

# Strathclyde Concessionary Travel Scheme Joint Committee



## Audit Scotland report: Transport Scotland's ferry services

**Date of meeting** 23 February 2018

**Date of report** 13 February 2018

### Report by Treasurer/Secretary

#### 1. Object of report

To advise the joint committee on the issue of an Audit Scotland report titled '*Transport Scotland's ferry services*'.

#### 2. Background

##### Audit Scotland report

On 19 October 2017, Audit Scotland published a report titled '*Transport Scotland's ferry services*'.

The report says '*Spending on Scotland's ferry services has more than doubled since 2007/08, increasing vital links to the islands. But the full extent of future spending requirements is not known and could be substantial.*'

*Transport Scotland currently supports 32 ferry routes through three main contracts and, overall, the operators of these contracts are performing well. More than £209 million was spent on ferry services and assets in 2016/17, an increase of 115 per cent since 2007/08. This is mainly due to an increase in services, new boats and the impact of the Road Equivalent Tariff, which has reduced the cost of ferry travel in the Clyde and Hebrides.*

*The report says Transport Scotland has made significant progress in its current ferries plan although this is largely focused on the Clyde and Hebrides routes. Major developments lie ahead, including reducing fares to the Northern Isles from 2018, but the full costs of these are not known. Substantial investment is required in harbours, but the full extent of this is also unclear. All of this underlines the need for a new, long-term strategy, covering the whole of Scotland, to determine and prioritise future investment.*

*The report says Transport Scotland does not routinely measure the social and economic impact made by ferries. Ferry users are generally happy but want to be better informed and involved in decisions which affect their services.*

*The report recommends that Transport Scotland improves its procurement arrangements for ferry services, after finding weaknesses in the arrangements for the recent Clyde and Hebrides contract. As Transport Scotland only received one compliant tender, it was not required to analyse the 350 commitments made by CalMac in its successful bid. This means it cannot fully show the added value that the new contract will provide. The contract was awarded from October 2016 at a cost of £868 million over eight years. Transport Scotland expects this to increase to reflect planned timetable and other changes and estimates the current cost at £975 million.*

The report and supplements can be found at:

<http://www.audit-scotland.gov.uk/report/transport-scotlands-ferry-services>

### 3. Outline of findings

#### Key messages

The key messages outlined in Audit Scotland report are:

- 1. Ferries are an essential part of Scotland's transport network. There are an estimated 66 scheduled ferry routes in Scotland, managed by a range of public and commercial operators. In 2016/17, Transport Scotland spent £209.7 million on ferry services and assets, such as vessels and harbours. It operates three main ferry contracts, through which it subsidises 32 ferry routes, carrying over five million people each year. Between 2007/08 and 2016/17, Transport Scotland's spending on ferries increased by 115 per cent in real terms. Over this period, the number of passengers travelling on its subsidised routes increased by 0.3 per cent and car numbers increased by 16.8 per cent. Subsidies for the Clyde and Hebrides Ferry Service (CHFS) have increased by 185 per cent since 2007/08. This is mainly due to an increase in services, new vessels and the introduction of the Road Equivalent Tariff (RET). RET has resulted in higher passenger and car traffic but its wider impact has been mixed;*
- 2. Transport Scotland's Ferries Plan sets out proposals to develop ferry services and assets between 2013 and 2022, at an estimated cost of £390 million in capital and £10 million a year in revenue. Transport Scotland has made significant progress against the commitments in the plan less than halfway through its duration. But the plan, and underpinning investment plans for vessels and harbours, is focused on the Clyde and Hebrides network. There is no Scotland-wide, long-term strategy which takes into account proposed developments to ferry operations, and the condition of about half of the harbours used by Transport Scotland's ferry operators is unknown. This means the full extent of Transport Scotland's future spending requirements on services and assets is not known. In the context of limited public finances, Transport Scotland will find it challenging to continue to provide ferry services that meet the needs of users within its allocated budget;*
- 3. The operators of Transport Scotland's ferry contracts are performing well and, in 2016, about 99 per cent of sailings were on time. Ferry users are generally happy with services but there is variation across routes and some frustrations exist. Transport Scotland's arrangements for consulting and involving ferry users could be improved. Ferry operations are complicated and responsibilities and accountabilities are not well understood by users. Transport Scotland does not routinely measure the contribution that ferry services make to social and economic outcomes at a network level, which makes it difficult to determine whether its spending is value for money. Better information would allow Transport Scotland to demonstrate the impact of its decisions and the contribution that ferries make to the Scottish Government's National Outcomes.*
- 4. The new CHFS contract started on time, in October 2016, despite delays and weaknesses in how Transport Scotland managed the procurement project. The chosen procurement method was new and the two bidders were not clear on what was expected of them. The bidders submitted over 800 queries during the tender process and there were delays in providing them with important information. Transport Scotland has previously treated ferry procurement exercises as individual projects rather than a programme. It is now developing a more strategic approach for future procurements which should help improve planning, the use of resources and knowledge transfer.*

5. *Transport Scotland received one compliant bid for the new CHFS contract, which it awarded to CalMac at a cost of £868 million over eight years. CalMac's bid met the minimum quality requirements and was £128 million lower than Transport Scotland's estimate of the contract cost. Transport Scotland was not required to assess the 350 commitments in CalMac's bid, which makes it difficult for it to demonstrate the added value of the new contract. Transport Scotland updated the contract before its start date to reflect, for example, planned timetable changes and this has increased the contract cost to £975 million. Contract management arrangements are still evolving and could be strengthened.*

### Recommendations

The recommendations contained within this report are for Transport Scotland to action:

- *as part of its Strategic Transport Projects Review, develop a Scotland-wide, long-term strategy for its network of subsidised ferries. This should take into account progress already made against the Ferries Plan and proposed developments to its ferry operations set out its intended benefits of subsidised ferry services, how these contribute to National Outcomes and how these will be measured, monitored and reported. It should then consider how this information could be used to inform operational and financial decisions and to demonstrate that ferry services are value for money;*
- *include an assessment of the long-term affordability of its spending on services and assets. This should take into account the level of service required, the condition of assets and the need for capital investment set out how its spending will be prioritised across its network be monitored regularly to ensure it is on time and on budget be reviewed regularly to ensure it remains relevant and affordable ensure that it has adequate resources to develop, monitor and report against its long-term ferries strategy;*
- *improve the transparency of decision-making for ferry users. This may include streamlining and formalising how it consults with and involves ferry users, by giving specific user groups a formal remit to comment on operational and policy matters;*
- *improve its approach to procuring ferry services. This should include: ensuring that procurement teams include staff with procurement qualifications and experience of the ferry sector applying lessons from previous procurement exercises building in sufficient time to prepare important project documentation, such as business cases ensuring that contract specifications are accurate, up to date and clear to potential bidders providing bidders with clear, good-quality and timely data to allow them to make informed bids;*
- *strengthen its contract management arrangements by: ensuring there is a sufficient number of people, with the right expertise, to effectively manage ferry contracts involving the contract management team in ferry procurement exercises to inform its understanding of contract requirements;*
- *better communicate roles, responsibilities and accountabilities to improve customers' and stakeholders' understanding.*

## **4. Conclusions**

Audit Scotland published a report titled '*Transport Scotland's ferry services*'.

## **5. Committee action**

The committee is asked to note the contents of this report and the issue of an Audit Scotland report titled '*Transport Scotland's ferry services*'.

## 6. Consequences

Policy consequences	<i>None</i>
Legal consequences	<i>None</i>
Financial consequences	<i>None</i>
Personnel consequences	<i>None</i>
Social Inclusion consequences	<i>None</i>
Risk consequences	<i>As detailed in the report.</i>

**Name** Valerie Davidson  
**Title** **Treasurer / Secretary**

**Name** Gordon MacLennan  
**Title** **Chief Executive**

For further information, please contact Martin Breen (Planning & Projects Officer) on 0141 333 3741.

# Transport Scotland's ferry services

AUDITOR GENERAL 

Prepared by Audit Scotland  
October 2017

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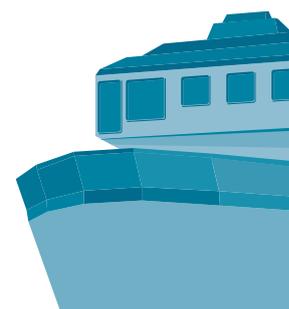
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- government agencies, eg the Scottish Prison Service, Historic Environment Scotland
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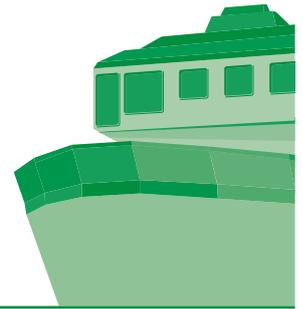
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## Exhibit data

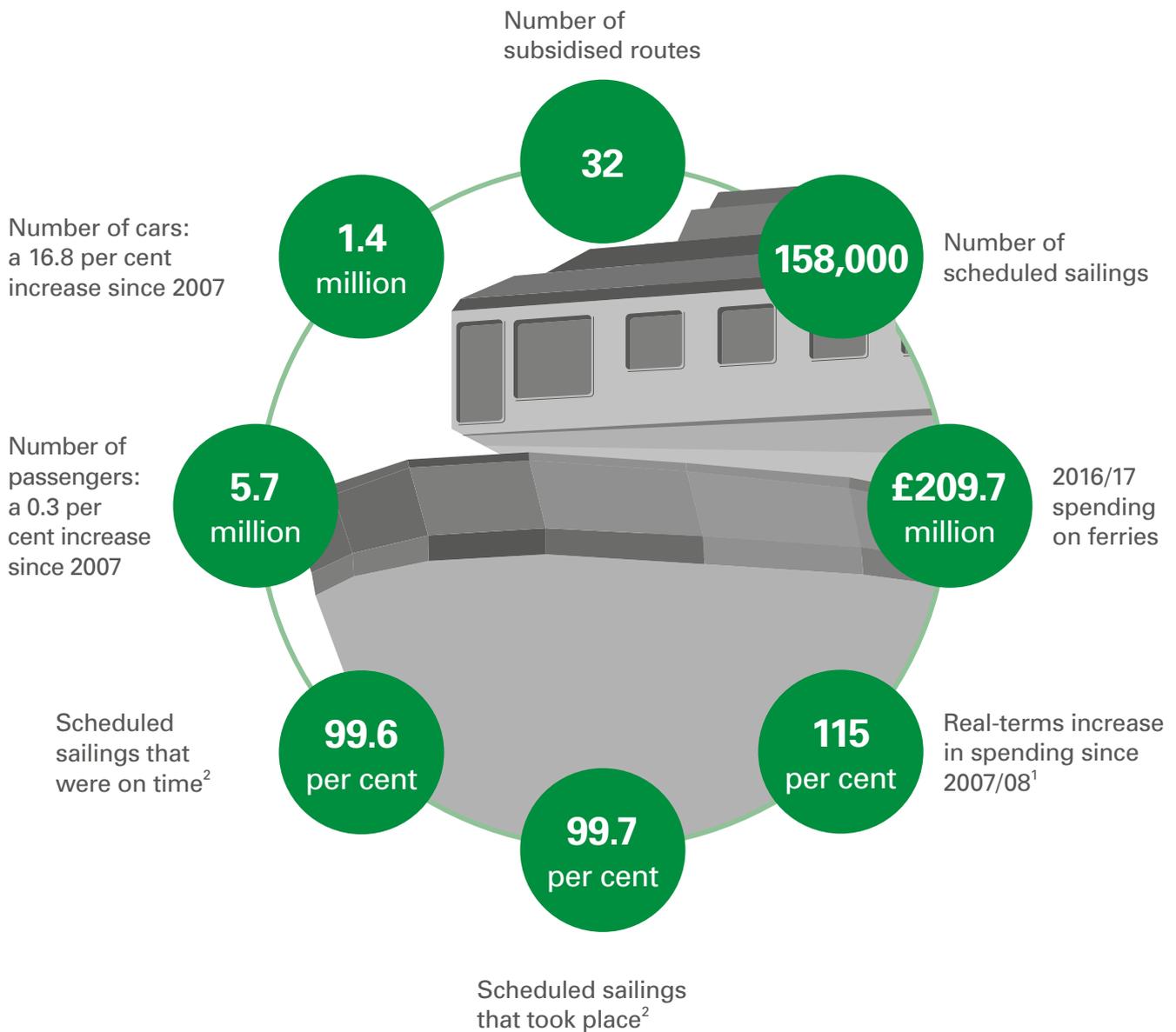
When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.

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# Key facts

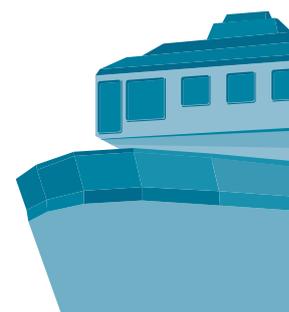


## About Transport Scotland's ferry services in 2016



1. Spending is presented in real terms, that is, adjusting for inflation, at 2016/17 prices.  
 2. After weather-related cancellations and delays have been accounted for.

# Summary



## Key messages

- 1** Ferries are an essential part of Scotland's transport network. There are an estimated 66 scheduled ferry routes in Scotland, managed by a range of public and commercial operators. In 2016/17, Transport Scotland spent £209.7 million on ferry services and assets, such as vessels and harbours. It operates three main ferry contracts, through which it subsidises 32 ferry routes, carrying over five million people each year. Between 2007/08 and 2016/17, Transport Scotland's spending on ferries increased by 115 per cent in real terms. Over this period, the number of passengers travelling on its subsidised routes increased by 0.3 per cent and car numbers increased by 16.8 per cent. Subsidies for the Clyde and Hebrides Ferry Service (CHFS) have increased by 185 per cent since 2007/08. This is mainly due to an increase in services, new vessels and the introduction of the Road Equivalent Tariff (RET). RET has resulted in higher passenger and car traffic but its wider impact has been mixed.
- 2** Transport Scotland's Ferries Plan sets out proposals to develop ferry services and assets between 2013 and 2022, at an estimated cost of £390 million in capital and £10 million a year in revenue. Transport Scotland has made significant progress against the commitments in the plan less than halfway through its duration. But the plan, and underpinning investment plans for vessels and harbours, is focused on the Clyde and Hebrides network. There is no Scotland-wide, long-term strategy which takes into account proposed developments to ferry operations, and the condition of about half of the harbours used by Transport Scotland's ferry operators is unknown. This means the full extent of Transport Scotland's future spending requirements on services and assets is not known. In the context of limited public finances, Transport Scotland will find it challenging to continue to provide ferry services that meet the needs of users within its allocated budget.
- 3** The operators of Transport Scotland's ferry contracts are performing well and, in 2016, about 99 per cent of sailings were on time. Ferry users are generally happy with services but there is variation across routes and some frustrations exist. Transport Scotland's arrangements for consulting and involving ferry users could be improved. Ferry operations are complicated and responsibilities and accountabilities are not well understood by users. Transport Scotland does not routinely measure the contribution that ferry services make to social and economic outcomes at a network level, which makes it difficult to determine whether its spending is value for money. Better information would allow Transport Scotland to demonstrate the impact of its decisions and the contribution that ferries make to the Scottish Government's National Outcomes.

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a new long-term strategy for ferries is required to take into account the many proposed developments to services and assets

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- 4** The new CHFS contract started on time, in October 2016, despite delays and weaknesses in how Transport Scotland managed the procurement project. The chosen procurement method was new and the two bidders were not clear on what was expected of them. The bidders submitted over 800 queries during the tender process and there were delays in providing them with important information. Transport Scotland has previously treated ferry procurement exercises as individual projects rather than a programme. It is now developing a more strategic approach for future procurements which should help improve planning, the use of resources and knowledge transfer.
- 5** Transport Scotland received one compliant bid for the new CHFS contract, which it awarded to CalMac at a cost of £868 million over eight years. CalMac's bid met the minimum quality requirements and was £128 million lower than Transport Scotland's estimate of the contract cost. Transport Scotland was not required to assess the 350 commitments in CalMac's bid, which makes it difficult for it to demonstrate the added value of the new contract. Transport Scotland updated the contract before its start date to reflect, for example, planned timetable changes and this has increased the contract cost to £975 million. Contract management arrangements are still evolving and could be strengthened.

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## Recommendations

### Transport Scotland should:

- as part of its Strategic Transport Projects Review, develop a Scotland-wide, long-term strategy for its network of subsidised ferries. This should:
  - take into account progress already made against the Ferries Plan and proposed developments to its ferry operations
  - set out its intended benefits of subsidised ferry services, how these contribute to National Outcomes and how these will be measured, monitored and reported. It should then consider how this information could be used to inform operational and financial decisions and to demonstrate that ferry services are value for money
  - include an assessment of the long-term affordability of its spending on services and assets. This should take into account the level of service required, the condition of assets and the need for capital investment
  - set out how its spending will be prioritised across its network
  - be monitored regularly to ensure it is on time and on budget
  - be reviewed regularly to ensure it remains relevant and affordable
- ensure that it has adequate resources to develop, monitor and report against its long-term ferries strategy
- improve the transparency of decision-making for ferry users. This may include streamlining and formalising how it consults with and involves ferry users, by giving specific user groups a formal remit to comment on operational and policy matters

- improve its approach to procuring ferry services. This should include:
  - ensuring that procurement teams include staff with procurement qualifications and experience of the ferry sector
  - applying lessons from previous procurement exercises
  - building in sufficient time to prepare important project documentation, such as business cases
  - ensuring that contract specifications are accurate, up to date and clear to potential bidders
  - providing bidders with clear, good-quality and timely data to allow them to make informed bids
- strengthen its contract management arrangements by:
  - ensuring there is a sufficient number of people, with the right expertise, to effectively manage ferry contracts
  - involving the contract management team in ferry procurement exercises to inform its understanding of contract requirements.

**Transport Scotland, along with Caledonian Maritime Assets Limited (CMAL) and the ferry operators, should:**

- better communicate their roles, responsibilities and accountabilities to improve customers' and stakeholders' understanding.

