

From: Frances Pacitti
Energy and Climate Change
Directorate
10 April 2018

First Minister
Deputy First Minister
Cabinet Secretary for Economy, Jobs and Fair Work
Cabinet Secretary for Finance and Constitution

**IMMEDIATE - COMMERCIALY CONFIDENTIAL – BURNTISLAND
FABRICATIONS LIMITED AND DF BARNES SERVICES LIMITED**

Purpose

1. To provide an update to the submission dated 18 March 2018, on the proposed acquisition of Burntisland Fabrications Limited (BiFab or the Company) by DF Barnes Services Limited, a subsidiary of the JV Drivers Group (DF Barnes), including proposed support by the Scottish Government (SG).
2. To seek your approval to revise the terms of support to be provided by SG to DF Barnes, in response to escalating costs of completion of the contracts associated with the Beatrice offshore wind farm (BOWL), with a view to concluding contracts in the coming days.

Timing

3. Urgent.

Background

4. A full background to the transaction is provided in the briefing of 18 March 2018, a copy of which is provided and Annex A and which should be read alongside this submission.
5. Heads of terms were concluded between Scottish Ministers and DF Barnes on 22 March 2018, setting out the terms of support by SG to DF Barnes for the acquisition of the entire share capital and subsequent implementation of proposed growth strategy for BiFab. In brief, the support comprised [REDACTED]
[REDACTED] This was to cover anticipated costs to completion of contracts between BiFab and Siemens and SHL in connection with the BOWL project. The heads of terms also made provision for a separate £10 million restructuring loan post acquisition.

Recent Developments

6. On forecast for costs to complete the BOWL contracts. This projected an increase in costs to completion 4 April 2018, BiFab prepared revised from [REDACTED]
[REDACTED]

██████████ This was to cover previously unanticipated cost increases attributed to adverse weather conditions in March, and contingency for future cost increases.

7. On 5 April 2018, DF Barnes prepared its own forecasts in light of pre-acquisition diligence and the BiFab forecasts of 4 April 2018. ██████████

██████████ DF Barnes has asked SG for support in meeting this cost overrun, in line with its position to date that its acquisition of BiFab is subject to its exposure to the BOWL contract being mitigated.

8. In subsequent discussion with officials and our commercial advisers, it became clear that this figure comprised ██████████ requirement, broadly in line with the revised BiFab forecasts, ██████████ where the extent of cash need may be within DF Barnes' own influence. This is reflected in the proposed pricing structure outlined below.
9. At a board meeting on Saturday 7 April, JV Drivers (the parent company of DF Barnes) concluded that, while it remains committed to the acquisition of BiFab, its view of the risk associated with escalating costs to complete the BOWL contract and underlying BiFab performance is such that it no longer wishes to provide a parent company guarantee in respect of the £10 million restructuring loan.

Revised Heads of Terms

10. Officials have taken advice from our financial advisers on appropriate terms upon which Ministers might extend support to the Company to reflect these recent developments.
11. Proposed changes to the previously agreed heads of terms comprise:
- Increase in total quantum of the commercial loan facility to ██████████
 - The first tranche in the sum of ██████████ has been drawn down, with interest accruing ██████████ per annum.
 - The second tranche in the sum of ██████████ has been drawn down, with interest accruing at ██████████ per annum. The total ██████████ debt associated with tranches 1 and 2 is convertible to ██████████ shareholding in the Company.
 - A third tranche in the sum of ██████████ will be available post acquisition by DF Barnes of the entire share capital of BiFab, with interest accruing at ██████████ per annum. The total ██████████ debt associated with tranches 1, 2 and 3 is convertible to ██████████ shareholding in the Company.
 - A fourth tranche in the sum of ██████████ will be available post acquisition by DF Barnes of the entire share capital of BiFab. These funds relate to certain contested items including treatment of warranty bond liabilities, treatment of variations, and contingency items, and so the pricing structure differs from earlier tranches. These are matters which DF Barnes/ BiFab should be able to influence and pricing is intended to incentive proactive mitigation of these costs. Draw down would be contingent upon demonstration of the

requirement for the funds to complete the contracts. Interest would accrue at [REDACTED] per annum. The principal debt would be capable of conversion to equity only following completion of the BOWL contracts. Conversion of all four tranches would be up to 38%, dependent upon the uptake of tranches 4. The interest on tranche 4 would accrue until conversion to equity.

