To the Members of the Mull and Iona Ferry Committee,

Dear Sirs,

You have asked for my opinion on the process of negotiations with CMAL for the potential sale of a 60m catamaran ropax ferry currently nearing completion of construction in Batam, Indonesia. The opinions I provide herein are my own in my personal capacity.

We have significant experience of both building new vessels and selling them to multiple jurisdictions for both private sector and publicly owned buyers. Both ordering new vessels and selling them are a normal course of business for the Australian group that owns this vessel.

Selling vessels to government owned companies can admittedly be "quirky" as on occasion they can take negotiating positions which appear unusual when compared to a sale between two private companies. But ultimately where there is a willing buyer and willing seller reasonably in agreement on primary commercial terms most other issues can be ironed out.

It's important to point out that I rarely if ever make any public comment on failed sales of vessels. Failure to reach agreement on terms, or for a buyer to consider a vessel may not be suitable for their requirement, is a more normal occurrence than agreeing a sale in the marine industry. One in ten sales typically proceed from first contact, just like you might look at a number of houses before finding the one you want to buy. It's no different.

In the case of this particular vessel I would normally have given no further thought on this negotiation once failed were it with any other jurisdiction outside of Scotland. But as a Scottish expat (as is the chairman of the Australian owning group) I've reluctantly decided to break my silence on this subject as a matter of public interest in Scotland.

Whereas there has been various exchanges between MIFC, the owners of the vessel and CMAL during the summer of 2020, it was clear that these exchanges were showing very little sign of advancement by September of 2020.

Negotiations had failed to commence to any meaningful level based on two assertions by CMAL. Firstly, that the vessel did not comply with Maritime and Coastguard Agency regulations. Secondly, that the existing overseas owners of the vessel were responsible for securing the sign off of MCA on design compliance, at their own expense, prior to CMAL entering into any meaningful dialogue with the owners on potential sales terms for the vessel.

I was at this stage asked to participate in a conference call with Transport Scotland primarily to discuss sales process. Without going into detail on the specifics of that conversation, TS agreed to encourage CMAL to enter into a negotiation which covered the commercial, technical / operational and regulatory aspects of a potential sale. We would negotiate directly with CMAL's executive and as appropriate for private sales discussions, MIFC would play no active part in the direct negotiations.

In one of my earliest written exchanges with CMAL the above mentioned assertions were reiterated by CMAL and we had explained to CMAL as we had to TS that per market practice the buyer was responsible for regulatory costs for design approval in their jurisdiction. We of course considered the vessel would require some modest design modification as part of this process. We advised CMAL that whereas we had up to that time been in informal dialogue

with MCA on issues around regulatory approval we had put these discussions on hold pending some resolution on commercial terms (on which we provided an outline) and a more complete understanding of operational preferences such as crew accommodation and passenger requirements.

We never received any feedback on commercial terms or operational preferences but CMAL initially agreed to go through the regulatory issues again directly between the two parties. Having reviewed all the regulatory points raised by CMAL over subsequent weeks the opinion of the owners of the vessel had not changed. We restated that we considered the vessel would comply with UK safety regulations either directly or in certain cases through minor design modification.

By December of last year we had still received no further input on any changes required that were operational in nature although we were asked for and provided an estimate of modification cost at the shipyard of build based entirely on our own assessment of modifications that were regulatory in nature and likely operational preferences. At the same time we still had no feedback on commercial terms.

From our extensive experience of selling vessels to overseas buyers, CMAL did not look like a serious buyer let alone a willing buyer. I cannot foresee a circumstance where we would ever assume the buyer's responsibility for regulatory design approval in their own jurisdiction but there equally had been no constructive negotiations on either commercial terms or an understanding from CMAL on what design modifications would be required for reasons of operating preferences. The negotiating stance was to us quite bizarre as it appeared to be driven by the need to create a paper trail rather than a bonifide attempt to negotiate a purchase of a vessel. To be seen to be negotiating without actually negotiating anything. It should not be overlooked or forgotten that Transport Scotland had encouraged both parties to negotiate on the basis of commercial, technical and regulatory matters. Reality is this never happened. We were stuck in a regulatory loop with no clear exit ramp to negotiate an actual transaction.

So to bring the matter to a head (with no great expectations either way) we made an offer in around mid-December for CMAL to purchase the vessel as designed at the shipyard and to assist them to negotiate any modifications they may require with the shipyard. We gave them one week to provide an initial response to this offer ("noted" wold have sufficed) and a further three weeks to enter into a memorandum of agreement on the purchase. Even then the purchase would not be outright as we proposed two further primary conditions of sale. That MCA would approve the design and design modifications prior to purchase, failing which the sale would be null and void, in addition to granting them a further subject of Scottish government budget approval. This last approval was a big risk to the sellers as it was vague enough that they could just change their mind or find another reason not to proceed but as long as they picked up their own regulatory approval costs (we were in agreement to cover design modification expense) it was something we could live with.