## Background

**1.** Ferries are an essential part of Scotland's transport network. The Scottish Government considers that the quality and affordability of ferry services are vital for sustaining some of the most remote and geographically dispersed communities in Europe. The total number of ferry routes in Scotland is not known. We estimate that there are 66 routes connecting mainland Scotland and its islands, managed by a number of public and private operators ([Appendix 1](#)). Every year about nine million passengers and 2.8 million cars travel on these routes. Ferries also transport essential goods to remote communities and help export large amounts of island produce, including seafood and whisky, which contribute significantly to Scotland's economy.

**2.** Transport Scotland has a major role in the development and operation of ferry services in Scotland. This involves implementing ferry policy on behalf of Scottish ministers and providing financial subsidies to the operators of ferry routes that it considers to be lifeline, that is, those it considers are required for communities to be viable. Transport Scotland's rationale for subsidising ferry services includes helping to maintain rural populations, encouraging tourism and increasing rural economic growth.

**3.** In 2016/17, **Transport Scotland**  spent £209.7 million on ferries, including operators' subsidies and investment in vessels and harbours. It subsidises almost half of the estimated number of ferry routes in Scotland (32 out of 66), carrying about two-thirds of all passengers (5.7 million a year) on almost 160,000 sailings each year. Its subsidised ferry routes vary greatly, in terms of length of journey and tidal conditions, which requires many different types of vessels and harbour



**Transport Scotland** is a Scottish Government agency. It is responsible for national transport services and infrastructure.

In 2016/17, it spent £2.1 billion, of which ten per cent was on ferry services and assets.

infrastructure. Transport Scotland manages the 32 ferry routes through three contracts. It provides the operators of these contracts with an agreed level of financial subsidy in return for a specified level of service. Its subsidies reduce the cost of ticket prices, making travel more affordable for ferry users.

## About the audit

**4.** Our audit looked at Transport Scotland's spending on ferry services to determine whether it is value for money. We examined:

- whether there is clarity around the operation of subsidised ferry services, including the roles and responsibilities of the different bodies involved
- how much is spent on subsidised ferry services, what this achieves and how Transport Scotland demonstrates that its expenditure is value for money
- the extent to which Transport Scotland's procurement arrangements for ferry services are appropriate and helping to obtain best value
- whether Transport Scotland has an evidence-based strategy for the long-term investment in ferry services and assets (that is, vessels and harbours).

**5.** Our audit focused on Transport Scotland's subsidised ferry services. We did not review ferry services that are operated by councils or the private sector, although we considered how well Transport Scotland works with partners to plan and operate ferry services and assets. As part of our audit, we reviewed Transport Scotland's procurement arrangements for ferry services. We focused on the procurement of the Clyde and Hebrides contract as this is the most recent ferry contract that Transport Scotland has awarded. We did not review any other of its ferry procurement exercises.

**6.** This report has four parts:

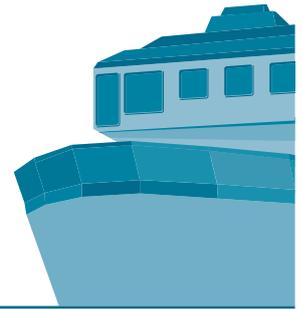
- [Part 1](#) explains Transport Scotland's ferry operations.
- [Part 2](#) analyses the cost and performance of Transport Scotland's subsidised services.
- [Part 3](#) examines procurement arrangements.
- [Part 4](#) considers the long-term planning of ferry services and assets.

**7. [Appendix 3](#)** sets out the methodology we used to gather evidence, which includes desk research, data analysis, community visits and interviews with Transport Scotland and its ferry service operators. We also spoke with private sector (commercial) operators, Regional Transport Partnerships (RTPs), councils and other interested parties, including trades unions. [Appendix 4](#) lists members of our advisory group who provided help and advice throughout the audit.

**8.** As part of the audit, we visited ten communities which rely on ferry services. This was not a representative sample of ferry users but was used to understand the range of users' experiences and views. We considered the views of these communities, alongside our other evidence, to help inform our judgements in this report. We have published an [online supplement](#)  which details our discussions with a sample of representatives from each of these communities.

# Part 1

## Ferry operations in Scotland



### The organisation of ferry services in Scotland is complex, involving many different bodies

#### European Union rules and guidelines have influenced the structure of ferry operations in Scotland

**9.** The Scottish Government has provided financial support for ferry services since the 1960s:

- Ferry services in the Clyde and Hebrides were initially operated by two companies, the Caledonian Steam Packet Company and David MacBrayne. In 1973 these merged to form Caledonian MacBrayne Limited, a public corporation wholly owned by Scottish ministers.
- Northern Isles Ferry Services (NIFS) were initially operated by P&O, a commercial operator.

**10.** Since then, a number of European Union (EU) rules and guidelines have influenced the structure, funding and operation of ferry services in Scotland. For example, to comply with Maritime Cabotage Regulation, Scottish ministers have been required to tender for ferry services to the Northern Isles (since 1997) and in the Clyde and Hebrides (since 2006).<sup>1</sup> EU State aid rules also led ministers to tender separately for the ferry service between Gourock and Dunoon, which had previously been part of the Clyde and Hebrides network ([Case study 1, page 10](#)).

**11.** The requirement to tender for the Clyde and Hebrides Ferry Service (CHFS) led Scottish ministers to change the structure of its ferry operations in 2007. The responsibilities of Caledonian MacBrayne Ltd were split between two new organisations, both of which are wholly owned by Scottish ministers:

- Caledonian Maritime Assets Limited (CMAL) was established to own and manage the assets (that is, vessels and harbours) on the network.
- David MacBrayne Limited (a holding company) was established to bid for and operate ferry contracts.

**12.** These changes were intended to create a fairer competition for future bidders for the CHFS contract because it allowed bidders equal access to the ferry assets by leasing them from CMAL.

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Transport Scotland's subsidised ferry routes vary greatly, requiring many different types of vessels and harbour infrastructure

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## Case study 1



### The history of the Gourock-Dunoon route

Until 2006, the Transport Scotland subsidised ferry service between Gourock and Dunoon was part of the Clyde and Hebrides network. A commercial operator, Western Ferries, has operated a passenger and vehicle service without subsidy on an adjacent route since 1973.

Scottish ministers first decided in 2002 that the route should be tendered separately to the rest of the Clyde and Hebrides network. This was in response to Western Ferries' concerns that Transport Scotland's subsidies were being used to reduce commercial vehicle fares. To comply with EU rules and guidelines, ministers considered the option of providing subsidies for passengers only on the Gourock-Dunoon route.

In 2006, Scottish ministers invited operators to bid for both the CHFS and the Gourock-Dunoon contracts. On the Gourock-Dunoon route, following a consultation on subsidies, operators were invited to run a fully commercial passenger and vehicle service (that is, no subsidy would be provided). No operators bid for the contract. Caledonian MacBrayne Ltd operated the other routes on the Clyde and Hebrides network at that time. It created a subsidiary company, Cowal Ferries, to operate the Gourock-Dunoon route and continued to run a subsidised passenger and vehicle service.

In 2008, the European Commission considered a further complaint from Western Ferries. It concluded that Transport Scotland should retender the route from 2011. Subsidies were to be paid for passengers only, although operators were free to provide a vehicle service at their own risk. None of the three bidders chose to operate a vehicle service. Argyll Ferries, a new subsidiary of David MacBrayne Limited, won the contract and has operated a passenger-only service since June 2011.

The procurement exercise for the next Gourock-Dunoon contract is currently paused while the Scottish Government carries out a review of ferry procurement ([paragraph 15](#)). The current contract, which was due to expire in June 2017, has been extended to account for the delay in the procurement exercise.

Source: Audit Scotland

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### Many bodies are involved in Transport Scotland's ferry operations

**13.** Transport Scotland currently subsidises 32 ferry routes to the Clyde and Hebrides, Northern Isles and between Gourock and Dunoon through separate contracts with three ferry operators – CalMac Ferries Limited (CalMac), Serco NorthLink and Argyll Ferries Limited ([Exhibit 1, page 12](#)). Numerous other bodies are also involved in ferry operations. For example, a range of public, private and independent bodies own the 41 vessels and 59 harbours on Transport Scotland's subsidised ferry network. Asset arrangements vary by contract, but in general ferry operators pay vessel owners a lease fee for the vessels and pay the harbour owners a 'harbour due' for harbour access. The numerous bodies and different arrangements in place for ferry services and assets have created complicated operational and funding arrangements ([Exhibit 2, page 14](#)).

[Appendix 2](#) sets out the main roles and responsibilities of these bodies.

### Numerous other models are in place for operating ferry services

**14.** Transport Scotland subsidises about half of the ferry routes in Scotland. Other models are in place for funding, tendering for and operating the remaining routes:

- Four councils (Argyll and Bute, Highland, Orkney Islands and Shetland Islands) subsidise 22 routes. Councils operate some of these routes, while others are contracted out to other operators.
- Strathclyde Partnership for Transport (SPT) subsidises one route.
- The private sector operates eight routes without public funding and one route with funding from Transport Scotland and Argyll and Bute Council.
- Community groups run two routes, one of which receives public sector subsidy from Argyll and Bute, and Highland councils.

### Transport Scotland's requirement to tender for ferry services may change

**15.** In February 2017, the Minister for Transport and the Islands announced a review into the future procurement of ferry services.<sup>2</sup> In particular, the review is to consider:

- whether the **Teckal exemption**  could be applied
- whether the tendering of ferry services is value for money
- the governance and organisational structures of David MacBrayne Ltd and CMAL.

The review has resulted in a pause to the procurement exercises for the next Gourock-Dunoon and NIFS contracts. The Scottish Government expects to publish a progress report on the review in autumn 2017.



#### Teckal exemption

In 1999, the European Court of Justice ruled that a public body may award a public services contract directly to a company that it wholly owns, provided that:

- the public body fully controls that company in a similar way to its own departments
- the publicly owned company carries out at least 80 per cent of its activities with the public body.

If these criteria are met, the public body is not required to tender for the public services contract.

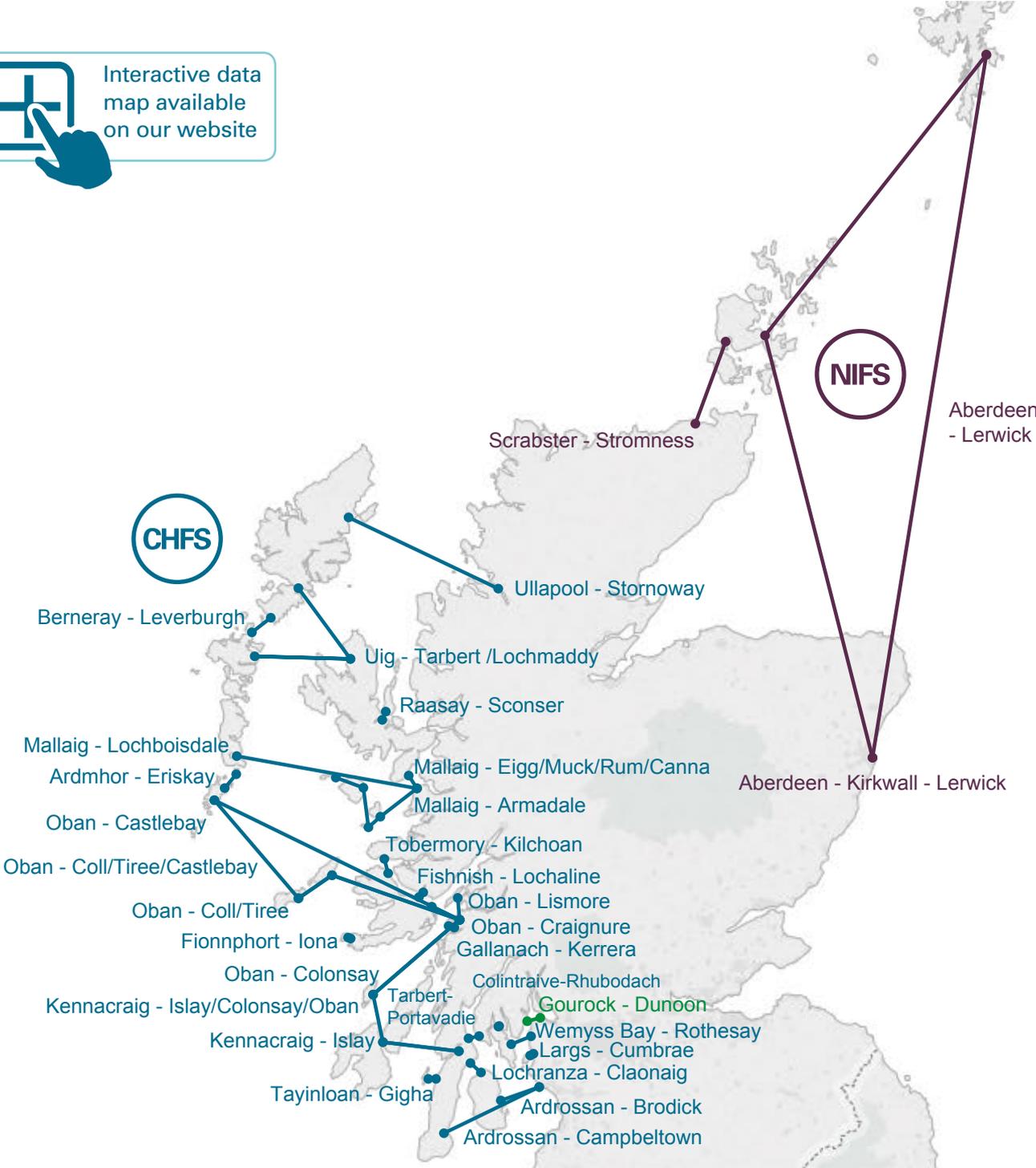
## Exhibit 1

### Transport Scotland's three main ferry contracts

Transport Scotland subsidises 32 ferry routes through three ferry contracts of varying sizes.

Contract	Clyde and Hebrides Ferry Services 	Northern Isles Ferry Services 	Gourock – Dunoon 
 <b>Routes</b>	28 <sup>1</sup> From the west coast of Scotland to 22 islands and four peninsulas From 0.6 to 89.5 miles <sup>2</sup>	3 From the north and north-east of Scotland to Orkney and Shetland From 30 to 221 miles <sup>2</sup>	1 Passenger-only service from Gourock to Dunoon 4.3 miles <sup>2</sup>
 <b>Current operator</b>	<b>CalMac Ferries Limited</b> A subsidiary of David MacBrayne Ltd, created in 2006 to bid for the contract	<b>Serco NorthLink Ferries</b> A subsidiary of Serco Group plc	<b>Argyll Ferries Limited</b> A subsidiary of David MacBrayne Ltd, created in 2011 to bid for the contract
 <b>Contract duration</b>	<b>Eight years</b> Oct 2016 – Sept 2024	<b>Five years, 10 months</b> Jun 2012 – Apr 2018 <sup>3</sup>	<b>Six years</b> Jun 2011 – Jun 2017 <sup>3</sup>
 <b>Expected contract cost at award date</b>	<b>£868 million</b>	<b>£243 million</b>	<b>£10.6 million</b>
 <b>Passengers (2016)</b>	<b>5,056,000</b>	<b>304,000</b>	<b>303,000</b>
 <b>Cars (2016)</b>	<b>1,356,000</b>	<b>64,500</b>	<b>0</b>
 <b>Vessels</b>	<b>33</b> <ul style="list-style-type: none"> <li>• CMAL owns 32</li> <li>• Lloyds Bank owns one</li> </ul> All vessels carry passengers and vehicles. Three further vessels are under construction CalMac is obliged to lease CMAL's vessels, due to the unique nature of the waters, tides and harbours on the network	<b>5</b> <ul style="list-style-type: none"> <li>• The Royal Bank of Scotland (RBS Group) owns three passenger and vehicle vessels</li> <li>• Two freight vessels are owned by a private company, Fortress</li> </ul> Serco NorthLink is not obliged to lease the passenger or freight vessels	<b>3</b> <ul style="list-style-type: none"> <li>• David MacBrayne Ltd owns two passenger vessels</li> <li>• A third vessel is leased from CalMac during the winter months</li> </ul> Argyll Ferries is required to supply its own vessels
 <b>Harbours</b>	<b>52<sup>1</sup></b> <ul style="list-style-type: none"> <li>• CMAL owns 25 harbours and pays CalMac a 'harbour operating fee' to operate these on its behalf</li> <li>• 27 harbours are owned by:               <ul style="list-style-type: none"> <li>– councils (21)</li> <li>– independent harbour authorities (4)</li> <li>– a private company (1)</li> <li>– the National Trust for Scotland (1)</li> </ul> </li> </ul>	<b>5</b> <ul style="list-style-type: none"> <li>• Orkney Islands Council owns two harbours</li> <li>• The others are owned by three different independent harbour authorities</li> </ul>	<b>2</b> <ul style="list-style-type: none"> <li>• CMAL owns Gourock harbour</li> <li>• Argyll and Bute Council owns Dunoon harbour</li> </ul>

Exhibit 1 (continued)