- No parent company guarantee will be provided on the £10 million restructuring facility, with security being provided by floating charge in favour of Scottish Ministers. The pricing associated with this lending would increase to [REDACTED] to reflect the increased risk to Ministers. Flexibility would be retained to allow parties to revisit should conditions materially change in future.
- DF Barnes has asked for some comfort that Ministers will consider a future request for a [REDACTED] project finance facility. It is proposed that this be provided by non-binding letter of comfort only, providing a commitment that the discussion may be revisited in future, but agreement on none of the essential terms, which would be considered at the date of any such discussion.

12. A table showing proposed revised heads of terms is included as Annex B to this submission for ease of reference.

Strategic Case for Government Intervention

13. The strategic case for Scottish Government intervention remains as set out in previous submissions. If SG does not facilitate further support, the BOWL contract will not be completed and prospects for BiFab to continue as a going concern and secure future contracts would be lost.

14. There may be a call for SG to step in to rescue and operate the company, both for the completion of the BOWL contract and as a going concern. The financial exposure and risk associated with such an undertaking would be significant. The locus and competence of the SG to commercially and credibly operate in this sector would also be challenged.

15. [REDACTED]

16. Within this context, the proposed acquisition of the company, SG equity share, and additional loan facility has wider strategic importance. The commercial rationale for this approach is that, by committing further funds now, we improve our ability to recover our investment over the longer period.

17. Our intervention will maintain confidence within this industry, while simultaneously supporting the local economy, and the Scottish economy more widely. The Programme for Government sets out a forward-looking economic vision for Scotland. Central to that is the opportunity to seize the economic opportunities of tackling climate change, helping existing industries adapt to future challenges, and to make our economy more competitive, productive, innovative, fair and profitable.

Risk

18. Risks and proposed mitigation measures remain as described in the submission of 18 March 2018. The debt equity conversion ratio and interest rates have been calculated on base assumptions about future performance provided by DF Barnes. There is an inherent risk that performance does not match the projected forecasts.
19. This risk has been mitigated by stress testing the forecasts, with base case, low case and high case projections having been considered by our commercial advisers when considering appropriate pricing.
20. There is a risk that the Company will be not be successful in securing either the Moray or Kincardine contracts, being the short term contract opportunities which inform the business model.

State Aid

21. State aid considerations remain as set out in previous submissions. We have received independent legal and commercial advice that the revised heads of terms set out in this submission are based on MEIP compliant principles. The approach to securing this deal has been conducted on a fully commercial basis. The agreed terms represent the best option presently available for Ministers to support a long-term future for BiFab as a going concern. The commercial terms provide the best available route for government to mitigate its existing exposure, maximise its ability to recover its initial investment and any further commitments. It has been advised that this is consistent with an Market Economy Investment Principle (MEIP) approach.

Recommendation

22. That you note the content of this submission, and provide approval for officials to amend the heads of terms agreed on 22 March and to conclude legal contracts.

23. This advice has been agreed with DG Economy and DG Organisational Development and Operations.

Frances Pacitti

Energy & Climate Change Directorate

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10 April 2018

Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness
Cabinet Secretary for Rural Economy & Connectivity Minister for Business, Innovation & Energy					X X

Permanent Secretary
Lord Advocate
DG Economy
DG Scottish Exchequer
DG Organisational Development & Operations
Chief Financial Officer
David Ritchie
David Stevenson
Gary Gillespie
Kerry Twyman
Derek Glover
Mark Richards
Caroline Beattie
Murray Sinclair
Elizabeth Lloyd
Stewart Maxwell

Annex A – Submission dated 18 March 2018

From: David Ritchie
Deputy Director Energy Industries
Division
18 March 2018

First Minister
Cabinet Secretary for Economy, Jobs and Fair Work

IMMEDIATE - COMMERCIALY CONFIDENTIAL – BURNTISLAND FABRICATIONS LIMITED AND DF BARNES SERVICES LIMITED

Purpose

24. To provide an update on the proposed acquisition of Burntisland Fabrications Limited (BiFab or the Company) by DF Barnes Services Limited, a subsidiary of the JV Drivers Group (DF Barnes), including proposed support by Scottish Government.
25. To seek your approval to progress Heads of Terms on the terms of support to be provided by SG to DF Barnes, with a view to concluding contracts in the coming weeks. This will incorporate terms for SG equity and debt pre- and post-acquisition, enabling a commercial deal between BiFab and DF Barnes.