After one week of submitting an offer there had been no response (so technically the offer had lapsed). However we waited another three weeks and there was still no response by which point the offer had assuredly lapsed. We received no further correspondence from CMAL until they became aware that we had agreed with MIFC to jointly commission the Strathclyde University report sometime in February. CMAL had been instructed by the Minister for Transport to officially decline the vessel based on their initial premises of vessel non-compliance and failure of the sellers to engage with MCA. It's is not without irony that that the timing of the

declination significantly post-dated the lapsing of the sales offer as if the usual rules of market engagement on a vessel sale were not pertinent. But then again it was indeed in keeping with the entire 'sales process' that preceded the offer so was never actually a surprise or shock as such.

To be clear this ultimately was never a failure of vessel regulatory compliance. This was a failure of process management either deliberately or unwittingly or possibly a bit of both. No competent international seller would ever proceed on the basis CMAL proposed. It was fraught with risk for a seller in terms of time and monetary cost and the process CMAL required had no basis within our market. That process fails every time. How many vessels has CMAL looked at over the last year and how many have they bought? I'll let others answer that question.

Let me now address specifically what was wrong with CMAL's premise that the vessel did not comply with UK regulations.

That the vessel, as originally designed, would not be fully compliant with all UK regulations was of course, on face value, correct. The vessel was designed to comply with the Australian flag state, regulated by the Australian Maritime Safety Authority or AMSA for short, and the rules of the two flag states are not homogenous. They both have high standards of safety regulations, as one would expect, but they somewhat differ around the margins on how they interpret safety requirements and therefore certain regulations and design requirements. The onus upon the builder of the vessel was to deliver us a vessel that would comply with Australian regulations and not UK regulations. In hindsight this is an important distinction as no one was building a new vessel for CMAL in accordance with UK regulations. More on this later.

It was in this regard not the CMAL claim of non-compliance with UK regulations that was wrong. It was the premise that was wrong. If you compare a UK compliance checklist against a ferry designed for Australia, she will fail to comply with some regulations in pretty much every case. The public needs to understand this is not a general, across the board, non-compliance. It's essentially a school exam where you have to pass by getting 100 out of 100 and everything else is a fail. But the question that should be asked in relation to a vessel built for trade in another jurisdiction is not does she comply? It is can she comply, not by exemption (which you will not get) but by BOTH direct compliance and modification?

The comparative UK regulatory checklist of a vessel as designed for an overseas jurisdiction is only stage one of the analysis when you buy a vessel internationally. An experienced buyer will know this and even an inexperienced buyer will usually understand it once explained. The public statements of CMAL's spokesperson earlier this year that the vessel does not comply with UK regulations may sound convincing to the public as an authoritative pronouncement but unfortunately it was completely unauthorative from an industry perspective.

The first true analysis of UK compliance of this vessel, directly, and through modification, was undertaken by the department of naval architecture at Strathclyde University (as commissioned jointly by MIFC and the vessel owner) which confirmed that this vessel would pass by high margins the UK requirements on damage stability and that where design modification was needed to satisfy other requirements of the UK regulations such modifications were generally straight forward and minimally invasive to achieve. Strathclyde provided both the analysis for direct approval and the template and analysis for approval through design modification, in each case as applicable.

Someone could quite rightly ask why did we agree to commission the Strathclyde report on the vessel if by that stage our offer had lapsed and there was no further negotiation on the vessel?

I would venture that we did so for the same reason I am providing public comment here. We knew they were wrong in the foundation of their decision making. We knew their analysis was incomplete. We did not necessary expect to change minds in a way that would bring CMAL back to the table. At the very least their public statement of non-compliance of the vessel could be detrimental and possibly should require correcting if we so chose to do so. But if someone at a level of authority within government was to start asking the right questions for future acquisitions that in itself would be a positive step for the future.

Which takes us to the second reason why the sales negotiation failed to get out of the gate and seemingly the reason why CMAL decided not to undertake a fuller analysis of likely compliance. They claimed that the seller was responsible for securing MCA compliance, at the seller's own expense, and prior to CMAL committing to negotiate a commercial agreement.

So let me explain how the international sale and purchase market works specifically as it relates to vessel regulations and registration. Let's talk specifics in terms of industry norms and also speculate on why CMAL would be so adamant that we proceeded the way they requested, a process that was rejected by the owners of the vessel.