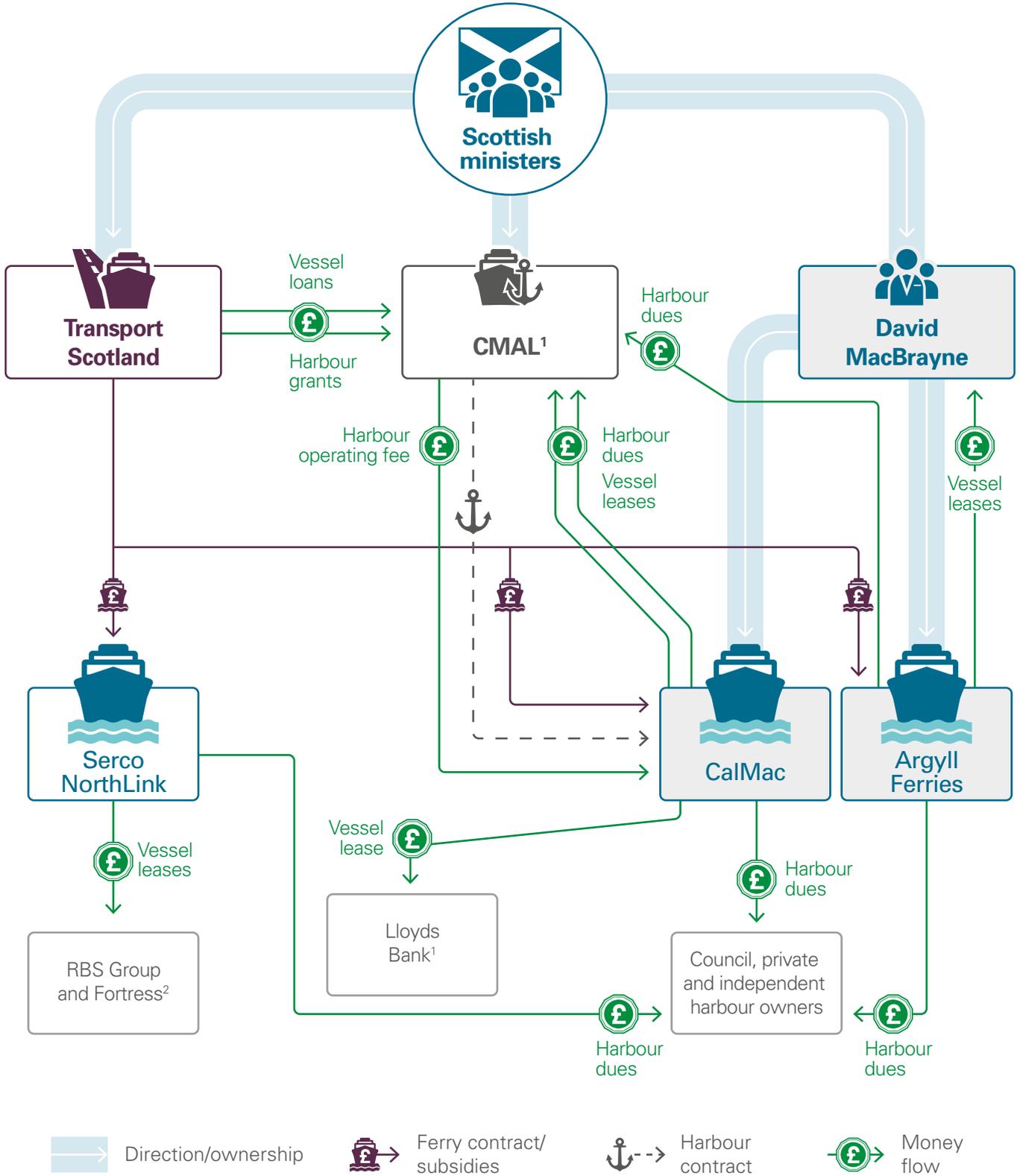
- Notes:
1. This includes the Gallanach to Kerrera route which was transferred to the CHFS network in July 2017. Prior to this, Transport Scotland had separately subsidised this service since 2013. The two harbours are owned by CMAL and are included in the harbours total.
  2. Route lengths taken from *The introduction of a road equivalent tariff based fares system on Scotland's ferry network*, Halcrow Group Limited, 2008 (Table 1).
  3. The procurement exercises for the next Gourock-Dunoon and NIFS contracts are currently paused, pending the results of a procurement review in 2017.
  4. Outside these three contracts, Transport Scotland also provides funding of about £40,000 a year to the private operator of the Craighouse to Tayvallich route.

Source: Audit Scotland, from information provided by Transport Scotland, CMAL and the ferry operators

## Exhibit 2

### How Transport Scotland's subsidised ferry services operate

Operational and funding arrangements are complex.



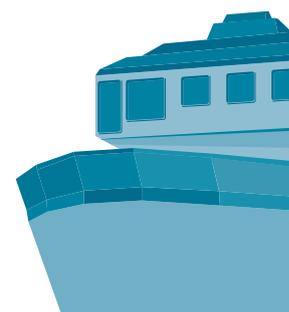
Notes:

1. For the Lloyds Bank-owned vessel, CalMac pays the lease fee through CMAL, along with a CMAL service fee.
2. In March 2017, CMAL took over the lease of the two freight ferries on the NIFS network, which are owned by Fortress.

Source: Audit Scotland

# Part 2

## Spending and performance



### Key messages

- 1 Between 2007/08 and 2016/17, Transport Scotland's total annual spending on ferries increased by 115 per cent in real terms, from £97.3 million to £209.7 million. Over this period, total annual subsidies to ferry operators doubled to £168.7 million and annual capital expenditure increased by 174 per cent, to £41.0 million. CMAL has procured eight new-build vessels in this time and Transport Scotland has spent £86 million on harbour upgrades.
- 2 Subsidies for services to the Northern Isles increased by three per cent between 2007/08 and 2016/17. Since the start of the new Northern Isles contract in 2012, subsidies have decreased by 24 per cent, to £35.2 million in 2016/17. This is partly due to a reduction in the annual number of sailings which has led to a decrease in Serco NorthLink's running costs.
- 3 Subsidies for services to the Clyde and Hebrides increased by 185 per cent between 2007/08 and 2016/17, to £133.8 million. This is mainly due to an increase in services, new vessels being added to the fleet and the introduction of the Road Equivalent Tariff (RET), which has significantly reduced the price of ferry travel for passengers and cars. Since 2008/09, Transport Scotland has spent £40 million to compensate CalMac for lower ticket income. RET has resulted in higher demand for services but the additional cost of meeting this demand is unclear. The wider impact of RET has been mixed. For example, while RET has increased the number of tourists visiting the islands, it has meant that islanders are sometimes unable to travel on certain sailings because they are full.
- 4 Between 2007 and 2016, the annual number of scheduled sailings, subsidised by Transport Scotland, increased by eight per cent. The annual number of passengers travelling on its subsidised routes increased by 0.3 per cent to 5.7 million, and the annual number of cars carried increased by 16.8 per cent to 1.4 million.
- 5 Ferry operators are performing well. In 2016, after taking into account weather-related cancellations and delays, about 99 per cent of scheduled sailings operated and about 99 per cent of these ran on time. Ferry users are generally happy with services but there is variation across routes and some frustrations exist. Ferry operations are complicated and responsibilities and accountabilities are not well understood.

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spending has doubled since 2007/08, mainly due to an increase in services, new vessels and lower ferry fares on most routes

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## Important notes on the data presented

The data we report on spending and performance comes from different sources and is reported in different time periods:

- Trend information on total spending on ferry subsidies and assets is from Transport Scotland's internal reports and is presented by financial year. Data is presented from 2007/08 to 2016/17. Figures are presented in real terms, at 2016/17 prices. Some figures may not add up due to rounding.
- Spending on individual contracts ([Exhibit 5, page 18](#), and [Case studies 2, 3 and 4, pages 20 to 22](#)) has been taken from each operator's Annual Outcome Statements and is presented by contract year. Contract years are different for each operator. Data is presented from contract years starting in 2007 to those ending in 2016. We have reported the gross annual subsidy provided by Transport Scotland to the operators. In each contract year, the operators may have received less than this as Transport Scotland can claw back a proportion of the operators' profits. However, due to incomplete data we are unable to present the annual net subsidy for each of the contracts. Figures are presented in real terms, at 2016/17 prices.
- Traffic numbers are from the Scottish Transport Statistics and individual ferry operators and are presented by calendar year (with the exception of Northern Isles traffic data, which Transport Scotland publishes for the period July to June).

This means it is not possible to make direct comparisons between, for example, spending and passenger numbers.

We have used 2007/08 as the base year as this is the first year of the first CHFS contract.

[Appendix 3](#) sets out more details on the methodology.

## Transport Scotland's spending on ferries has more than doubled since 2007/08

**16.** In 2016/17, Transport Scotland spent £209.7 million on ferries (capital and revenue). This is a 115 per cent increase, in real terms, since 2007/08 ([Exhibit 3, page 17](#)). The majority of Transport Scotland's 2016/17 spending (80 per cent) was on subsidies to ferry operators and the remaining 20 per cent was capital investment in vessels and harbours.

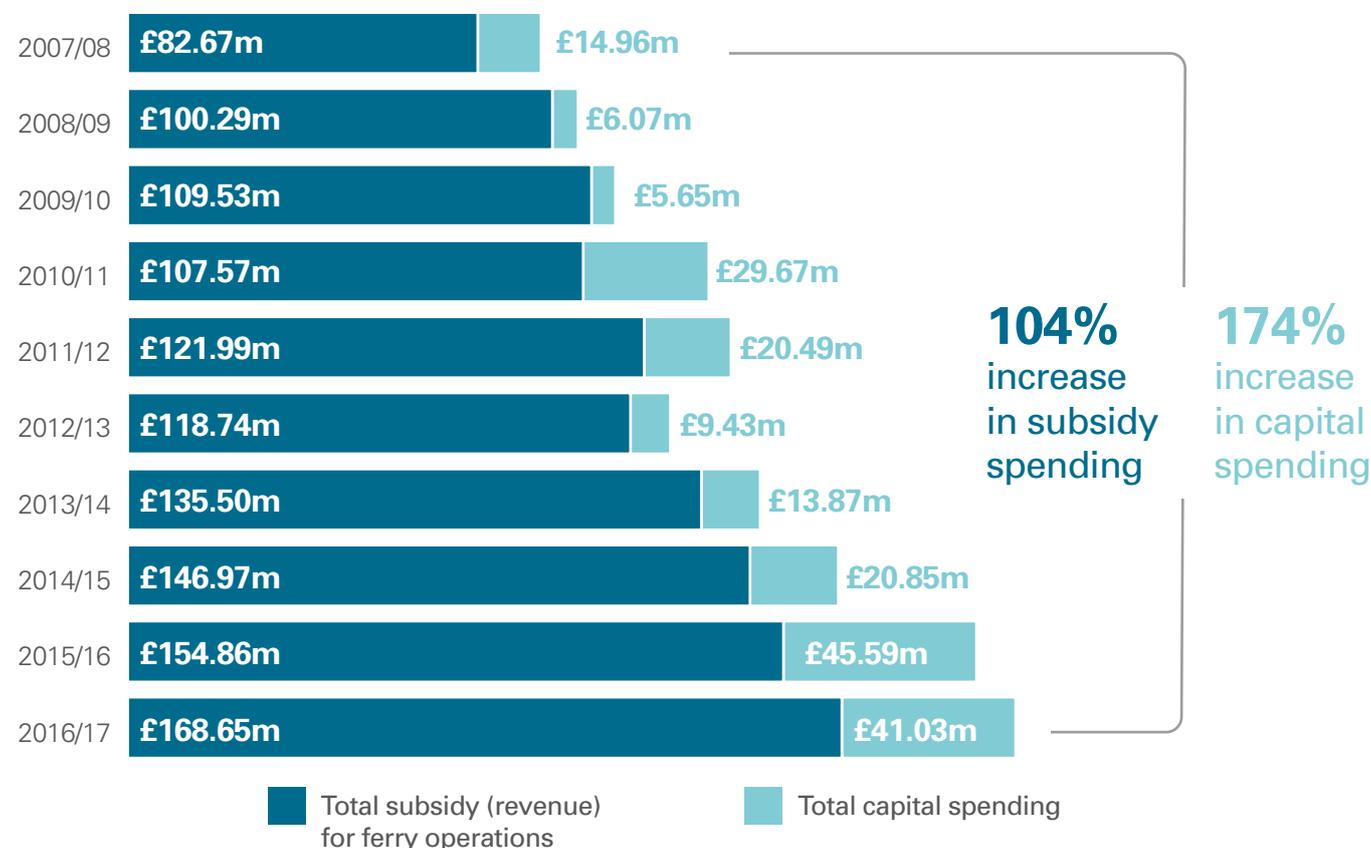
### Total subsidies to ferry operators have increased but there is variation by contract

**17.** In 2016/17, Transport Scotland spent £172.4 million on subsidies to the operators of its three main ferry contracts (its net spending on the three contracts was £168.5 million, as operators returned £3.9 million). It also spent £180,000 on financial support to the commercial operators of two other routes. Most of its spending on operators' subsidies (78 per cent, £133.8 million) was on the CHFS contract, 20 per cent (£35.2 million) was on NIFS and the remainder (£3.5 million) was on Gourock-Dunoon.

### Exhibit 3

#### Transport Scotland's ferry spending, in real terms, 2007/08 to 2016/17

Total spending on ferries has increased by 115 per cent since 2007/08.



#### Notes:

1. Data is shown by financial year, in 2016/17 prices.
2. Total annual spending excludes payments made directly into the CalMac Pension Fund.
3. Total annual subsidy is net of any receipts Transport Scotland receives from the ferry operators.
4. The increase in capital spending in 2015/16 was largely due to a £34 million payment towards two new vessels which are currently under construction.

Source: Audit Scotland, using Transport Scotland's Ferries Section 70 report, August 2017

**18.** Total subsidies have increased by 104 per cent, in real terms, since 2007/08. This is largely due to a 185 per cent increase in CHFS subsidy and 148 per cent increase in subsidy for the Gourock-Dunoon contract. Subsidies paid in respect of the NIFS contract have increased by three per cent since 2007/08, but have decreased by 24 per cent since the start of the new contract in 2012 ([Exhibit 4, page 18](#)).

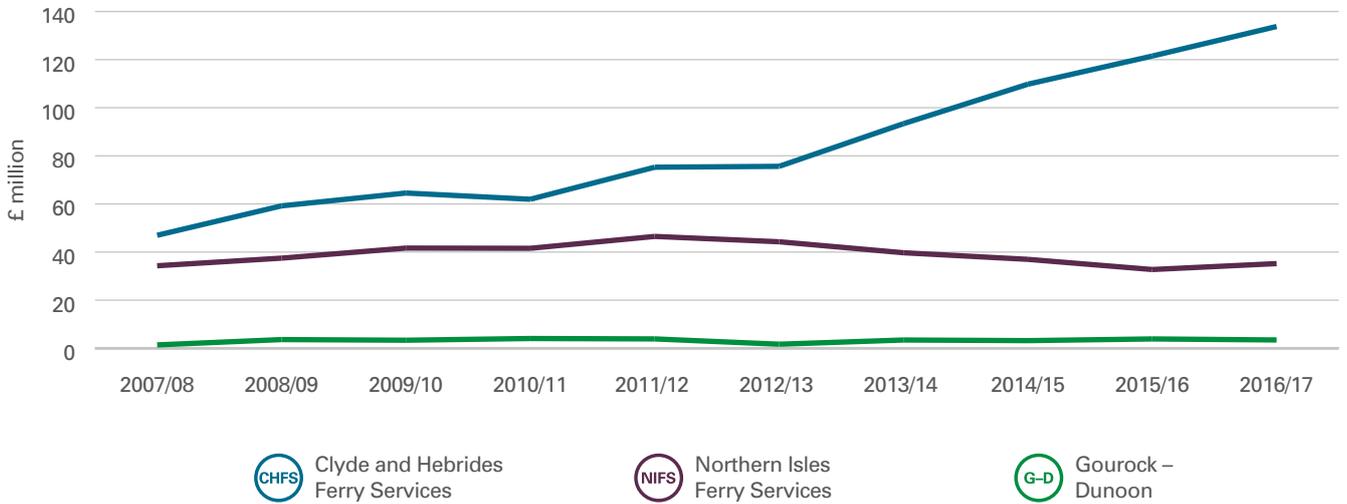
**19.** Transport Scotland's subsidies are intended to cover the difference between the ferry operator's costs of running the contract and income received, while allowing a capped profit to be made. Transport Scotland will claw back a proportion of any profit in excess of this cap. There is variation across contracts in the percentage of total costs that are covered by Transport Scotland subsidies ([Exhibit 5, page 18](#)). For example, in the contract years ending in 2016, subsidies were equivalent to:

- 83 per cent of the total costs of the Gourock-Dunoon service
- 71 per cent of the total costs of CHFS
- 51 per cent of the total costs of NIFS.

### Exhibit 4

#### Transport Scotland subsidies for each ferry contract, in real terms

Subsidies have increased for all three Transport Scotland contracts.



Note: Data is by financial year at 2016/17 prices.

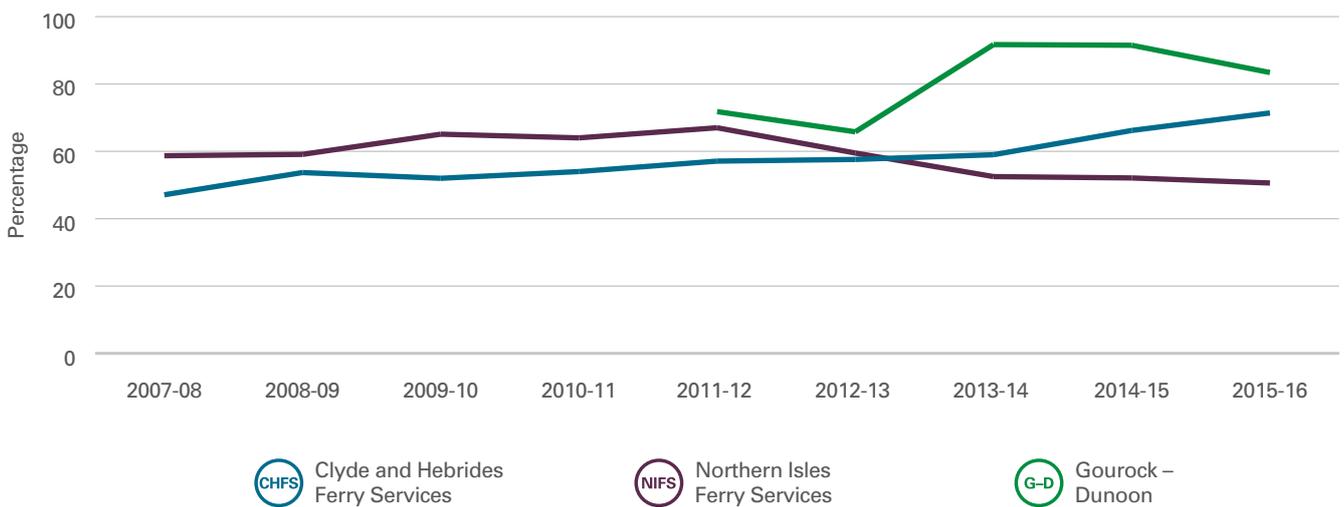
Source: Audit Scotland, using Transport Scotland's ferries Section 70 report, August 2017



### Exhibit 5

#### The percentage of total costs covered by Transport Scotland subsidies, by contract year

The percentage of subsidy has decreased on the NIFS contract and increased on the other two.