Timing

26. Urgent.

Background to the transaction

27. BiFab is a fabricator of oil and gas and offshore wind structures. It operates from three sites: Burntisland and Methil on the east coast of central Scotland; and Arnish on the Isle of Lewis. At maximum capacity, it has the potential to utilise a workforce in excess of 1,000 individuals across the three sites.
28. The previous majority shareholding of JCE Offshore AB (a Swedish owned investment vehicle) has now been transferred to management, and the shareholding of SSE Venture Capital Limited is also in the process of being transferred to management. The balance of equity is owned by 5 individuals including a director, a non-executive director and 3 investors not directly involved in the running of the business.
29. The Company has a contract with SHL Offshore Contractors BV to provide 26 offshore wind jackets. The Company also has a contract with Siemens to provide two transformer platform jackets. Both contracts are for the Beatrice Offshore Wind development (BOWL). It has no other confirmed contracts at present.

30. Both contacts were in dispute and the Company was facing severe cash flow difficulties, partly driven by significant cost overruns. Within this context, a Notice of Intention was filed to appoint administrators on 10 November 2017. In the period from the Notice of Intention being filed to 18 November 2017, Scottish Ministers, in meetings chaired by First Minister, brokered a negotiated position between all interested parties.
31. The two main shareholders agreed to provide convertible loans to the Company:
- SSE Venture Capital Limited [REDACTED]
 - JCE Offshore AB [REDACTED]
32. The financial commitments by SSE and JCE were secured on the basis of a reciprocal commitment by Scottish Ministers to provide the Company with support in the form of [REDACTED] commercial loan facility. The solution brokered by the First Minister also included the waiving of liabilities and release of funds by other interested parties, including BOWL, SHL and Siemens.

Public Sector Involvement

33. Scottish Government's initial intervention in November prevented an insolvency situation materialising.
34. The rationale for our support was to secure the completion of the BOWL contracts, and to deliver a long-term future for fabrication across all three yards operated by BiFab. Both these points had wider strategic importance across Scotland.
35. Our steps have maintained confidence in and the reputation of the Scottish supply chain, an important sector central to Ministers' ambitions for a prosperous transition to a low carbon economy. SG's support has extended some employment that would, without intervention, have been terminated.
36. Prior to the Notice of Intention being lodged, DF Barnes had expressed interest in the acquisition of BiFab, but that acquisition was put at risk by the prospect of an insolvency situation. Ministers' approach has kept DF Barnes engaged, and has now led to them committing to investment in BiFab over the longer term. As a result, the prospects of BiFab securing future contracts has improved. This will realise longer term employment opportunities, and a platform for further diversification into other sectors. The management, knowledge and skill that DF Barnes brings can lead to demonstrable improvement in execution of project delivery.
37. Within this context, there is now a tangible path to expand the scope and remit of BiFab, post-acquisition by DF Barnes. The ambition is not only to service the domestic market but to export this expertise internationally.

Recent Developments

38. BiFab experienced significant cash flow difficulties in advance of our initial loan. There was a known risk to repayment of that loan given the lack of assets in BiFab, and the forward cash projections being precarious. This was outlined in previous submissions and ongoing updates to Ministers. The lending risk reflected in the commercial terms upon which the loan was provided.

39. [REDACTED]

40. [REDACTED]

41. [REDACTED]

42. [REDACTED]

43. [REDACTED]

44. [REDACTED]

45. [REDACTED]
- is also our belief that BiFab tenders and prospects of securing contracts would be enhanced if there was an improved balance sheet, particularly with a strong parent company, and that DF Barnes' expertise and project delivery competence would be viewed positively.