In the case of a second hand sale of a vessel between one jurisdiction of registration and another jurisdiction of registration, industry practice and precedent is that the buyer is responsible for the process of registration in its own jurisdiction. This would include design approval (including any required design modifications) and the actual process of registration. The buyer can confirm that there is no impediment to registration in its own jurisdiction through direct application to the agency responsible for compliance either before purchase (on which basis it would most likely request regulatory approval as a condition of sale with the agreement of the seller) or after purchase at its own risk The notion of a seller being responsible for approval in the buyer's jurisdiction (if this is a foreign jurisdiction to the seller) has no precedent in our industry. None. Zero. It does not happen as a matter of international sale and purchase of vessels so far as normal business practice is concerned between experienced parties.

A second hand sale includes not only a vessel already trading but equally the resale of a vessel under construction which is being built to comply with the existing owner's jurisdictional regulations. I touched on this distinction earlier. CMAL was not ordering a new vessel from a shipbuilder. They were negotiating with a party that had ordered a new vessel which was exploring sales opportunities in the international sale and purchase market.

With respect to an experienced seller of vessels a deal would in virtually every circumstance fail on CMAL's primary condition alone. But we were not only being asked as a seller to undertake and pay for this process with MCA. We were equally being told they would not even negotiate terms until we had done so.

There has been some speculation as to why CMAL would insist upon a non-market based sales process for this vessel. They don't like catamarans appears to be the general sweeping consensus. But of course they probably needed to show Scottish Ministers that they were making every effort to negotiate vessel purchases. Not least in the case of the Mull service which is in desperate need of new capacity. So one explanation that is plausible is that this was

largely an exercise in optics. But there is also one other reason which could explain their negotiating position which is equally speculative. Perhaps there is no one within CMAL's executive who has ever bought a second hand vessel before at least outside of the UK or Europe (if at all)? Bear with me on this one as it's pretty easy to explain if their experience is entirely in ordering new vessels from a shipyard.

Ordering a brand new vessel from a shipyard is the only exception to a second hand sale in terms of which party is responsible for regulatory compliance of a vessel design in the jurisdiction of the buyer. When a new vessel is ordered there is an obligation on the builder to construct the vessel in accordance with a classification society that approved design drawings and that will certify that the vessel is built in accordance with that design AND per the rules and regulations of a nominated flag state authority. It remains the responsibility of the buyer to actually register the vessel upon delivery but this does not remove the builder's responsibility to deliver a vessel capable of being registered in that jurisdiction. That is a newbuilding order. Not a second hand sale of a trading vessel nor a vessel already under construction in accordance with the regulatory requirements of another jurisdiction. To repeat in this instance CMAL was not ordering a vessel from a shipbuilder with the requirement that she complies with their own jurisdiction. They were negotiating with the party that ordered the vessel in compliance with another jurisdiction.

The more I thought about this recently the more it dawned on me that this may not have been just an exercise in optics as I must admit we originally suspected. Perhaps they had just completely conflated a second hand and resale process with a newbuilding order.

Sidebar - when I first drafted this letter to MIFC a few weeks back, the acceptance that some form of testimony may be of use to the public understanding of whether or not the negotiating position of CMAL was deliberately obstructive or just misguided was an open question or hypothesis. I did not know for sure. The reality of the matter is it actually does not have to be one or the other. It can be both. Even if CMAL had genuinely believed the seller was responsible for MCA approval, a reasonable buyer would still usually understand that a seller would be more likely to assume such a responsibility with the knowledge that there was pre-agreed purchase terms and pre-stated and confirmed operational modification requirements. So even if, with my and the group chairman's combined industry experience of over 80 years, we were still wrong on the MCA process (which of course we were not) a serious and/or willing buyer would surely still understand why a seller may want a modicum of deal certainty to proceed to do anything formally with MCA if they could. Some rules of engagement beyond "we'll talk about it later". There is a requirement for a degree of empathy in business negotiations. Not of an emotional nature but of a business nature. A sensible, rationale and reasonable approach to business negotiations. So yes a negotiation can be set up to fail AND be based upon an erroneous premise. These positions are not mutually incompatible if not directly correlated. However, with the recent written position from CMAL to MIFC that this was not a second hand sale but rather a newbuilding I think that we have greater clarity that this is at least partially a matter of insufficient industry knowledge on the part of CMAL rather than merely obstructionism.

Finally, let me just address process oversight for one second. It certainly appeared that during and after these discussions with CMAL that both Transport Scotland and the Minister for Transport were essentially rubber stamping CMAL's position on process and regulatory compliance management. This was apparent to us not through direct communication at government department level (we had not had any direct contact with Transport Scotland

since October of 2020) but in feedback from MIFC. So where exactly is the oversight let alone real time overview of CMAL's procurement practices?