Notes:

1. Data is by contract year, at 2016/17 prices. Percentages are based on the gross subsidy paid to operators
2. Annual Outcome Statements are only available for Gourock-Dunoon from contract year 2011-12.

Source: Audit Scotland, using Operators' Annual Outcome Statements, based on individual contract years, which are as follows: CHFS – 1 October to 30 September; NIFS and Gourock-Dunoon – 1 July to 30 June



**20.** Ferry operators submit an Annual Outcome Statement (AOS) to Transport Scotland at the end of their contract year. These set out the operator's running costs (which include staff, vessel leases, harbour access charges and fuel), its income and the amount of subsidy required. Our analysis of each operator's AOS identifies a number of reasons for changes to the amount of annual subsidy which Transport Scotland has paid since 2007:

- CHFS – annual subsidies have increased, largely due to the additional costs of extra sailings and new vessels, and as a result of the introduction of Road Equivalent Tariff ([RET, page 24](#)).
- NIFS – annual subsidies have decreased since 2012 as a result of Serco NorthLink generating additional revenue and reducing its operating costs, for example as a result of fewer sailings.
- Gourock-Dunoon – annual subsidies have increased, largely as a result of additional costs arising from leasing a third vessel in winter months to improve service reliability.

[Case Studies 2, 3 and 4 \(pages 20 to 22\)](#), set out more details of our analysis. All data is presented in real terms at 2016/17 prices.

### Transport Scotland is making financial contributions aimed at reducing the CalMac Pension Scheme deficit

**21.** Staff working for CalMac, Argyll Ferries and CMAL are members of the CalMac final salary pension scheme. The pension fund has been in deficit for a number of years and CMAL has paid £0.7 million a year into the fund since 2007 to try and reduce this. Following a fund valuation in 2012, which showed a deficit of £32 million, Scottish ministers decided that Transport Scotland should also contribute to help reduce the deficit. The agreed contribution was £3 million a year until 2024. This is in addition to the subsidies it pays to CalMac and Argyll Ferries to provide ferry services, some of which covers their employer contributions into the pension fund.

**22.** The most recent pension scheme valuation, in 2015, found that the deficit had increased to £41.9 million. This was largely due to pension liabilities increasing, for example as a result of people living longer and low interest rates. To help reduce the deficit, Scottish ministers decided that between April 2015 and April 2024:

- Transport Scotland should increase its contribution to £3.4 million a year
- CMAL should continue to contribute £0.7 million a year.

**23.** In 2007, the pension fund trustees also increased the employer's pension contribution rate, from 14.5 per cent to 24.2 per cent of employees' salaries. In 2016, this increased again, to 30.8 per cent. This is now one of the highest employer contribution rates for a public pension scheme in Scotland. The increased employer's contribution, for CalMac and Argyll Ferries staff, is funded by Transport Scotland through increased subsidies. The 2016 increase will cost Transport Scotland, in relation to CalMac employees only, an additional £22.5 million over the eight years of the new CHFS contract.

**24.** The next valuation, in 2018, will show whether the additional contributions have made a positive difference to the deficit. If the deficit has not decreased, Transport Scotland and CMAL will have to consider the sustainability of paying increased pension contributions. They may have to consider whether other steps, such as amending scheme terms and conditions, are more affordable in the context of Transport Scotland's overall ferries budget.

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## Case study 2



### Changes to Gourock-Dunoon gross subsidies between June 2011 and June 2016

Information on the breakdown of spending is only available from June 2011 when Argyll Ferries won the contract for the service. Between June 2011 and June 2016 (five contract years), the annual amount of subsidy paid to Argyll Ferries increased by 76 per cent, from £1.9 million to £3.3 million. The level of subsidy, as a proportion of operating costs, increased from 72 per cent to 83 per cent over the same period. This is due to a 52 per cent increase in the total operating costs and an eight per cent reduction in income. Specific operating costs increased as follows:

- Vessel leasing costs increased by 156 per cent.
- Harbour charges increased by 66 per cent.
- Staff costs increased by 51 per cent.

These increases are largely due to a contract variation requiring Argyll Ferries to lease a third vessel in the winter months to help improve service reliability. This vessel has a much higher passenger capacity than required and an unused car deck. Using a third vessel requires additional crew and also results in increased harbour charges.

Other costs increased by 74 per cent. This is largely due to the cost of a replacement bus service used to transfer passengers from cancelled Argyll Ferries services to Western Ferries services (which are able to operate better in bad weather).

The above increases have been partially offset by a 58 per cent reduction in fuel costs.

#### Notes:

1. Initial start-up costs have been excluded from the total expenditure for contract year one.
2. Figures for contract year one cover the period June 2011 to June 2012, contract years two to five, cover July to June each year.

Source: Audit Scotland, using Argyll Ferries' Annual Outcome Statements, June 2012 to June 2016, provided by Transport Scotland

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## Case study 3



### Changes to CHFS gross subsidies between October 2007 and September 2016

Between October 2007 and September 2016 (nine contract years) the annual amount of subsidy paid to CalMac increased by 153 per cent, from £57.0 million to £144.2 million. The percentage of operating costs covered by subsidy increased from 47 per cent to 71 per cent over the same period.

The level of subsidy increased because the total cost of running the contract increased by 67 per cent while CalMac's revenue decreased by eight per cent:

- CalMac's revenue decreased due to the introduction of Road Equivalent Tariff ([RET, page 24](#)). RET has decreased CalMac's income from ticket sales, requiring more subsidy from Transport Scotland.
- CalMac's running costs have increased due to an increase in service provision. Since 2007, two routes have been added to the network and the annual number of sailings has increased by 3.5 per cent (from 130,968 to 135,542). Within this, the annual number of sailings on:
  - routes that use large vessels increased by 29 per cent (from 15,472 to 19,961)
  - routes that use small vessels increased slightly, by 0.1 per cent (from 115,496 to 115,581).
- Additional services require longer working hours and more crew, vessels, fuel and harbour access. This has contributed to higher annual costs as follows:
  - Staff costs increased by 91 per cent.
  - Harbour charges increased by 163 per cent. This is largely due to CMAL realigning harbour and vessel leasing charges in October 2013. CMAL increased harbour charges so that they more closely reflect the actual cost of harbour operations.
  - Vessel leasing costs increased by 29 per cent. This is due to five new vessels being added to the fleet.
  - Vessel maintenance costs increased by 136 per cent, due to a larger and increasingly older fleet.

These cost increases have been partially offset by a 30 per cent decrease in fuel costs. Although more fuel was used due to additional sailings, the price of fuel has decreased.

Source: Audit Scotland, using CalMac's Annual Outcome Statements, September 2008 to September 2016, provided by Transport Scotland

## Case study 4



### Changes to NIFS gross subsidies between July 2007 and June 2016

There have been two operators of the NIFS contract between 2007 and 2016. NorthLink Ferries (a subsidiary of David MacBrayne Ltd) ran the service until the end of its contract in June 2012. Since then, Serco NorthLink has operated the contract. There are different trends in the amount and level of subsidy provided for the different contracts:

- Between July 2007 and June 2012 (five contract years, which was contract year two (CY2) to contract year six (CY6) of that contract), the amount of annual subsidy increased by 52 per cent, from £34.0 million to £51.5 million. The level of subsidy increased from 59 per cent to 67 per cent of operating costs.
- Between July 2012 and June 2016 (four contract years), the annual amount of subsidy has decreased by 36 per cent, from £51.5 million to £33.2 million. The level of subsidy has decreased from 67 per cent to 51 per cent of operating costs.

NorthLink Ferries' annual operating costs increased by 33 per cent, between CY2 and CY6 of the previous contract. This was mainly due to the cost of fuel, which almost doubled, from £10.0 million to £19.1 million a year. Staff costs also increased by 28 per cent.

NorthLink Ferries' revenue increased in this period, but only by 17 per cent, which resulted in an increase to the amount and percentage of subsidy required.

Since the start of the new NIFS contract in July 2012, annual running costs have decreased by 15 per cent and revenue has increased by ten per cent. This means that less subsidy is required. Serco NorthLink's annual running costs have decreased due to:

- a nine per cent reduction in the number of annual sailings due to a reduction in the service between Scrabster and Stromness (from six daily sailings to four)
- a 29 per cent reduction in fuel costs
- a 30 per cent reduction in staff costs, partly due to voluntary redundancies and more efficient operational management.

Despite the reduction in the number of sailings, harbour charges have increased by 11 per cent, between 2012 and 2016. This is largely due to a 33 per cent increase in harbour charges by Aberdeen Harbour Board to pay for development work.

Source: Audit Scotland, using NorthLink Ferries' and Serco NorthLink's Annual Outcome Statements, June 2008 to June 2016, provided by Transport Scotland. Trends in harbour charges were provided by Serco NorthLink

### Transport Scotland has spent £197.5 million on ferry assets since 2007/08

**25.** Transport Scotland's expenditure on ferry assets includes:

- loans provided to CMAL to procure new vessels
- grants paid to CMAL and other harbour owners for harbour developments.

**26.** Its annual capital expenditure has varied in the last ten years, between £5.7 million in 2009/10 and £45.6 million in 2015/16 ([Exhibit 3, page 17](#)). Between 2007/08 and 2016/17, Transport Scotland spent a total of £197.5 million on ferry assets.

**27.** In this period, Transport Scotland spent a total of £123 million on vessel loans and it has received £29.7 million in loan repayments. About half (£60 million) of its vessel loans has been on four new-build vessels which have been added to the CHFS fleet since 2011. Transport Scotland also spent £34 million in 2015/16 towards the £106 million cost of two vessels, which are currently being built and are expected to enter service in late 2018.

**28.** In 2012, Lloyds Bank financed the £42 million cost of the fifth new-build vessel that has been added to the CHFS network since 2011. Transport Scotland did not have sufficient capital budget available at that time, and is therefore paying for the vessel through an eight-year operating lease. Transport Scotland pays the cost of the lease through a subsidy payment to CalMac. The cost to Transport Scotland over the long term is higher than the conventional method of providing loans to CMAL. In addition, CMAL will not own the vessel at the end of the lease and will have to either negotiate a new lease in 2022 or consider other options.

#### **Transport Scotland pays for harbour upgrades directly through harbour grants and indirectly through harbour dues**

**29.** Transport Scotland has spent £86 million on harbour grants since 2007/08. Almost half of this (£42 million) was spent on CMAL-owned harbours. Improvements include the £17.8 million development of Brodick harbour and the £4.5 million upgrade of Largs pier. Transport Scotland also spent £44 million improving harbours that are not owned by CMAL. For example, in 2014 Transport Scotland contributed £8.8 million to the £12 million cost to upgrade the harbour in Stornoway, which is owned by Stornoway Port Authority.

**30.** Transport Scotland's harbour grants only part-fund the cost of harbour improvements. For example, the harbour grants provided to CMAL are expected to cover up to 75 per cent of costs, with CMAL funding the remaining amount. CMAL and other harbour owners are responsible for improvement works and raise funding for this through a harbour access charge, known as a harbour due. This is a charge made to ferry operators, and other users such as fishing boats, for harbour access. Harbour owners set their own dues which, for subsidised ferry services, are largely funded by Transport Scotland. If a harbour owner increases the dues paid by the ferry operator, Transport Scotland pays for this by increasing the amount of subsidy paid to the operator.

**31.** Transport Scotland spent a total of £200 million on harbour dues between contract years 2007-08 and 2015-16. Of this, £155 million (78 per cent) was on harbours not owned by CMAL. Transport Scotland does not know how much of the harbour dues paid to non-CMAL harbour owners have been used for improvement works. In addition, where Transport Scotland has funded the capital cost of upgrading non-CMAL harbours, it has continued to pay the same or higher levels of harbour dues (which are meant to pay for the upgrade costs). For example, Ullapool harbour dues have increased by 78 per cent since September 2014 despite Transport Scotland paying the majority of the upgrade costs.

## Transport Scotland has spent £40 million on the Road Equivalent Tariff since 2008/09

**32.** In 2007, the Scottish Government committed to lowering the cost of ferry travel to reduce the economic disadvantages experienced by remote island communities. It introduced the **Road Equivalent Tariff (RET)** , which is a simple and transparent fares structure based on the equivalent cost of travelling by road. RET was introduced on a pilot basis to help the Scottish Government determine the impact of lower ferry fares on local communities and economies. After the pilot exercise, the Scottish Government did not set clear objectives for the roll-out of RET, including what benefits it expected to achieve or how these would be measured.

**33.** RET applies to routes on the Clyde and Hebrides only. It does not apply to the Northern Isles or the Gourock-Dunoon routes. Orkney and Shetland residents (and their friends and family) are entitled to a 30 per cent discount on passenger and non-commercial vehicle fares on Northern Isles services. The Scottish Government has committed to lower fares, for all passengers, to the Northern Isles from 2018 ([page 44](#)). RET has lowered CHFS passenger fares by up to 50 per cent and car fares by up to 65 per cent, compared to 'summer single' fares. RET was also initially applied to commercial vehicles but Scottish ministers decided to remove this in 2012, following an evaluation which showed that the costs outweighed the benefits.<sup>3</sup>

**34.** Transport Scotland has gradually rolled out RET since October 2008. It was initially introduced as a pilot on routes to the Western Isles, Coll and Tiree and extended to:

- Islay, Colonsay and Gigha in October 2012
- Arran and Campbeltown in October 2014
- the remaining CHFS network in October 2015.

**35.** Before its introduction in 2008, Transport Scotland investigated the potential impact of RET.<sup>4</sup> It concluded that lower fares would increase demand for ferry services and have an overall positive economic and social impact on islands. It estimated that applying RET to all routes included in the initial pilot would require additional annual subsidy of £7.6 million to compensate CalMac for lower ticket income. At that time, it did not consider the cost of applying RET across the full CHFS network or the costs associated with increased demand, such as the need to operate additional sailings. However, as part of its evaluation of the pilot in 2011, Transport Scotland estimated an additional annual subsidy of at least £13 million would be required to implement RET across all CHFS routes, excluding any associated additional costs.<sup>5</sup> Transport Scotland used the results of the 2011 evaluation to inform the ministerial decisions on the further roll-out of RET across the CHFS network.

### The full cost implications of RET are unknown and the impact has been mixed

**36.** Between 2008/09 and 2015/16, Transport Scotland spent about £40 million on RET. This cost relates to the additional subsidy provided to CalMac to offset lower fare income. The full cost of implementing RET is not known but will include the associated costs of higher demand, including additional sailings, which require extra crew and fuel, more harbour dues and increased vessel and harbour maintenance. Transport Scotland estimates that the full introduction of RET across the CHFS network cost between £14 million and £16 million in 2016/17. It does



**RET** links ferry fares to the cost of travelling an equivalent distance on land. It is made up of a fixed fare plus a rate per mile – based on the costs associated with travelling by car (for example, insurance, tax and fuel costs).

not estimate the cost of RET beyond the following financial year, nor has it made any assessment of the long-term financial sustainability of the policy.

**37.** RET has increased traffic on the CHFS network, in particular car journeys. For example, the first two years of the RET pilot (on routes from the mainland to the Western Isles, Coll and Tiree) saw increases of:

- 20 per cent in passenger numbers
- 31 per cent in car numbers
- 125 per cent in motorhome numbers.

This compares to a three per cent increase in passenger numbers, no change in car numbers and a 28 per cent increase in motorhome numbers across the rest of the CHFS network.<sup>6</sup>

**38.** In 2016, which was the first full year of RET across the whole CHFS network, there was a nine per cent increase in passenger numbers and a 16 per cent increase in car numbers compared to 2015. The largest increase, in absolute terms, of passenger and car numbers between 2015 and 2016 was on the Oban to Craignure route:

- Passenger numbers increased by 16 per cent to 644,800.
- Car numbers increased by 41 per cent to 162,300.<sup>7</sup>

**39.** Transport Scotland commissioned impact assessments on the three stages of the RET roll-out which highlighted numerous benefits.<sup>8</sup> These include higher visitor numbers and increased social, cultural and economic opportunities for islanders. There have also been unintended consequences of RET. For example, islanders told us that spaces were limited on some sailings, that traffic congestion was being experienced on certain islands and road condition had declined. The RET fares policy also means that CalMac is unable to adjust fares to help manage demand. For example, it cannot increase fares on sailings with high demand for spaces to encourage users to travel at a different time. Our [online supplement](#)  sets out the impact of RET from different communities' perspectives.

**40.** It is too early to assess the full impact of RET across the CHFS network. As the Scottish Government did not set clear objectives or targets for RET, it will be difficult for it to determine whether RET has been more, or less, successful than planned.

## **There has been little change in passenger numbers on subsidised ferries, but car traffic has increased by about 17 per cent**

### **Passenger numbers on subsidised ferries have increased by 0.3 per cent**

**41.** Between 2007 and 2016, total passenger numbers on ferry routes across Scotland increased by one per cent, from 8.9 million to 9 million. Over this period, passenger numbers on Transport Scotland's subsidised routes increased by 0.3 per cent to 5.7 million. There have been different trends in Transport Scotland's passenger numbers during this period:

- Between 2007 and 2012, the number of passengers decreased by nine per cent, to 5.2 million.

- Since 2012, passenger numbers have increased by ten per cent, mainly due to an eight per cent increase between 2015 and 2016.

