025

RESEARCH AND STRATEGY DELIVERY

CHFS 3

Purpose of Report

To update Members on progress following the announcement by Ministers of the proposal to make a direct award for the third Clyde and Hebrides Ferry Service Contract, summary of the Consultation on the proposal and recent publication of the Subsidy Advice Unit Report on the proposals.

Clyde and Hebrides Ferry Service Contract (CHFS 3)

The Minister for Transport provided a statement to Parliament on 16 November 2023 regarding the Clyde and Hebrides Ferry Services contract. The current contract was due to expire on 30th September 2024.

A due diligence process continues on the the feasibility of direct award from a financial, operational, and legal perspective.

While progress has been made on the due diligence work, there are a number of complex issues still being worked through, including subsidy control, individual entity status and associated accounting impact. It became clear that the process could not be concluded by 30 September 2024 and Ministers decided to implement an extension of the current contract up to 12 months to enable this work, and associated assurance processes, to be concluded prior to the final decision being made.

The current policy position regarding unbundling of the CHFS network has been expressed and there are no plans to split up the network.

In relation to ferry priorities and governance structures under consideration through Project Neptune, the Cabinet Secretary of Transport in response to Parliamentary Questions advised Parliament that no immediate decision will be taken on the merger of bodies or governance arrangements.

Stakeholder Engagement

Transport Scotland have indicated they will continue to work with key stakeholders, including communities and trade unions, to inform the development of these key services. Following the recent round of Ferry Stakeholder Group meetings the Membership collectively and unanimously expressed frustration at the lack of meaningful engagement they have been afforded even in comparison with the stakeholder engagement that supported CHFS 2.

A formal public consultation did take place from December 2023 to March 2024. All public consultation responses have now been analysed and the [executive summary](#) and [full analysis report](#) are available to view. The recorded responses have been published by Scottish Government and are available to view on [Citizen Space](#).

A total of 434 responses were available for analysis, with most of these submitted through the Scottish Government's Citizen Space consultation analysis platform. In addition to undertaking the online consultation, Transport Scotland held a number of engagement events between November 2023 and February 2024, on Arran, Bute, Cumbrae, Islay, Colonsay, Mull, Tiree, Skye, Lewis and North and South Uist. The feedback from these events is also included in the analysis.

Most of the 434 standard consultation responses were submitted by individual members of the public. There were 41 responses from organisations, with Ferry Board, Committee or Groups and Community Council or Development Trusts the two largest groups (with eight and seven respondents respectively).

Subsidy Advice Unit Report

The due diligence on Subsidy Control aspects of a direct award saw Transport Scotland submit a request to the Competition and Markets Authority Subsidy Advice Unit (SAU) to provide a report concerning the proposed subsidy to CalMac Ferries Limited. This request relates to a Subsidy of Particular Interest (SoPI).

The SAU prepared a report that evaluated Transport Scotland's assessment of whether the subsidy complies with the subsidy control requirements (Assessment of Compliance).

Transport Scotland is proposing to provide a subsidy to CalMac Ferries Limited for the running of Clyde and Hebrides Ferry Services (CHFS) between the islands and the mainland. The estimated total subsidy is £3.7 billion over a period of 10 years. This subsidy level has been calculated on the basis of cost estimates of providing the lifeline ferry services over that period.

The policy objective of the subsidy is focussed on ensuring that the island/peninsular communities on the CHFS network are provided with a service that is accessible, reliable, convenient and will provide adequate resilience to those communities.

As part of the subsidy assessment, Transport Scotland has concluded that the subsidy is an SoPI. Transport Scotland also considers the subsidy to be for a service of public economic interest (SPEI).

The grant is being awarded pursuant to the exemption for "in-house" contractual arrangements provided for in Regulation 13(1) of the Public Contracts (Scotland) Regulation 2015 (as amended) (the Teckal Exemption).

Transport Scotland has said the the subsidy is not subject to an exemption under sections 43-51 of the Subsidy Control Act (SCA) 2023.