Current Position

46. DF Barnes has asked for SG support for its acquisition of BiFab, to reflect the changing risk profile associated with acquisition post financial difficulties which came to light in November 2017.
47. Two principles have underpinned its request for support. The first is that its commitment to BiFab is conditional upon the liabilities of the BOWL contract being ring-fenced. DF Barnes' consistent and clear view is that the execution, pricing and management of that contract was not their responsibility. For DF Barnes to deliver a prosperous future for the company the liabilities cannot remain on the balance sheet. The second is that the pricing of any debt must not restrict its ability to invest in the business going forward, nor impose unduly onerous securitisation requirements which might undermine other parts of its business. These principles have been reflected in the negotiated commercial terms outlined below.

48. [REDACTED]

Principles to Inform Heads of Terms

49. In summary, the main components of the support by SG to DF Barnes to secure its acquisition of BiFab would be:

[REDACTED]

[REDACTED]

50. Following lengthy commercial negotiation, the principles of SG support were agreed late Friday, 16th March, subject to necessary internal and Ministerial approvals being obtained. Our independent commercial advisers Grant Thornton LLP and legal advisers MacRoberts LLP were closely involved in those negotiations.

51. Given the pace at which matters are progressing, this submission has been drafted in advance of receipt of written confirmation of the advice provided verbally during the course of the negotiation. However, they have clearly advised that the approach to securing this deal has been conducted on a fully commercial basis. The agreed terms represent the best option presently available for ministers to support a long-term future for BiFab as a going concern. The commercial terms provide the best available route for government to mitigate its existing exposure, maximise its ability to recover its initial investment and any further commitments. It has been advised that this is consistent with a Market Economy Investment Principle (MEIP) approach.

Short-Term Sequencing

52. [REDACTED]

53. [REDACTED]
54. The Directors of BiFab are due to meet at 3pm on Monday, 19th March. In order to carry out their fiduciary duties with competence, the Directors will need to be satisfied that they are content to continue to trade and accept more credit. We have agreed with PWC and the Finance Director at BiFab that an update will be provided in advance of the 3pm Board of Directors meeting at BiFab on Monday, 19th March.

Risk

55. [REDACTED]
56. [REDACTED]
57. [REDACTED]
58. It is also our view that once Heads of Terms are agreed and that all interested parties are aware, BiFab will be in a stronger position to manage their debtors and creditors more effectively. This should mitigate the risk of any creditor placing a cessation of assets and demanding payment in the fear that an insolvency situation is pending.

Recovery of Equity

59. [REDACTED]
60. [REDACTED]
- [REDACTED]

[REDACTED]

61. [REDACTED]

Future Contracts

62. There is a risk that the Company will be not be successful in securing either the Moray or Kincardine contracts, being the short term contract opportunities which inform the business model.

63. [REDACTED]

State Aid Considerations

64. We considered two methods of public sector support for BiFab:

- Rescue and Restructure (R+R); and
- Market Economy Investment Principle (MEIP).

R+R

65. R+R can be provided where a company is in distress and the state wishes to provide short term funding to improve liquidity. R+R requires advance referral by the member state (in this case BEIS on behalf of the UK Government) to the EC for approval.

66. Cashflow challenges for BiFab have always been known, though the scale of these challenges have been further exacerbated by cost overruns and delays in conclusion of the BOWL contracts. Without an immediate cash injection, it is understood that the company will go into administration in week beginning 19th March.

67. Within this context, the timescales associated with such a referral would exceed the time available to secure funding to alleviate BiFab's current cash flow issues. After discussion with State Aid colleagues, we also concluded that given the sector which BiFab operates within, it is unlikely that the EC would support any R+R intervention.

MEIP

68. Our preferred option is to provide support which is MEIP compliant. To demonstrate compliance, the facility must be delivered on a commercial basis. This can be assessed by benchmarking against comparable loan arrangements, the terms offered by alternative finance providers, the commerciality of the specific terms of the investment, project profitability, general market conditions, and terms being progressed through commercial negotiations.
69. The EC has the ability to consider MEIP compatibility and review the use of state resources at a later date. If the EC were to conclude that the principles of MEIP had not been demonstrated, the Company would need to repay funds received, even if that led to its future insolvency.
70. Audit Scotland will also comment on any assessment in the context of regularity, propriety and value for money and has set out its intention to consider the original transaction in November in its audit plan for the 2017-18 annual accounts. This would focus on the use of public funds, and given that the original loan facility and wider deal was discussed in parliament it is clear that they will look at the range of actions the SG took both then and now.
71. Within this context, we have received independent professional advice that the terms outlined in this submission are based on MEIP principles. We still await written reports from our independent commercial advisers Grant Thornton LLP and our legal advice from MacRoberts LLP. However, they have clearly advised that the approach to securing this deal has been conducted on a fully commercial basis. The agreed terms represent the best option presently available for ministers to support a long-term future for BiFab as a going concern. The commercial terms provide the best available route for government to mitigate its existing exposure, maximise its ability to recover its initial investment and any further commitments. It has been advised that this is consistent with an Market Economy Investment Principle (MEIP) approach.