**42.** There has also been variation across the three contracts between 2007 and 2016:

- CHFS passenger numbers increased by 6.9 per cent, from 4.7 million to 5.1 million. In the first seven months of 2017, 3.1 million passengers travelled on CHFS routes.
- NIFS passenger numbers decreased by 1.2 per cent from 307,700 to 304,000. However, in the most recent contract year (ending in June 2017), passenger numbers increased by 1.7 per cent, to 304,500, compared to the contract year ending in 2016.
- Gourock-Dunoon passenger numbers decreased by 50 per cent, from 607,200 to 303,400. In the first seven months of 2017, 171,300 passengers travelled on the route (2007 passenger numbers include foot passengers and passengers who travelled with cars, while the 2016 and 2017 figures include foot passengers only).

**43.** There are two routes in Scotland where a Transport Scotland subsidised service operates in competition with a commercial operator:

- Serco NorthLink's Scrabster to Stromness service is similar to the route operated by Pentland Ferries across the Pentland Firth.
- Argyll Ferries operates an adjacent route to Western Ferries between Gourock and Dunoon.

**44.** Since 2007, passenger numbers on the commercially operated services have increased, in contrast to passenger numbers on the subsidised services ([Exhibit 6, page 27](#)). Cowall Ferries/Argyll Ferries' passenger numbers have fallen by 50 per cent since 2007, partly due to the removal of the vehicle service in 2011. Passengers who want to travel in their cars use the Western Ferries service ([Case study 1, page 10](#)). Passenger numbers on the Scrabster to Stromness service have decreased by ten per cent since 2007. However, despite reducing the number daily of sailings on the route (from six to four), Serco NorthLink has increased passenger numbers by 20 per cent since 2013, through improved marketing and special offers.

#### **The number of cars travelling on CHFS routes has increased, but has fallen on other subsidised routes**

**45.** The total number of cars travelling on ferry routes across Scotland has increased by 11 per cent since 2007, from 2.5 million to 2.8 million in 2016. There was an overall 16.8 per cent increase in car traffic on Transport Scotland subsidised routes, to 1.4 million in 2016, but there was variation between contracts. Between 2007 and 2016:

- car numbers on the CHFS network increased by 27 per cent from 1.1 million to 1.4 million. This includes a 16 per cent increase between 2015 and 2016 alone. The increase is due to the reduced cost of car travel following the introduction of RET. In the first seven months of 2017, 836,600 cars travelled on CHFS routes

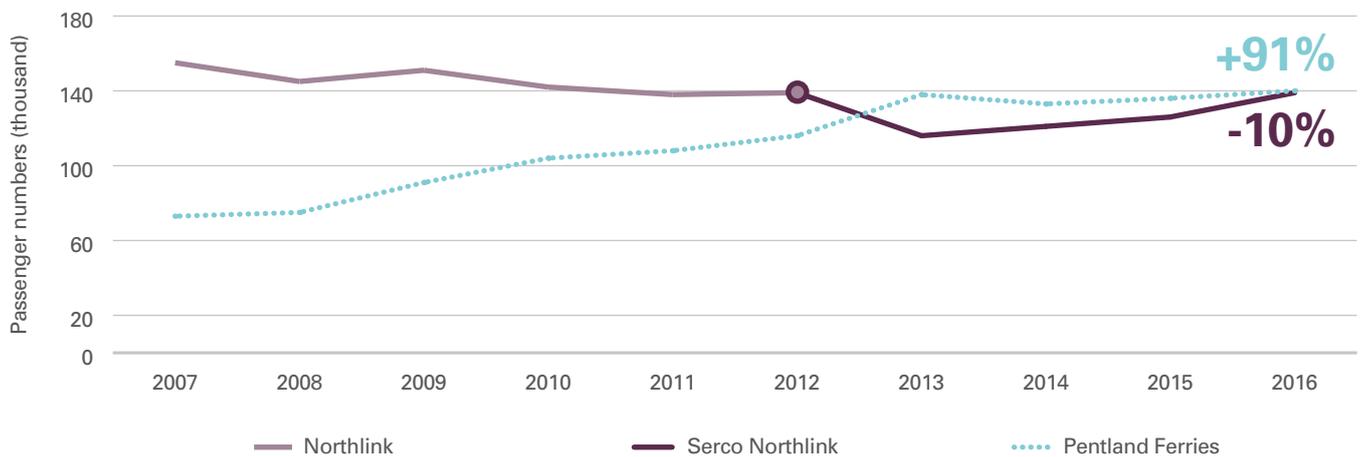
- car numbers on the NIFS network decreased by 7.5 per cent, from 69,700 to 64,500, mainly due to the reduction in the Scrabster-Stromness service ([paragraph 44](#)). However, car numbers on this route have increased by 22 per cent since 2013, due to improved marketing. In the most recent contract year, ending in June 2017, car numbers increased by 8.1 per cent, from 70,900 in 2015-16 to 76,700 in 2016-17
- the number of cars on the Gourock-Dunoon route decreased from 80,100 in 2007 to zero in 2012 because the service is now passenger only.

## Exhibit 6

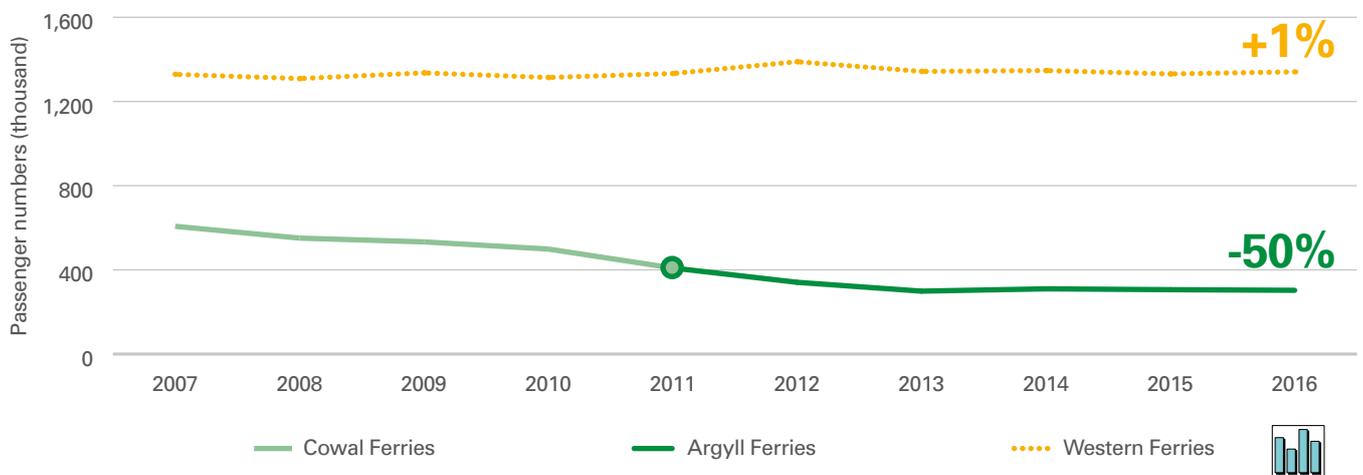
### Passenger numbers on the Pentland Firth and Gourock-Dunoon routes

Passenger numbers on publicly operated ferries have decreased while they have increased on commercially operated services.

#### Pentland Firth route



#### Gourock-Dunoon route



Note: Cowal Ferries' passenger numbers between 2007 and 2011 include foot passengers and passengers who travelled with cars.

Source: 2016 Scottish Transport Statistics, Transport Scotland and Pentland Ferries

### The total amount of commercial vehicle traffic travelling across all ferry routes is unknown

**46.** Transport Scotland does not have a single, comprehensive dataset on **commercial vehicle**  traffic. Its annual publication of Scottish Transport Statistics includes information on the number of commercial vehicles, which includes lorries and buses, travelling on CHFS and some non-subsidised routes. But it does not include data on the number of commercial vehicles travelling on NIFS routes. Between 2007 and 2016, the number of commercial vehicles travelling across CHFS routes decreased by 22 per cent, to 89,500 vehicles. In contrast, the number travelling on non-Transport Scotland subsidised routes increased by 16 per cent, to 81,900 vehicles.

**47.** CalMac and Serco NorthLink have datasets on commercial vehicle traffic for their own purposes. This is reported to Transport Scotland's ferry contract management team on a monthly basis, but is not included in the Scottish Transport Statistics dataset. Both CalMac and Serco NorthLink measure commercial vehicle traffic by the length of the vehicle, in lane metres, and their data excludes buses. In 2016, 1.6 million lane metres of commercial vehicle traffic travelled on CHFS and NIFS routes, which is a 13 per cent increase since 2007. Most of the 2016 commercial vehicle traffic travelled on the CHFS network (1.1 million lane metres, an increase of 4.3 per cent since 2007). The Ullapool-Stornoway route accounted for about a quarter of all CHFS commercial vehicle traffic and the Kennacraig-Islay route accounted for 19 per cent. There is no breakdown available on the type, or value, of freight being carried on the CHFS routes. This information is currently unavailable as hauliers are not required to report this information to CalMac or Transport Scotland. It is also complicated by the fact that commercial vehicles often carry a mix of different freight.

**48.** Commercial vehicle traffic on the NIFS network increased by 44 per cent between 2007 and 2016, to 464,000 lane metres. Serco NorthLink records the amount and type of freight imported to and exported from the islands. For example, in 2016 the largest export from the Northern Isles was seafood (54,000 lane metres) and almost 50,000 tonnes of salmon was exported.

**49.** Working with hauliers, Transport Scotland and CalMac could develop better information on commercial vehicle traffic travelling on the CHFS routes, which includes an estimate of the type and value of freight being transported. This would help Transport Scotland demonstrate the contribution that ferry services make to Scotland's economy.

### Numerous forums exist for Transport Scotland and operators to communicate with ferry users

**50.** Ferries are essential to the sustainability of many island communities. It is important therefore that these communities are involved in, and are kept aware of, decisions that affect their ferry services. A number of forums are in place at an operational and strategic level for Transport Scotland and ferry operators to communicate with ferry users, communities and other stakeholders, such as councils. Each ferry contract states that operators must take part in:

- consultation meetings with relevant councils and Regional Transport Partnerships (RTPs)
- 'local community liaison' with ferry users and the wider public.



**Commercial vehicles (CVs)** on the CHFS network have been reclassified with the roll-out of RET:

- From – vehicles over five metres
- To – vehicles over six metres.

This means that vehicles between five and six metres are now classed as cars rather than CVs.

This has contributed to an increase in car numbers and a decrease in CV numbers.

It means that accurate trend information is not available.

**51.** Arrangements for consulting and involving local communities vary across Scotland. For example, on the CHFS network, 13 ferry committees (or equivalents) are in place. These are generally open to all members of the public and they usually discuss issues on a specific community or route basis. On a more strategic level, there are four Ferry User Groups (FUGs) covering Argyll, Clyde, Hebrides, and Skye and Lochaber. HITRANS (the RTP for the Highlands and Islands) administer the FUGs, which are a forum for Transport Scotland, CMAL and CalMac to update members and receive feedback on ferry operations. Membership is by invitation only and FUGs typically comprise local councillors and representatives from local businesses and other relevant partners.

**52.** Different arrangements are in place on the NIFS network. There are currently no specific ferry forums in Orkney, although Orkney Islands Council runs a Transport and Travel Forum for interested people to discuss all transport issues affecting the island, including air, sea and road. In Shetland, Transport Scotland and Serco NorthLink attend two forums on a quarterly basis. The Shetland External Transport Forum is administered by ZetTrans, the RTP for Shetland, and the Stewart Building Transport Group represents the seafood industry. These appear to work well and forum members appreciate the information that Serco NorthLink provides on the ferry service.

### **There is scope to streamline and strengthen arrangements for consulting and involving communities**

**53.** Current community engagement arrangements are time-consuming and costly. All parties involved agree that, with the exception of Shetland arrangements, improvements could be made. For example:

- ferry committees do not have a specific purpose and not all communities have one
- Transport Scotland, CalMac, CMAL, HITRANS and FUG members told us that FUGs are not fit for purpose in their current state. They do not have a specific remit and there is no requirement for them to be consulted on any policy or operational decisions, including timetables
- we were also told that arrangements in Orkney are not effective and could be improved
- individual forums are often established on an ad-hoc basis to discuss specific ferry issues.

**54.** To help improve customer engagement, CalMac has appointed a Director of Community and Stakeholder Engagement. It has also set up a Communities Board to be the 'voice of communities on strategic issues'. It will comprise 12 community representatives and an independent chair. In July 2017, CalMac invited residents from rural communities across the Clyde and Hebrides to apply for these positions and the chair was appointed in September 2017. We heard mixed feedback from communities on whether the Communities Board will be effective. HITRANS has also suggested how user consultation might be improved over the duration of the new CHFS contract. It presented a number of proposals to FUG members in April 2017, which included how and when ferry committees and FUGS might be consulted in future. HITRANS is working with CalMac to implement the proposals.

## Users are generally happy with ferry services but frustrations exist

**55.** Operators gather user feedback from surveys carried out online, on board and by email. These cover various aspects of the customer experience including the use of online and telephone booking systems, the ability to book specific sailings which they want to travel on, ticketing and on-board facilities. Results are generally positive. CalMac's most recent post-journey customer satisfaction survey (December 2015 – April 2017) showed that 92 per cent of customers were fairly or very satisfied with the service provided. In a separate on-board survey run by Serco NorthLink, between January and June 2017, 97 per cent of customers rated their overall experience as good or excellent.

**56.** We spoke to a small sample of ferry users across a number of communities which rely on ferry services (see our [online supplement](#) ). While our discussions were specific to the individual communities, some common themes emerged:

- CHFS: users were generally happy about the level and frequency of service and were positive about new vessels being added to the fleet. However, many reported that the choice of vessels used on some routes was confusing and could be better communicated.
- NIFS: users were very positive about the service and in particular the level of engagement and information provided by Serco NorthLink. The main concern that users expressed were the ticket prices, which are set by Transport Scotland and are high compared to the CHFS network ([page 50](#)).<sup>9</sup> The availability of cabins during the summer months was also a concern.
- Gourock-Dunoon: users were unhappy with Argyll Ferries' decision in 2011 to bid for a passenger-only service. In their opinion, the two main vessels used on the route are often not suitable for the weather conditions, and this has led to an increase in weather-related cancellations. Users were also unhappy, for a variety of reasons, with the tendering exercise for the new contract, which has currently been paused.

**57.** The operation of ferries is complicated. The roles and responsibilities of Transport Scotland, CMAL and the operators are not well understood by people who are not directly involved in ferry operations. Ferry users told us that it can be unclear who is responsible or accountable for individual decisions. This causes frustration as some users feel that they are not listened to. In addition, if users are dissatisfied with the response to a complaint, they are unsure how they can take it further.

## Most ferry services operate on time

**58.** As part of its contract management arrangements, Transport Scotland has a series of performance measures to assess its ferry operators. It reports two of these to its senior management team, namely:

- reliability (the percentage of scheduled sailings that take place)
- punctuality (the percentage of sailings that are on time).

**59.** Each ferry contract sets out the financial penalties that will apply for failures against the measures. Performance deductions are not made against reliability and punctuality measures when a sailing is cancelled or delayed due to a 'relief event'. Relief events include adverse weather, tidal conditions, traffic problems

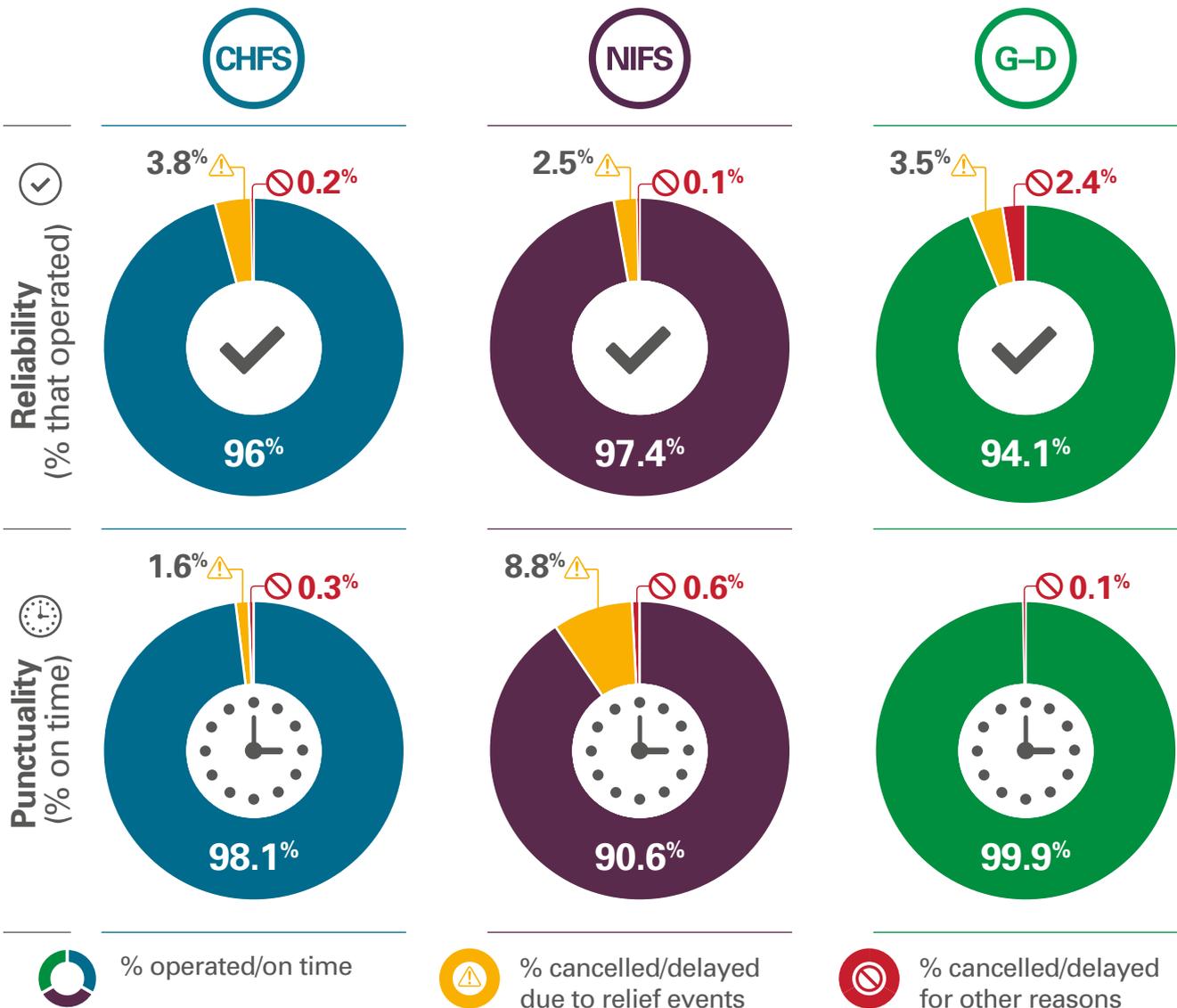
and other issues of safety. Other reasons for cancellations, or the late running of services, include vessel breakdowns or crew shortages.