I'm advised by MIFC that Transport Scotland has claimed to receive independent legal advice supporting CMAL's position which only goes to prove you can indeed be wrong twice. Transport Scotland claimed to MIFC that they cannot release what the direct advice was under an archaic ruling that Scottish ministers do not disclose legal advice publicly. I for one would argue this is not specifically legal advice no matter if it comes from a legal source. Whatever advice they received it should have been process advice which is substantially commercial, market driven, and not legal in nature. The question is what is the normal process in the purchase of a vessel already under construction for another jurisdiction when it comes to the sale of a vessel to your own jurisdiction? Where exactly is the sensitive legal advice there? It's a question of market norms. You don't need a legal strategy - and ergo sensitive legal advice – to get a market based process response. Of course there is also the newbuilding "rabbit hole". I could see why they may not want to put their hand up for that one. So to the people of Mull and Iona I'd say if it's just process advice the Scottish Government can comfortably tell you what that advice was. I obviously don't know what the position is based on. I just know it's not how our market works.

Whilst on the subject of non-disclosure, I'm advised that CMAL will not release the Leadship report refuting the Strathclyde analysis. To be clear to everyone this is not even arguably legal advice to Scottish Ministers. The small extract shared from that report to MIFC suggests that modifications required on the vessel would be substantial and have a material impact upon cargo capacity. This is curious. Both the vessel designer and the naval architects at Strathclyde University considered that the modifications required to achieve regulatory compliance of the vessel as designed would be modest and minimally intrusive. As such I can only speculate that they are addressing both regulatory modifications and modifications to crewing capacity and passenger space or something analogous thereto, or what could be generically referred to as operational preferences. If this is the case it would only vindicate further the vessel owner's decision to not proceed to engage in and pay for an exercise on regulatory approvals and regulatory design modifications prior to agreeing operational requirements and commercial terms with CMAL.

One of our primary stated concerns with the CMAL process was we would not engage in and pay for a regulatory process (which they were responsible for as a matter of industry practice) only to be tripped up by the process of operational approval which they didn't even want to discuss prior to MCA sign off. If I am wrong about this they can so prove it by releasing the Leadship report. If lost capacity is purely a matter of regulatory required design modification as opposed to operationally required modifications then I'll stand corrected on that one aspect. But it doesn't take away the fact that CMAL never once shared what their capacity requirements were and for this only comes to light now is "just not cricket". Don't you think perhaps they should have mentioned specific capacity requirements just as a matter of reasonableness and professional courtesy before insisting we had to pay for the MCA approval process? Damned if you do. Damned if you don't but thank heavens we held our position of sticking to a market based approach to sales negotiations. Similar to the process advice to TS the Scottish public would be within their rights to draw their own conclusions if CMAL fail to release this report.

In summary both CMAL and Transport Scotland were adamant than an overseas company was responsible for securing regulatory approval for their vessel in the UK. Both were wrong. CMAL were equally issuing public statements around the vessel's non-compliance with UK regulations when they, or at least their advisors, had to know that such compliance analysis should be iterative and not static for a vessel designed for an overseas jurisdiction. Where was the actual analysis?

In the meantime the Mull community has been deprived of the use of a vessel that could be berthed at Craignure and have a meaningful positive impact upon island life. A vessel that would have offered superior fuel and crewing efficiency at a fraction of the acquisition cost of a typical CMAL purchase.

Everything I've said above in terms of industry practice in regulatory compliance within the international sale and purchase market can be verified by independent international facing experts in maritime law, ship brokerage and naval architecture.

MIFC should insist on seeing the process advice to Scottish Ministers. If it's based upon market practice that is not sensitive legal advice. If it's based upon a legal strategy to support another position other than normal market process it still justifies an answer, even if it does demonstrate they added one plus one and got three. If you don't get the information I suggest you already know the answer. Equally, for the Leadship report there is no legal impediment to its release. Frankly the sellers of the vessel are vindicated either way as CMAL failed to disclose any sensitivity to cargo requirements based upon either undisclosed operationally required changes or regulatory modifications. I don't think you have to be a shipping expert to understand that it's unreasonable to insist a party goes through a lot of time and expense to secure regulatory approval without first advising them on operational restraints in terms of capacity requirements. I'll say it again PROCESS MANAGEMENT!!!

In my mind this vessel sale failed in January of this year. An offer was made and an offer lapsed without response. However, as a Scot, I would just ask the Scottish Government to take a long and meaningful look at process management and decision making in the Scottish public ferry sector for the sake of Scottish tax payers and lifeline ferry users. This vessel sale was not the be all and end all to the vessel owner or the Scottish public ferry service. But it does not appear to be an outlier, a one off in procurement practice from what I can see.

Yours faithfully,

Ken MacArthur