Strategic Case for Government Intervention

72. [REDACTED]
73. [REDACTED]
74. [REDACTED]

75. Within this context, the proposed restructuring of the company, equity share SG, and additional loan facility has wider strategic importance. The commercial rationale for this approach is that, by committing further funds now, we improve our ability to recover our investment over the longer period. The commercial rationale for this approach is that, by committing further funds now, we improve our ability to recover our investment over the longer period.
76. Our intervention will maintain confidence within this industry, while simultaneously supporting the local economies, and the Scottish economy more widely. The Programme for Government sets out a forward-looking economic vision for Scotland. Central to that is the opportunity to seize the economic opportunities of tackling climate change, helping existing industries adapt to future challenges, and to make our economy more competitive, productive, innovative, fair and profitable.

Employment

77. The Scottish Input-Output Model estimates the impact of a plant closure across the wider Scottish economy. This includes the direct (output of the plant), indirect (wider supply chain impacts including suppliers, utilities and services) and induced (consumption effects of the expenditure by workers) in the economy.
78. Focussing on the aggregate results for Scotland, based on the maximum potential total combined employment estimates from Blfab of c1,400 being treated as direct, it is estimated that BiFab operations could support between 2,000 and 3,000 full time equivalent employees in the wider Scottish economy.
79. The provision of a loan facility will deliver short term security for employment that would, without intervention, be terminated. It significantly enhances the possibility of securing future contracts to provide longer term employment opportunities.

Strategic Location

80. The yards from which BiFab operate have characteristics which make them strategic in both their location and infrastructure.
81. The east coast yards are in close proximity to potential offshore wind developments in Scotland, as well as future north sea investment. They have deep water access, and are able to accommodate heavier structures. The quayside configuration also allow for easy barge transfer.
82. The west coast facility is in close proximity to potential offshore wind developments, and can serve future oil and gas investments west of Shetland. The proximity to these markets allow developers to reduce costs and risks from transportation.
83. The location of the yards from which BiFab operate also mean that is an advantageous position to bid for work on decommissioning. Decommissioning

is a £300 million opportunity over the next decade. Scottish Ministers are committed to Scotland capturing as much of this business as possible. The loss of BiFab would compromise Scotland's capacity and capability to take full advantage of these opportunities.

Offshore Wind

84. Offshore wind is a key part of the UK's current energy mix. It generates 5% of UK electricity, and is expected to generate 10% by 2020. By 2030, it has the potential to supply over a third of the UK's power needs.
85. The cost of offshore wind continues to fall. The result of the recent Contracts for Difference (CfD) auction was £57.50 per megawatt hour for capacity delivered in 2023, nearly 50% lower than prices at the last auction in 2015. This will see 10GW constructed by the end of this decade and up to a further 20GW by 2030.
86. It is estimated that Scotland has a future potential of over 7.6GW of offshore wind capacity, with the opportunity to power over 6.3 million homes.

Supply chain

87. The UK has the largest offshore wind market globally, closely followed by Germany and Denmark. Scotland's close proximity to these markets enables our domestic supply chain to also target these markets. The BOWL, Neart na Gaoithe and MORL projects are due to deliver 2GW of power by 2023. This will be followed by the next CfD auction in Spring 2018, for projects due to be built out in 2024/25.
88. In addition to Moary and Kincardine projects which are currently being bid for, NNG, and Hornsea 2 will also be finalising their tier 1 contractors and subcontractors. Other offshore wind projects in France, and oil & gas projects in Scotland will also be contracting over the course of 2018 and 2019. Combined, these provide an opportunity for BiFab/DF Barnes to bid for high value contracts. DF Barnes have also indicated that they would look to place work from their North American base.