**60.** The operators of the three contracts have performed very well since 2007. Both the CHFS and NIFS operators have, with a few exceptions, operated over 99 per cent of scheduled sailings each year with over 99 per cent of these running on time, after relief events have been accounted for ([Exhibit 7](#)). Reliability on the Gourock-Dunoon route is lower, with 97.6 per cent of sailings operating in 2016, after relief events have been accounted for. This is mainly due to mechanical problems with the vessels. Argyll Ferries operates a replacement bus service to transfer passengers from its cancelled services to Western Ferries, which enables users to complete their journeys.

### Exhibit 7

#### Reliability and punctuality of sailings, by contract, in 2016

A higher percentage of sailings are cancelled on the Gourock-Dunoon route than on CHFS and NIFS routes.



Note: Operators of the Gourock-Dunoon service are not required to report the number of punctuality failures split by relief events and other reasons.

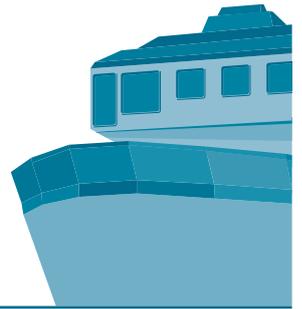
Source: Audit Scotland, using data returns from CalMac, Serco NorthLink and Argyll Ferries

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# Part 3

## Procurement

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### Key messages

- 1** EU rules and guidelines on ferry tendering have led to Transport Scotland operating three main ferry contracts with different timescales. As a result, it previously treated the procurement of each ferry contract as an individual project rather than a programme of work. It is now developing a more strategic approach which should help improve procurement planning, the use of resources and knowledge transfer.
- 2** There were weaknesses in how Transport Scotland managed the recent CHFS procurement project, although the appointment of key project staff introduced improvements. The chosen procurement method was new and the two bidders (CalMac and Serco) were not clear on what was expected of them. The bidders submitted over 800 queries during the tender process and there were delays in providing them with important information.
- 3** Transport Scotland estimated that the new CHFS contract would cost £996 million, based on the cost of continuing the old contract on the same terms. Transport Scotland received one compliant bid, from CalMac, which was £128 million lower than Transport Scotland's estimate. Although CalMac's bid met the minimum quality requirements, Transport Scotland was not required to assess the 350 commitments included in CalMac's bid which makes it difficult for it to demonstrate the added value of the new contract.
- 4** Transport Scotland awarded the new CHFS contract (CHFS2) to CalMac at a cost of about £868 million over eight years. Transport Scotland updated the contract requirements before the start date in October 2016 to reflect planned changes, which included updating the timetables. The required amendments have increased the contract cost to £975 million.
- 5** Transport Scotland has restructured and increased the size of its ferry contract management team to manage the additional workload associated with the new CHFS contract. But the team is still small compared to the significant amount of work required. The contract management team was not fully involved in the CHFS2 procurement exercise. This meant that it did not have sufficient time to understand the contract management requirements prior to the contract starting.

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the new  
CHFS  
contract  
started on  
time despite  
delays and  
weaknesses  
in the  
procurement  
process

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## Transport Scotland has not previously taken a strategic approach to procuring ferry services

**61.** As highlighted in [Part 1](#), EU rules and guidelines on ferry tendering have resulted in Transport Scotland operating three main ferry contracts with different timescales. This meant that these ferry procurement exercises were carried out by different people in Transport Scotland and were treated as individual projects rather than a programme of work.

**62.** Transport Scotland's procurement strategy for the 2016-24 CHFS contract (CHFS2) set out a number of learning points from previous ferry procurement exercises, including:

- the need for good governance structures, which includes information provided to project boards, roles and responsibilities, and decision-making procedures
- sufficient time must be built in to every aspect of the procurement exercise
- the importance of making information available to bidders in good time.

However, our review of the CHFS2 procurement exercise found that these lessons had not been applied.

**63.** Transport Scotland carried out a post-project review of the CHFS2 project in early 2017. It did not request feedback from the bidders as part of the review. Its review report identified a number of areas for improvement but it did not set out how these lessons would be applied to future procurements.

**64.** Transport Scotland recognises the advantages of a strategic approach to procurement. This includes better use of resources, improved planning, knowledge transfer, more coordinated use of external support (for example, financial advice), and the opportunity to create standard processes. Transport Scotland has now developed a more strategic approach for the next round of renewing ferry services contracts, which it expects will improve procurement practices in future. For example, the CHFS2 project sponsor and project manager will also oversee the next Gourock-Dunoon and NIFS tendering exercises.

## There were weaknesses in the management and governance of the CHFS2 project

**65.** Transport Scotland has guidance in place which sets out the governance arrangements and the appropriate steps that should be followed for all investment decisions.<sup>10</sup> All ferry procurements are required to comply with the guidance and must be signed off at key stages by Transport Scotland's Investment Decision Making (IDM) Board due to their 'novel, contentious or otherwise politically sensitive' nature. The CHFS2 project did not fully comply with the requirements of the IDM guidance ([Exhibit 8, page 34](#)).

**66.** Preparation for the CHFS2 project began in June 2014. In October 2014, Transport Scotland appointed the project sponsor and established a project steering group (PSG) to oversee the project. The PSG was responsible for reviewing the work of the CHFS2 project team and for all aspects of delivering the project, including developing the business case, managing risk and reviewing the



### The CHFS2

**project** was a joint procurement exercise for a single bidder to operate two separate contracts:

- The provision of ferry services in the Clyde and Hebrides.
- The operation of CMAL's harbours.

project. The PSG had clear terms of reference. The head of Transport Scotland's ferries unit chaired the PSG and it comprised appropriate senior staff from relevant areas of Transport Scotland's business, such as procurement, policy and finance.

## Exhibit 8

### CHFS2 compliance with Transport Scotland's Investment Decision Making guidance

The CHFS2 project did not fully comply with guidance.

IDM guidance requirement	Compliance
Sign off by the IDM Board	 <b>Full</b> – However, the CHFS Project Steering Group was not aware who had authority to sign off the project
The IDM Board must be presented with a completed Strategic, Outline, or Full Business Case at key decision points	 <b>Partial</b> – The IDM Board was not presented with the Outline Business Case or the Full Business Case when making the decision to 'Proceed to Procurement' and 'Proceed to Contract' respectively. A Strategic Business Case was not prepared
Appropriate governance procedures are in place	 <b>Partial</b> – Project sponsor and other important team members were not in place at the outset
Gateway reviews completed	 <b>Partial</b> – Not all reviews were undertaken
Full project costs reported	 <b>Partial</b> – Whole-life costs were not reported
Equalities Impact Assessment carried out	 <b>Full</b>
Strategic Environmental Assessment carried out	 <b>Full</b>
Benefits realisation plan in place	 <b>Partial</b> – This was not developed until August 2016
Risk register must be in place	 <b>Partial</b> – An appropriate risk register was not developed until December 2015

Source: Audit Scotland

**67.** CHFS2 was a high-value, complicated project with a high level of public, political and media interest. It was therefore important that Transport Scotland had effective arrangements in place to manage it. Although the PSG received regular updates from the project team and provided challenge on progress, there were a number of weaknesses in governance and management arrangements:

- Roles and responsibilities and decision-making processes were not fully established at the outset of the project.

- There were delays in appointing important members of the project team. For example, the project manager was not appointed until May 2015 and project support was appointed later, in October 2015. The appointment of financial consultants to support the team did not take place until June 2015.
- No one in the project team had a procurement qualification, although some staff in the project team had extensive experience of procurement projects and all members received procurement training. There was also no one in the project team with a ferries or shipping background.
- A detailed project plan was not in place at the outset, just a list of project milestones.
- Although risks were reported to the PSG from the outset, they were not well documented until after the project manager was appointed.

**68.** Using business cases is vital for scrutinising projects effectively and ensuring the right information is available at the right time to support decision-making. Transport Scotland's IDM guidance states that business cases must be presented to the IDM Board at key decision points, to provide a clear justification for investment and demonstrate value for money and the affordability of projects.

**69.** The CHFS2 Outline Business Case (OBC) and Full Business Case (FBC) were not presented to the IDM Board when important decisions were being made. For example, the OBC should have been presented when the IDM Board made the decision to 'Proceed to Procurement' but it was not developed until November 2015, seven months after the pre-qualification questionnaire was published. Our 2013 report on transport infrastructure projects similarly found that Transport Scotland did not routinely develop and update business cases.<sup>11</sup>

**70.** The project manager prepared the OBC and FBC after their appointment and these followed the HM Treasury's 'five case' model. That is, the OBC and FBC set out the strategic, economic, commercial, financial and management case for the project.<sup>12</sup> The project manager made a number of other project improvements, including:

- developing a detailed project plan
- revising and shortening the risk register
- preparing whole-life project costs
- creating clearer, more useful reports for the PSG.

**71.** Transport's Scotland's IDM guidance requires projects that are high value or risky to be subject to the Scottish Government's gateway review process. Gateway reviews should be carried out by an independent team ahead of key decision points to provide assurance on the progress made to date. However, some of these reviews were not carried out for the CHFS2 project, partly due to the absence of business cases ([Exhibit 9, page 36](#)). It is therefore not clear what independent assurances were being provided to the PSG or the IDM Board that the project was being delivered well and on time.

## Exhibit 9

### CHFS2 gateway reviews

Some gateway reviews could not be completed due to lack of project documentation.

 <b>Stage/ Purpose</b>	 <b>Date completed</b>	 <b>Issue</b>
<p><b>1 Gateway review 1 Business justification</b></p> <p>This review assesses the justification of the project. It should take place after the Strategic Business Case has been prepared and before project proposals are presented to the Project Board.</p>	<p>Did not take place</p>	<p>Transport Scotland prepared a strategic outline case for the project, which was discussed by the PSG. It did not consider it necessary to complete a formal Strategic Business Case as there was no doubt that the project would go ahead.</p>
<p><b>2 Gateway review 2 Delivery strategy</b></p> <p>This review investigates the assumptions in the Outline Business Case (OBC) to assess the project's viability, its potential for success, the value for money to be achieved, and the proposed approach. It should take place before invitations to tender are issued.</p>	<p>February 2015</p> <p>A supplementary gateway 2 <b>health check</b>  was carried out in May 2015, before the Invitation to Tender (ITT) was issued.</p>	<p>The assumptions in the OBC were not independently assessed as the OBC for the project was not developed until November 2015.</p> <div data-bbox="981 936 1481 1146" style="border: 1px solid #0070C0; border-radius: 10px; padding: 5px;"> <p> <b>Health check</b> reviews generally use the same principles and processes as gateway reviews. They are less formal and there is normally more flexibility on the remit and scope of the review and the subsequent report.</p> </div>
<p><b>3 Gateway review 3 Investment decision</b></p> <p>This review assesses the Full Business Case (FBC) to confirm that the recommended investment decision is appropriate. It should take place before the contract is awarded.</p>	<p>Did not take place</p> <p>A health check was carried out instead in April 2016.</p>	<p>The review could not take place because the bids were still being evaluated. This meant that mandatory documents, including the FBC, were not available for the gateway review team to assess.</p> <p>The FBC was not developed until May 2016 and was finalised in August 2016.</p>
<p><b>4 Gateway review 4 Readiness for service</b></p> <p>This review assesses whether an organisation is ready to implement the service and whether appropriate contract management arrangements are in place. It should take place prior to the service initiation date.</p>	<p>September 2016</p>	<p>Delays in the project meant that this review could not take place in August 2016 as planned.</p>
<p><b>5 Gateway review 5 Operations review and benefits realisation</b></p> <p>These reviews check that the project is on track to deliver its intended benefits. They should take place several times during service operation.</p>	<p>Not yet taken place</p>	<p>N/A</p>

## The CHFS2 procurement exercise was complex and the two bidders were not clear on what was expected of them

The chosen procurement method for CHFS2 was new and there were no guidelines in place on how it should be used

**72.** The CHFS2 procurement strategy considered the suitability of three different procurement routes for the project:

- Competitive Dialogue and Competitive Procedure with Negotiation (CPwN), both of which involve discussion with bidders on their proposals.
- The Restricted Procedure, which does not involve any discussion with bidders.

**73.** Transport Scotland assessed each option against a range of criteria, including the likelihood of achieving compliant bids, bidders' access to the process, timescales and costs. The Restricted Procedure was Transport Scotland's least favoured option because it did not allow it to enter into any discussion with bidders. This created a risk of bidders submitting bids that did not comply with Transport Scotland's minimum requirements. Transport Scotland considered the CPwN route to be the best option because it scored highly against most of its criteria. It was, however, the lengthiest of the three routes and Transport Scotland estimated it would take about four months longer than the Restricted Procedure.

**74.** The CPwN route enables contracting bodies to negotiate with bidders over the quality of service to be provided. Once these negotiations are complete, bidders submit a final bid, with a price, to provide a set standard of service, which is non-negotiable. For the CHFS2 procurement exercise, Transport Scotland set minimum contract requirements and award criteria which were not negotiable. It negotiated with the two bidders (CalMac and Serco) on aspects of their initial and interim bids which were deemed 'weak' or 'unacceptable', with the aim of improving the final bids received. Transport Scotland selected the CPwN procedure to minimise the risk of receiving non-compliant bids. However, it received only one bid (from CalMac) which it considered to be compliant with its minimum requirements. It also received a bid from Serco, but it considered this to be non-compliant ([paragraph 82](#)).

**75.** CPwN is a complex procurement route and, at the time, there were no guidelines in place on how it should be used. It was introduced by the 2014 European Procurement Directives. Specific details on how and when it should be used were not set out in the Public Contracts (Scotland) Regulations until December 2015, eight months after pre-qualification exercise for the procurement started.<sup>13</sup> The Regulations state that the CPwN route should be used when services require 'innovative solutions' or when the specification cannot be fully established by the public body. Transport Scotland's CHFS2 procurement strategy stated that the specification was heavily constrained by the Ferries Plan and was more prescriptive than NIFS, as the routes, timetables, fares and use of vessels are all determined by Scottish ministers. The strategy also lists a few areas where bidders could be innovative, including customer service, technology and catering.

### Transport Scotland received over 800 queries from bidders during the tender process

**76.** The specification for the CHFS2 ferry contract was based on Transport Scotland's Ferries Plan. This sets out service proposals to meet the needs of communities, based on extensive analysis and consultation carried out in 2009 and 2010. Transport Scotland did not consider it necessary to carry out a separate exercise to update the CHFS2 specification, due to the amount of work that had been carried out to develop the Ferries Plan.

**77.** Transport Scotland issued three versions of the **Invitation to Tender (ITT)**  – an initial, interim and final one – which covered both ferry and harbour operations. Both bidders told us that, in their opinion, the ITTs were not clear and contained a number of errors and omissions, which resulted in changes being made to the documents. An Independent Procurement Reference Panel (IPRP) also provided Transport Scotland with feedback on each of the ITTs. The Minister for Transport and the Islands established the IPRP to ensure that the procurement was fair, open and transparent. The IPRP reviewed the initial and interim ITTs, after they were issued to the bidders, which resulted in changes being made. It may have been more useful for the IPRP to review the initial and interim ITTs before they were issued, as was the case with the final ITT. This may have resulted in a clearer, more comprehensive ITT from the outset.

**78.** Transport Scotland set up an online information room to provide bidders with the information required to prepare bids. Transport Scotland acknowledges that there were significant delays in providing important data, in particular information on staff costs and vessel condition. Reasons for the delays include insufficient staff within the team to deal with all the queries and not holding all the data that bidders asked for (Transport Scotland therefore had to request this from CalMac as the incumbent bidder). Transport Scotland also failed to provide a clear financial baseline – bidders were provided with a range of financial information from different periods and had to reconcile the data. These issues made it difficult for bidders to make fully informed bids. Bidders told us that, in their opinion, there was also a lack of clarity in the contract specification and on the level of detail that they were expected to provide in their bids. This, along with the data issues, led bidders to submit over 800 queries during the tender process (352 from CalMac and 452 from Serco).

### Although the new service began on time, delays in the tender process increased bidders' costs

**79.** The weaknesses in project management, delays in providing data and external factors, such as discussions with unions and strike action by CalMac crewing staff, all contributed to delays in the procurement process. The most significant was in issuing the ITTs ([Exhibit 10, page 39](#)). Transport Scotland delayed the submission date for interim bids to allow bidders more time to prepare. This subsequently reduced the time they were given to prepare their final bids. Despite the delays, the new service began on time in October 2016.

**80.** The CHFS2 procurement project took over two years to complete, from June 2014 to September 2016. Transport Scotland's project costs totalled £1.1 million, which included £439,000 on consultancy support. Bidders told us that their costs were increased due to delays during the project. Serco told us that its costs also increased due to Transport Scotland providing insufficient data, for example on asset costs, which created more work.