The Subsidy Advice Unit Report is available at this [link](#). The report provides non-binding advice to Transport Scotland. It does not consider whether the Subsidy should be given, or directly assess whether it complies with the subsidy control requirements. The SAU view expressed in the report is that the Transport Scotland Assessment clearly describes and evidences both the Subsidy's policy objective of ensuring the continued provision of lifeline ferry services to island/peninsula communities and its equity objectives of tackling the inequalities faced by these communities.

However, the SAU identified a number of areas for improvement which are summarised below:

- a) To the extent that Transport Scotland wish to rely on a market failure argument (as well as the strong equity rationale that it sets out), the Assessment should better demonstrate the existence of positive externalities, notably by explaining how the subsidy will achieve a more efficient outcome by describing the additional economic spillovers that would be created by providing a lifeline ferry service that is accessible, reliable, convenient and which provides resilience to island/peninsula communities (Principle A).
- b) the Assessment should better demonstrate that Transport Scotland considered a range of alternatives to the subsidy and explain, with appropriate evidence, why it concluded that they were not suitable to achieve the policy objective (Principle E).
- c) the Assessment of the counterfactual should be more granular and include a route-by-route assessment examining whether any level of service could be commercially provided, when allowing for variations in price and frequency (Principle C).
- d) On proportionality (Principle B), the Assessment should further explain and evidence:
 - (i) the extent to which the leasing and maintenance costs by CalMac for the use of Caledonian Maritime Assets Limited's (CMAL) ferries (see paragraph 1.10) and the costs paid to CMAL by CalMac to fund the purchase of new ferries are the minimum necessary amount to achieve the policy objective;
 - (ii) whether bundling the network ensures that the Subsidy is proportionate to the policy objective and limited to the minimum necessary. This could include cost modelling of unbundled routes, which might permit more efficient business models; and
 - (iii) why an open competitive tender would not allow the policy objective to be met with a lower level of subsidy. This could include, for example, market testing with potential operators who might bid for the 10-year Clyde and Hebrides Ferry Services (CHFS) contract, and benchmarking of how costs compare across ferry services in Scotland.
- e) the Assessment should more systematically set out and evidence potential competition and investment impacts of the Subsidy, drawing on the relevant parts of the Statutory Guidance (Principle F).
- f) the Assessment should more fully set out and explain the intended benefits of the Subsidy, including qualitative assessment where necessary (Principle G).
- g) the Assessment should better explain how Transport Scotland will ensure that the greater flexibility to adjust service level in the lifetime of the contract remains consistent with the transparency requirements of Section 29 of the Act.

Within the above recommendations the point around whether the existing single CHFS bundle (point d. ii) is perhaps the most significant in considering a departure from past practice. Comhairle nan Eilean Siar have set out an alternative case for a Western Isles Bundle which would be similar in scale to the Northern Isles Ferry Service contract and if tendered would offer resilience within the bundle which would include five dedicated major vessels and two island class vessels. The island class vessels would need an arrangement in place for relief cover shared with other bundles should CHFS be split into smaller bundles. Mull and Iona Ferry Committee have also suggested a Community Ferry Company for Mull and Iona and a wider exploration of unbundling of CHFS. Clearly any change in the make up of the CHFS bundle would need meaningful community engagement and reassurance to communities on continued service security. It is also noted that the SAU advice in non binding and Scottish Government have been clear in their position on retaining the single large CHFS bundle.

Risk Register

RTS Delivery

Impact - Positive

Comment – Securing the long term future of the lifeline CHFS services is important to connecting the Highlands and Islands. The services are critically important to the region and service improvements and investment is planned for the future.

Policy

Impact - Positive

Comment – Ferry services are a critically important part of the Highlands and Islands transport system and the opportunity to improve their delivery is important.

Financial

Impact – Neutral

Equality

Impact – Positive

Comment – Improving ferry service accessibility is an important part of the Consultation.

Recommendation

1. Members are asked to note the report.

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Designation:	Partnership Director
Date:	27 th January 2025