DF Barnes

89. DF Barnes proposed a three stage approach to delivering long terms growth for BiFab.
90. The first stage is to re-establish BiFab in its existing markets. This will be delivered by securing capital to operate more effectively and secure new work, by investing in client relationships to mitigate impact of recent performance issues on BiFab's reputation, by supplementing the existing management team with DF Barnes staff, by securing near term Moray and Kincardine contract opportunities in the first instance, and implementing established project management and execution practices from across the JV Drivers group. This is anticipated to take around 2 years.

91. The second stage will be to diversify BiFab's services to include maintenance, fabrication for export, exhaust gas cleaning systems and oil and gas decommissioning. This forms years 3 – 5 of the plan.
92. The third stage is for European expansion by year 10, with specific entry points to be determined closer to implementation.

Affordability

93. [REDACTED]

Financial Accounts

94. The loans will be recorded as financial assets and our preference is they charged against Financial Transactions. Once loans are converted to equity they remain as financial assets on the balance sheet.
95. SG would need to formally consider the value of equity stake a minimum of once a year as part of the annual accounts process. If there were events in the intervening period that caused us to reflect on their recoverability then we would write down as we would any other loan.
96. The equity stake will be priced via an agreed formula of company book value. GT have identified a range of ways this could be done. This will be agreed with all parties following Heads of Terms being concluded.

Timescales to completion

97. Subject to agreeing more formal heads of terms (w/b 19th March), [REDACTED] This will alleviate the immediate cashflow pressure and remove the immediate threat of administration.
98. Our focus would then switch to finalising a set of commercial terms acceptable for all parties. DF Barnes have indicated that they would like to conclude as soon as possible, and our aim would be to conclude **legal agreements by Friday, 30 March would be prudent.**
99. However, there will be some diligence required by SG and DF Barnes, and within this context we will seek views from MacRoberts on an achievable point to conclude legal agreements.
100. As we approach conclusion we will seek your approval to execute the agreements, outlining the full terms in which ministers are investing.

Parliamentary Handling

101. In November 2017, Mr Brown notified parliament of SG's commitment to support BiFab. This outlined the process to stabilise the company and the commitment of all interested parties to deliver the Beatrice contract and provide BiFab with an opportunity to continue as a going concern.
102. We recommend that a further statement to parliament is delivered. We will liaise with MPO on timing, and that formal planning for this should only commence once Heads of Terms are agreed between SG and DF Barnes,

Communications

103. We are in constant dialogue with DF Barnes. We have agreed there will be no communications with any other interested parties over the weekend.
104. We have discussed with Cabinet Secretary EJFW and Chief of Staff, and agreed to now develop a comms plan which will establish our narrative and sequence of engagement. This will include engagement with BiFab and parties who will need reassurance that Scottish Ministers' are extending their commitments to secure delivery of the BOWL contract and enable a long term future for BiFab/DF Barnes.
105. We will also liaise with Private Office and SpAds on opportunities to announce the formal conclusion of the deal with DF Barnes. We recommend that the detailed terms of our agreement between DF Barnes, and the deal between DF Barnes and BiFab are treated as commercially confidential.

Recommendation

106. That you note:

[REDACTED]

107. This advice has been agreed with DG Economy and the Chief Financial Officer.

David Ritchie

Energy & Climate Change Directorate

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18 March 2017

Restricted - Commercial in Confidence

Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness
Deputy First Minister Cabinet Secretary for Finance & Constitution Cabinet Secretary for Rural Economy & Connectivity Minister for Business, Innovation & Energy					

Permanent Secretary
 Lord Advocate
 DG Economy
 DG Scottish Exchequer
 DG Organisational Development & Operations
 Chief Financial Officer
 Chris Stark
 Frances Pacitti
 David Stevenson
 Gary Gillespie
 Kerry Twyman
 Derek Glover
 Mark Richards
 Caroline Beattie
 Murray Sinclair
 Elizabeth Lloyd
 Stewart Maxwell

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Annex B – Proposed Revised Heads of Terms

Project Harris – Phase 2

Heads of Terms

9 April 2018

1. Finance

[illegible]

[illegible]

[illegible]