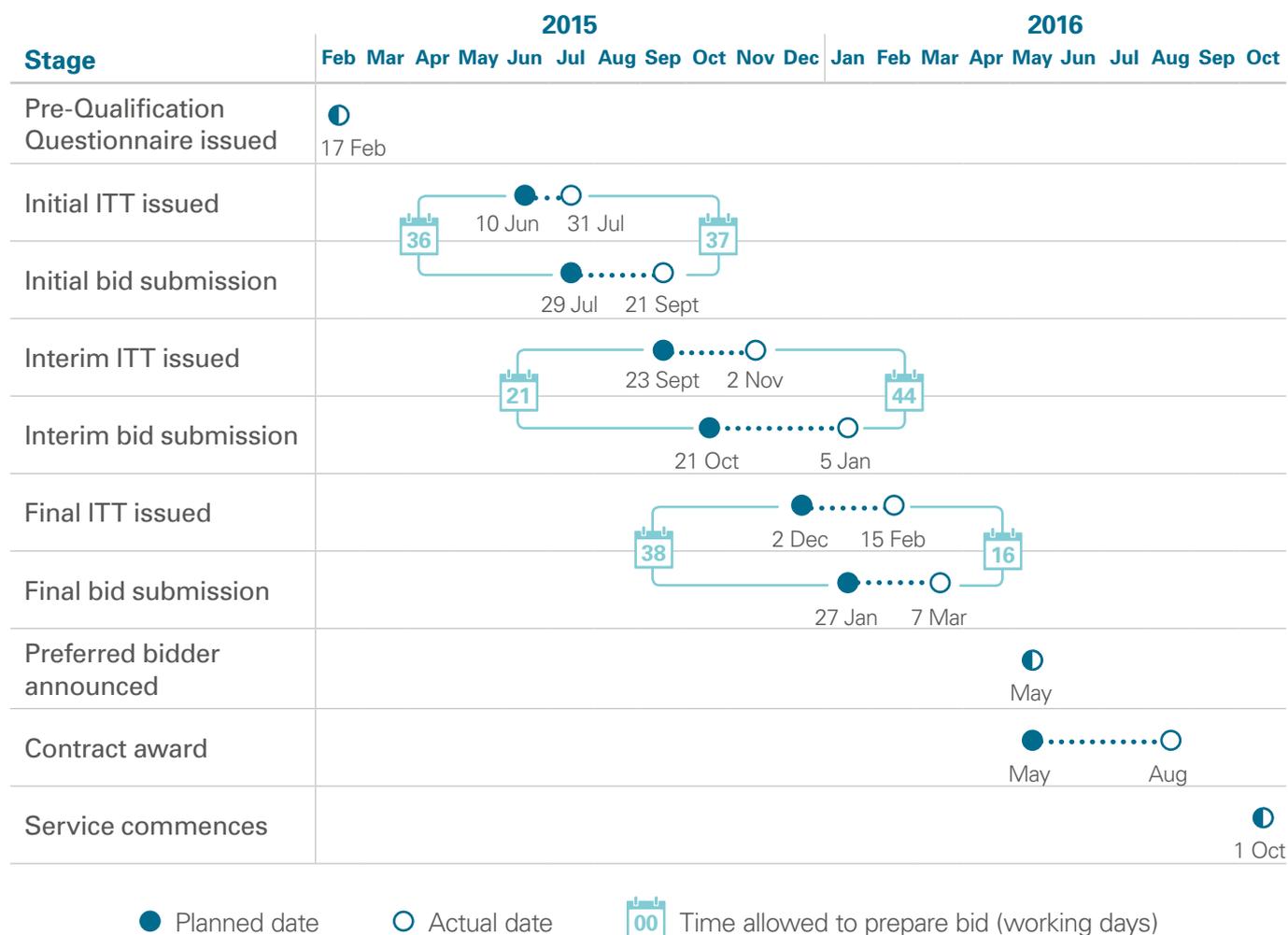


**An invitation to Tender (ITT)** is a formal invitation to bidders to make an offer to run a public-sector contract. It sets out the public body's requirements for goods or services, procurement timescales, details on how bids will be evaluated and contract terms and conditions.

## Exhibit 10

### CHFS2 procurement delays

The final ITT was issued two months later than planned.



Note: Planned dates taken from Transport Scotland's estimated project timescales in January 2015. Project timescales prepared prior to January 2015 were based on a Competitive Dialogue procedure and therefore cannot be directly compared to the actual dates. Transport's Scotland initial timetable (dated October 2014) planned for the final tender to be submitted in December 2015 (actual date was March 2016).

Source: Transport Scotland

## The added value of the CHFS2 contract is unclear

### Transport Scotland assessed that only one bid for the CHFS2 contract was compliant

**81.** Transport Scotland had a thorough process in place to evaluate the financial and quality aspect of the CHFS2 bids. The initial and interim bids did not include bidders' costs and were not scored. The final ITT required bidders to submit four packages (covering their operational proposals, personnel, costs and certificates) for both the ferry and harbour operations contracts. The ITT set out, in detail, how each package was to be evaluated, including how individual elements were to be scored and weighted, and what information bidders were required to include in their bids. Staff

involved in the assessments were provided with guidance and training. Eight panels were established to evaluate the final tenders after checking them for compliance and completeness. The financial package was only to be evaluated after the others had been checked for compliance against the minimum specification.

**82.** Transport Scotland assessed Serco's bid as non-compliant as it did not meet the minimum contract requirements. In particular, Serco was not willing to accept some of the risks specified in the contract. For example, it was not willing to accept financial liabilities relating to maintaining assets because it considered it did not have enough information on asset condition. In Transport Scotland's opinion, this made the bid non-compliant and it did not open the quality or financial aspect of the bid. Transport Scotland had a process in place for bidders to suggest amendments to the contract although it was not obliged to accept these. In Serco's opinion there was limited scope for negotiation and Transport Scotland rejected its suggested contract amendments without any explanation. However, Serco remained in the procurement process and submitted a final bid, with proposed amendments to the contract, in the hope that Transport Scotland would consider them.

#### **Transport Scotland did not assess the 350 commitments included in CalMac's bid**

**83.** Ministers decided that the bids were to be evaluated using a price/quality ratio of 65/35. The quality aspect of the tender required bidders to submit their proposals on:

- summer and winter timetables
- managing customer demand
- catering and retail services
- vessel deployment and investment
- marketing
- customer care and accessibility.

**84.** As Transport Scotland only received one compliant bid, from CalMac, it only checked the quality aspect of the bid for compliance and completeness. It was not required to formally evaluate and score the quality aspect of the single bid.

**85.** CalMac's bid included a total of 350 commitments, with milestones, across the different quality categories in the ITT. Commitments included a combination of specification requirements, as set out in the ITT, and additional offerings, such as a new post of Director of Community and Stakeholder Engagement. Transport Scotland did not analyse the 350 commitments to assess which of these were:

- requested by Transport Scotland in the specification
- a continuation of service offerings from the previous contract
- new practices or additional offerings which were not in the specification.

Without analysing these 350 commitments, Transport Scotland cannot demonstrate the additionality or added value that it expects the new contract to provide. However, Transport Scotland expects to benefit from the 350 commitments as CalMac is contractually required to deliver them. It is important that Transport Scotland monitors these commitments throughout the duration of the contract to help demonstrate value for money.

**86.** CalMac reports that its bid identified inefficiencies and opportunities to enhance value for money over the duration of the new contract. It proposed that it could make savings and stimulate additional revenue, thereby reducing the amount of subsidy required, as follows:

- It estimated that it could achieve savings of between five and 20 per cent over the duration of the contract through better procurement and management of spares, maintenance and fuel.
- It anticipated that it could increase revenue through local marketing and better demand management that would increase commercial traffic by 12 per cent and passenger and vehicle traffic by ten per cent.<sup>14</sup>

Transport Scotland plans to monitor how CalMac is performing against these proposals as part of its contract management arrangements.

### **Transport Scotland awarded the CHFS2 ferry contract at a cost of £868 million; contract variations have increased costs to £975 million**

**87.** Scottish ministers awarded CalMac the contract to run ferry services for eight years, at a cost of £868 million. CMAL awarded a separate contract to CalMac, at a cost of £32.5 million, to operate its harbours. Transport Scotland estimated the cost of the ferry services contract to make comparisons with bidders' estimates. Its estimated cost was £996 million, based on the cost of continuing the previous contract on the same basis (that is, the same timetables, fares and vessels). CalMac's winning bid for the ferry contract was £128 million lower than Transport Scotland's estimate.

**88.** The £868 million cost of CalMac's bid is based on the ITT specification. If any changes are subsequently made to that specification, such as the need for additional sailings, a contract variation is required. Although the specification was up to date when the initial and interim ITTs were issued, it had to be updated before the contract start date. For example, the specification was based on the 2014/15 timetable and RET had not yet been fully implemented.

**89.** Since the contract was signed in August 2016, CalMac has had to recalculate a number of its costs to take into account the expected changes. It has submitted contract variations to reflect, for example, the planned timetable changes and increased pension contributions imposed by the CalMac Pension Fund Trustees. Transport Scotland's ferries unit reviews the contract variation requests and corresponding costs. It has approved some of the contract variations, which will increase the cost of the contract over its duration by £107 million to £975 million.

## Arrangements for managing the three ferry contracts are evolving and could be strengthened

**90.** Transport Scotland's ferries unit has a contract management team which monitors the three main ferry contracts, plus the funding provided for one commercially operated route (Tayvallich to Craighouse). Contract management includes:

- monitoring the performance of operators through analysing monthly performance reports and meetings with operators
- checking monthly grant claims
- reviewing contract variations, which can be technical in nature
- annual reconciliations of operators' costs and subsidy payments.

**91.** Transport Scotland introduced changes to the new CHFS ferry contract to help control its costs. More financial risk has been transferred to the operator (for example, in relation to income generation, certain staff costs and maintaining asset condition). This means that if CalMac's bid has underestimated certain elements of its running costs or overestimated its revenue, Transport Scotland will not increase its subsidy payments to reflect this. This differs from the previous contract, which committed Transport Scotland to meeting the full net cost of delivering services. The changes will require more thorough contract management than was necessary during the previous contract.

**92.** Transport Scotland identified early in the CHFS2 procurement exercise that the new contract would require enhanced contract management due to the degree of specialism required and the volume of work involved. CHFS2 contract management arrangements:

- have been recorded on Transport Scotland's corporate risk register since the start of the procurement process
- were highlighted in the project's gateway review process, with a recommendation that appropriate resourcing should be put in place ahead of services starting
- were identified by internal audit as an area for further investigation in 2017.

**93.** The ferries contract management team has been restructured and increased by three posts to help manage the additional work the CHFS2 contract created. The team now consists of five staff, with two dedicated to the CHFS2 contract. It is too early to tell whether the new arrangements will allow for effectively managing the contracts. The contract management team still appears small compared to the amount of work involved.

**94.** The ferries contract management team was not fully involved in the CHFS2 procurement exercise. This meant that the team did not have sufficient time to understand the contract management requirements until the **contract mobilisation**  stage. This caused a delay in the team agreeing what information it needed to effectively monitor the contract. For example, at the start of the contract, the team did not know how it would monitor progress against



The **contract mobilisation** stage is the period between the contract award date and the start of the contract.

For CHFS2 the mobilisation stage ran from 22 August to 30 September 2016.

CalMac's 350 commitments. The contract management team would have been better prepared to effectively manage the contract from the outset if it had been made aware of the contract specifications at an earlier stage.

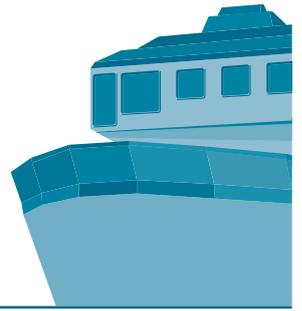
**95.** Operators provide Transport Scotland with a range of detailed financial and performance reports every month, quarter, six months and year (depending on the contract). Despite key performance indicators being largely similar across the three contracts, there is little consistency between the content and format of reports. Although this is to be expected to a degree, it would be more efficient if Transport Scotland requested common information from each operator in a consistent format. This would allow it to make comparisons and identify trends, which it is currently difficult to do.

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# Part 4

## Long-term planning

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### Key messages

- 1** Transport Scotland's Ferries Plan sets out proposals to develop ferry services and assets between 2013 and 2022. The estimated cost of these proposals, as at December 2012, was £390 million in capital and £10 million a year in revenue. The Ferries Plan was based on extensive analysis and consultation, and was Transport Scotland's first attempt to set out a long-term strategy for ferries. This was a positive development and was welcomed by communities and other interested bodies.
- 2** The Ferries Plan is focused on the Clyde and Hebrides network. Transport Scotland does not have a Scotland-wide strategy that takes into account its responsibilities across its network of subsidised ferries or the many proposed developments to its ferry operations. This means that the full extent of Transport Scotland's future spending requirements, and how it will prioritise spending across its three contracts, is unclear.
- 3** Transport Scotland's investment plans for vessels and harbours are focused on the CHFS network. Transport Scotland is currently considering how to develop its vessels plan to include its responsibilities across the rest of its network.
- 4** Less than halfway through the duration of the Ferries Plan, Transport Scotland has made significant progress against its proposals. It is not clear, however, if this has been achieved within budget as Transport Scotland does not monitor the associated costs.
- 5** Maintaining and investing in harbours will have significant cost implications for Transport Scotland. CMAL estimates that at least £466 million of investment in its harbours is required over the next 30 years. The condition of the remaining harbours across the subsidised ferry network is not reported to Transport Scotland, which means that the level of any required investment in these harbours is not known.
- 6** Transport Scotland does not measure systematically the benefits arising from its spending on ferry services, or the overall contribution ferries make to social and economic outcomes, such as employment or reducing inequality. Better information on this would help Transport Scotland make more informed decisions and demonstrate value for money.

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Transport Scotland has made significant progress against its Ferries Plan but there are substantial proposed developments to its ferry operations

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## Transport Scotland's Ferries Plan sets out its proposals to develop services and assets over ten years

**96.** Transport Scotland published a Ferries Plan in December 2012, setting out its proposals for ferries investment between 2013 and 2022.<sup>15</sup> This was Transport Scotland's first attempt to set out a long-term strategic approach to ferries and was welcomed by communities and stakeholders, such as councils and other interested parties. The plan involved extensive stakeholder consultation, data analysis and research and included a needs-based assessment of routes and services to determine:

- the needs of each community (that is, whether ferries were required for commuting, personal use, freight or tourism)
- what level of service was required to meet those needs
- how the current service model compared to needs.

**97.** Transport Scotland assessed options for each community against a range of criteria including feasibility, scale and complexity, to determine whether additional sailings or vessels were required. Most communities were offered an enhanced service and none received a reduction. Transport Scotland then developed a number of short, medium and long-term proposals to address communities' needs.

**98.** The Ferries Plan sets out Transport Scotland's investment proposals for services and assets, which would go ahead subject to the budget being available. The estimated cost of the proposals in December 2012 was £400 million, split as follows:

- Vessel replacement – £295 million capital.
- Ports and harbour works – £73 million capital.
- Development of routes and services – £22 million in capital and £10 million in annual revenue.

**99.** The plan also contained other commitments for Transport Scotland, including:

- rolling out RET across all ferry routes
- taking on responsibility for council-run services and harbours (if requested)
- reviewing commercial vehicle fares.

### The Ferries Plan focuses largely on the CHFS network

**100.** The Ferries Plan focuses largely on services and assets on the CHFS network. However, it contains some reference to the other contracts, in particular:

- a commitment to consider vessel deployment on the Northern Isles before the current lease ends in 2018
- a proposal to upgrade Gourock harbour by 2025.

**101.** Transport Scotland reports that the plan focuses on the CHFS network because of the significant investment made in the Northern Isles before the Ferries Plan was developed. For example, in 2002 the RBS Group funded three new passenger vessels at an estimated cost of £100 million. However, this still means that Transport Scotland does not have a Scotland-wide strategy for the full network of services that fall within its responsibilities. It is therefore not clear how Transport Scotland plans and prioritises its investment across the three contracts.

### **Transport Scotland has made substantial progress against the Ferries Plan, but it does not know if this has been achieved on budget**

**102.** Transport Scotland regularly reviews progress against the Ferries Plan. In March 2017 (just over four years into the ten-year plan), Transport Scotland reported significant progress to Scottish ministers. Of the 75 commitments made (covering routes and services, vessel replacement, harbour works, funding and procurement, fares, accessibility and responsibilities), 53 had been met and 21 were on schedule to be met. The one commitment that was not met was buying a passenger-only vessel for the Small Isles (the islands of Canna, Eigg, Muck and Rum) during the period of the interim CHFS contract (2013-16). Transport Scotland reported in March 2017 that it will no longer be buying the new passenger vessel as the local communities had decided against an increased ferry service.

**103.** Transport Scotland does not know whether it has delivered the Ferries Plan commitments within budget as it does not monitor progress against individual cost estimates. The plan does not estimate the cost of individual commitments. Instead it categorises commitments into short, medium and long-term proposals and estimates a total cost for each category. This means that it is not possible to determine the extent to which individual commitments have been delivered on budget.

**104.** Since publishing the plan, Transport Scotland has also made a number of other investments and improvements that were not included in it, to respond to changes in circumstances. Examples include increasing the capacity on the Kennacraig-Islay service, extending the operating day on the Tobermory-Kilchoan route and introducing a new route between Mallaig and Lochboisdale.

### **Better information on assets would assist long-term planning**

#### **Transport Scotland's vessels plan is not Scotland-wide**

**105.** The Ferries Plan sets out a high-level proposal of vessel replacement on the CHFS network, based on vessel age. In 2013, Transport Scotland, alongside CMAL and CalMac (the tripartite group), started to consider a more detailed plan of vessel retentions, acquisitions and disposals to support the delivery of the Ferries Plan. The tripartite group published its Vessel Replacement and Deployment Plan (VRDP) for the Clyde and Hebrides in October 2015 and refreshed it in December 2016.<sup>16,17</sup> A further refresh is due in late 2017.

**106.** The VRDP takes into account historical and projected customer demand, the impact of RET and vessel capacity for both passengers and vehicles. It is based on actual and forecast weekly capacity utilisation (that is, how full the ferries are) over the peak nine-week summer season on the CHFS network. The VRDP lists short, medium and long-term proposals to address issues of high-capacity

utilisation on the Clyde and Hebrides network, which is predicted to reach over 100 per cent on some routes by 2024. Proposals include the deployment of two new vessels that are currently under construction, adding a second vessel onto some routes or using larger ones. It does not set out the cost implication of vessel decisions.

**107.** Transport Scotland is considering how it can develop the VRDP to include all of its vessel responsibilities across its subsidised network. In doing so, Transport Scotland should ensure that it includes the estimated cost of its vessel decisions, including the cost of any associated harbour works.

### Detailed information on vessel capacity utilisation is important for both financial and operational planning

**108.** The VRDP is a positive and useful development to help make difficult and complicated vessel decisions on the CHFS network. However, it is based on average weekly capacity utilisation data, which hides significant variations in how busy, or empty, vessels are on particular sailings, at different times of the day, or on different days of the week. More detailed information would allow Transport Scotland, in cooperation with CMAL and operators, to accurately identify peaks and troughs and allow it to better plan services and assets to manage these.

**109.** CalMac and Serco NorthLink record information on capacity utilisation for their own purposes. On both CHFS and NIFS routes, average monthly capacity utilisation varies significantly throughout the year, mainly due to higher numbers of tourists during the summer. For example:

- on the CHFS network in 2016, vehicle deck capacity utilisation varied from seven per cent on the Kennacraig toIslay/Colonsay/Oban route in December, to 80 per cent on the Oban to Craginure route in August
- in contract year 2015-16, cabin utilisation on the Northern Isles routes varied from 37 per cent in January 2016 to 79 per cent in July 2015.

These monthly figures hide huge variations that can exist on a daily and weekly basis.

**110.** Argyll Ferries does not record capacity utilisation on the Gourock-Dunoon route. Based on passenger numbers and vessel sizes, we estimate that the average passenger capacity utilisation ranges from six per cent in winter months (October 2015 to March 2016) to seven per cent in the summer months (April to September 2016).

**111.** The VRDP sets out how Transport Scotland will increase capacity on ferry routes which have high average capacity utilisation. But low levels of capacity utilisation can also be a problem and may indicate that sailings are too frequent or vessels are too big. Transport Scotland should consider, when developing its refreshed strategy for ferry services, opportunities to address low capacity utilisation, which may include reducing the frequency of sailings.

### Substantial investment in harbours is required but the full extent of this is unclear

**112.** Transport Scotland's subsidised ferries operate in and out of 59 harbours across Scotland. CMAL owns 25 harbours and one berth on the CHFS network, plus Gourock Harbour. It is responsible for both maintaining these and investing in new and upgraded facilities. Between 2007 and 2016, CMAL spent about £30 million on harbour improvement works. However, it considers this has not been enough to address historical underinvestment in harbours and there is now a need to replace infrastructure:

- which is reaching the end of its useful life
- to accommodate new vessels
- to manage higher demand, resulting from RET
- to comply with disability and accessibility legislation
- to improve the customer experience.

**113.** Transport Scotland does not have a harbours investment plan. CMAL has a programme of improvements for its harbours, which is based on condition surveys carried out in 2007 and 2015. The estimated cost of the improvement works is £466 million over 30 years (excluding inflation). This excludes the cost of upgrading harbours to accommodate new vessels, which may be significant ([Case study 5, page 49](#)). CMAL's estimated investment requirement is significantly higher than the estimated ten-year cost of harbour works in the Ferries Plan (£73 million). It is not clear how the improvement works will be funded within Transport Scotland's allocated budget.

**114.** Although Transport Scotland has information on the condition of CMAL's harbours, it does not collate details on the condition of more than half (33) of the harbours that its services operate from. The condition of these harbours is fundamental to operating ferry services safely and efficiently. It also has financial implications for Transport Scotland. It is therefore important that Transport Scotland collates this information and builds it into its long-term operational and investment plans.

### A number of ferry developments will have a financial impact on Transport Scotland

**115.** There are a number of pressures on Transport Scotland's ferries budget, some of which we have already mentioned. These include:

- the significant investment required in harbours
- the increasing demand pressures created by RET
- rising pension costs
- ongoing public and political pressures to improve services.

## Case study 5

### An example of how vessel decisions affect harbour costs



#### Harbour modifications to accommodate the new Ullapool to Stornoway vessel cost £31.6 million

In 2011, Transport Scotland, on the advice of CMAL and CalMac, decided to build a new, large ferry on the Ullapool to Stornoway route to replace the existing passenger and vehicle vessel and separate freight vessel. Although an initial option appraisal exercise indicated that the preferred option was to build two medium/large-sized vessels, a later evaluation indicated that a single, larger ferry would be more reliable in bad weather. Lloyds Bank funded the £42 million cost of the new ferry, which has the capacity to carry an extra 20 passengers and an extra 20 cars, compared to the previous passenger and vehicle vessel.

The existing harbour infrastructure was unable to accommodate the larger vessel, requiring both harbours to undergo major upgrade and extension in 2014. Although CMAL did not own the harbours, Transport Scotland agreed to pay a significant proportion of the upgrade costs:

- Stornoway Harbour (owned by Stornoway Port Authority): Transport Scotland paid £8.5 million of the £12 million cost (71 per cent).
- Ullapool Harbour (owned by Ullapool Harbour Trust): Transport Scotland paid £18 million of the £19.6 million cost (92 per cent).

Between October 2014 and September 2016, harbour dues paid by Transport Scotland, through CalMac, increased by:

- 56 per cent at Stornoway harbour, to £1.4 million per contract year
- 78 per cent at Ullapool harbour, to £1.5 million per contract year.

Source: Audit Scotland using figures provided by Transport Scotland and CalMac

**116.** A number of other developments are also likely to have implications for Transport Scotland's capital and revenue expenditure. For example:

- In 2014, the Scottish Government committed to the principle of 'fair funding' for Orkney and Shetland councils' inter-island ferry services.<sup>18</sup> Scottish Government funding for councils' ferry services is currently part of their local government funding settlement. Orkney and Shetland councils supplement Scottish Government funding by about £2.5 million and £7.5 million a year respectively. In contrast, Transport Scotland subsidises inter-island ferry services in the Western Isles, as part of the CHFS contract, without financial support from Comhairle nan Eilean Siar. Transport Scotland has been discussing the future funding of inter-island services and assets with Orkney and Shetland councils for about two years. 'Fair funding' will require substantial capital investment plus annual funding to cover the operational costs.

- In 2016, the Scottish Government committed to reduce fares to the Northern Isles in response to RET being introduced on CHFS routes. As part of its planning for the new NIFS contract, Transport Scotland has been considering its methodology for reduced fares, how much this will cost and how it will manage the implications. Lower fares will be introduced from 2018. This is anticipated to significantly increase demand for ferry travel, which is likely to create capacity issues. Transport Scotland is planning to manage this by operating additional sailings using the current vessels on the network. This is likely to require major timetable changes, which will have an impact on freight customers in particular. While making greater use of assets will save on the costs of new vessels, it will increase crewing, fuel and maintenance costs and harbour dues. Transport Scotland will also introduce RET on the commercially operated service on the Pentland Firth from 2018. This means it will be required to pay compensation to the operator, Pentland Ferries, in respect of lower ticket income.
- Transport Scotland is currently considering how to deal with the three passenger vessels on the NIFS routes. Transport Scotland has an operating lease with the owners, RBS Group, and this is due to end in 2018. Transport Scotland and CMAL are currently assessing the cost of their options, which include renewing the lease.
- Transport Scotland has been reviewing and discussing freight fare options since 2014. The aim is to introduce a consistent freight fare structure across the Transport Scotland network which means that costs will increase on some routes and decrease on others. Depending on the route, it may mean that additional sailings or vessels are required to meet demand, or that Transport Scotland loses custom to commercial operators on routes where its fares are increased. Transport Scotland is alert to this risk from its experience of the NorthLink Ferries contract failure in 2004. One of the reasons for the failure was competition from Norse Island Ferries, which a group of hauliers created in response to NorthLink's high freight charges.
- The specification for the new Gourock-Dunoon contract requires the operator to use its own 40-metre vessels, to help improve reliability on the route. If the contract is awarded to David MacBrayne Ltd (DML), this will require public sector investment in new vessels. While the tender exercise is currently paused, it is important that Transport Scotland considers the value for money of providing financial support for this route, in the context of:
  - the cost of the new vessels. In 2013, Transport Scotland commissioned consultants to estimate the cost, which ranged from £3.0 million per passenger vessel to £6.0 million per passenger/vehicle vessel.<sup>19</sup> In January 2017, DML estimated this could cost in the region of £25 million to £30 million per vessel<sup>20</sup>
  - falling passenger numbers since 2007
  - increasing subsidies since 2011 (which are estimated to increase further to £4.2 million a year at the start of the new contract)
  - the required £13 million investment in Gourock harbour (as estimated in the Ferries Plan)
  - the presence of a successful commercial operator on an adjacent route.

## It is difficult to determine whether Transport Scotland's spending on ferries is value for money

### Transport Scotland does not routinely measure the impact of its ferry spending

**117.** Transport Scotland's Ferries Plan states that its funding of ferry services helps to:

- improve connections for island and remote rural communities
- improve reliability and journey times
- maximise the opportunities for employment, business, leisure and tourism
- promote social inclusion.<sup>21</sup>

**118.** Transport Scotland's ferries team does not have a performance measurement framework in place to assess the extent to which its funding for ferry services contributes to these aims. Similarly, Transport Scotland considers that transport contributes to nine of the Scottish Government's National Outcomes.<sup>22</sup> But it has not set out how it intends the Ferries Plan to contribute to these outcomes, nor does it have a framework in place to measure this.

**119.** Some work has been carried out to estimate the impact of specific aspects of ferry services. For example:

- Transport Scotland has evaluated the impact of RET on certain communities
- CalMac has estimated the contribution that it makes to local economies, in terms of the number of jobs and salary levels that it supports.<sup>23</sup> For example, in 2014 it employed over 1,400 staff and supported a further 4,300 jobs, resulting in a total of £85.8 million being paid in direct and indirect salaries
- Serco NorthLink regularly reports how much it spends on local suppliers to help demonstrate its contribution to local economies.

**120.** But there has been no overall assessment of the contribution that ferry services make to economic and social outcomes, such as supporting well-paid employment in remote communities.

**121.** Transport Scotland's spending on ferries has doubled since 2007/08 ([Exhibit 3, page 17](#)). Although this has delivered tangible outputs, including additional vessels and sailings, the impact of this increased spending, for example on employment or tourism, is not known. Transport Scotland does not know the specific impact of increasing or reducing service levels, either on an individual route basis or across the whole network. Without detailed information, it is difficult for Transport Scotland to demonstrate the impact of its operational or spending decisions. It is important that Transport Scotland can demonstrate that it is getting the best level of service for the money available and that it is targeting its future ferries investment where it will have the biggest impact on local communities.

### There are opportunities for Transport Scotland to set out more clearly its intended benefits of ferries

**122.** Transport Scotland, at a corporate level, is currently in the process of developing a methodology and assessment tool to enable it to prioritise all of its future spending decisions and assess the impact of its spending against Scottish Government objectives. It intends to use its Policy Assessment Framework (PAF) tool to assess how projects perform against Scottish Government policies, such as:

- promoting economic growth
- improving transport integration
- protecting the environment and improving health
- improving journey safety
- promoting social inclusion.

**123.** In these times of financial constraint, it is important that Transport Scotland can demonstrate it is getting the best level of service for the money available. There is an opportunity for Transport Scotland to use the PAF to develop a Scotland-wide ferries strategy which:

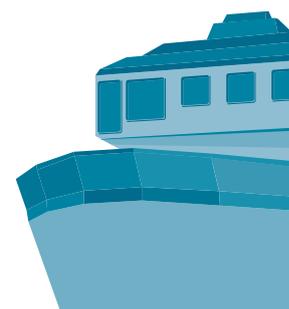
- clearly identifies what Transport Scotland's spending on ferries services is intended to achieve
- includes a framework for assessing the contribution that its ferries spending makes to the Scottish Government's National Outcomes
- is clearly aligned with the plans of relevant **Community Planning Partnerships (CPPs)**  to improve local economies and social wellbeing. Transport Scotland is currently not a partner on CPPs
- is financially sustainable and clearly identifies its priorities for future ferries development
- takes into account its current ongoing review of its Strategic Transport Projects and refresh of its National Transport Strategy.



There are 32 **CPPs** in Scotland, one for each council area.

They are a statutory forum for bodies, such as councils, NHS boards, RTPs and the police and fire services, to work with local communities to plan and deliver better services.

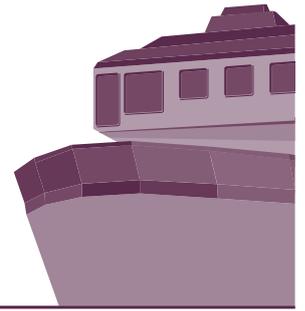
# Endnotes



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- ◀ 2 Official report, Meeting of the Parliament, Scottish Parliament, Thursday 2 February 2017.
- ◀ 3 *Assessment of the Impacts of the Road Equivalent Tariff Pilot, Final Report*, Halcrow Group Limited, July 2011.
- ◀ 4 *The introduction of a road equivalent tariff based fares system on Scotland's ferry network*, Halcrow Group Limited, 2008.
- ◀ 5 *Assessment of the Impacts of the Road Equivalent Tariff Pilot, Final Report*, Halcrow Group Limited, July 2011.
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- ◀ 7 *2016 Annual Carrying Statistics*, CalMac Ferries Ltd, February 2017.
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- ◀ 9 The Scottish Government announced in August 2017 that lower fares will be introduced from 2018.
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- ◀ 20 Official report, Scottish Parliament's Rural Economy and Connectivity Committee, Scottish Parliament, 25 January 2017.
- ◀ 21 *Scottish Ferries Services. Ferries Plan (2013-2022)*, Transport Scotland, December 2012.
- ◀ 22 [www.scotland.gov.uk/About/scotPerforms](http://www.scotland.gov.uk/About/scotPerforms) 
- ◀ 23 *The Economic and Social Impact of CalMac Ferries Ltd on Scotland*, Fraser of Allander Institute, April 2015.

# Appendix 1

## Ferry routes in Scotland



We estimate that there are 66 ferry routes within Scotland, as follows:

Route	Operator
<b>32 Transport Scotland subsidised routes</b>	
Gourock-Dunoon	Argyll Ferries
Ardmhor-Eriskay	CalMac
Ardrossan-Brodick	CalMac
Ardrossan-Campbeltown	CalMac
Berneray-Leverburgh	CalMac
Colintraive-Rhubodach	CalMac
Fionnphort-Iona	CalMac
Fishnish-Lochaline	CalMac
Gallanach-Kerrera*	CalMac
Kennacraig-Islay	CalMac
Kennacraig-Islay/Colonsay/Oban	CalMac
Largs-Cumbrae	CalMac
Lochranza-Claonaig	CalMac
Mallaig-Armadale	CalMac
Mallaig-Eigg/Muck/Rum/Canna	CalMac
Mallaig-Lochboisdale	CalMac
Oban-Castlebay	CalMac
Oban-Coll/Tiree	CalMac
Oban-Coll/Tiree/Castlebay	CalMac
Oban-Colonsay	CalMac
Oban-Craignure	CalMac
Oban-Lismore	CalMac
Raasay-Sconser	CalMac
Tarbert-Portavadie	CalMac
Tayinloan-Gigha	CalMac
Tobermory-Kilchoan	CalMac
Uig-Tarbert/Lochmaddy	CalMac
Ullapool-Stornoway	CalMac
Wemyss Bay-Rothesay	CalMac
Aberdeen-Lerwick	Serco Northlink
Aberdeen-Kirkwall-Lerwick	Serco Northlink
Scrabster-Stromness	Serco Northlink

Route	Operator
<b>34 Non-Transport Scotland subsidised routes</b>	
<b>Councils</b>	
Cuan-Isle of Luing	Argyll and Bute
Ellenabeich (Isle of Seil)-Isle of Easdale	Argyll and Bute
Islay-Jura (Port Askaig-Feolin)	Argyll and Bute
Port Appin-Lismore	Argyll and Bute
Camusnagaul-Fort William	Highland
Cromarty-Nigg. Summer only*	Highland
Nether Lochaber-Ardgour	Highland
Houton-islands of Flotta and Lyness (Hoy)	Orkney Isles
Kirkwall-North Isles (islands of Stronsay, Eday, Sanday, North Ronaldsay, Westray and Papa Westray)	Orkney Isles
Kirkwall-Shapinsay	Orkney Isles
Papa Westray-Pierowall*	Orkney Isles
Stromness-Graemsay/North Hoy	Orkney Isles
Tingwall-Rousay/Egilsay/Wyre	Orkney Isles
Grutness (Sumburgh)-Fair Isle*	Shetland Isles
Gutcher (Yell)-Belmont (Unst)-Hamars Ness (Fetlar)	Shetland Isles
Laxo (Mainland)-Symbister (Whalsay)	Shetland Isles
Lerwick (Mainland)-Bressay	Shetland Isles
Lerwick (Mainland)-Skerries	Shetland Isles
Toft (Mainland)-Ulsta (Yell)	Shetland Isles
Vidlin (Mainland)-Skerries*	Shetland Isles
Walls (Mainland)-Foula*	Shetland Isles
West Burrafirth (Mainland)-Papa Stour*	Shetland Isles
<b>Regional Transport Partnerships</b>	
Gourock-Kilcreggan	Strathclyde Partnership for Transport
<b>Private operators</b>	
Tayvallich-Craighouse (Jura). Summer only*	Private operator with Transport Scotland funding
Cape Wrath Ferry (May-Sept only)*	Private operator
Hunter's Quay-McInroy's point	Private operator – Western Ferries
Mull-Ulva*	Private operator
John O' Groats – Burwick. Summer only*	Private operator
Mallaig-Loch Nevis (Inverie – Tarbet)*	Private operator
Scoraig-Badluarach*	Private operator
St Margaret's Hope-Gills Bay	Private operator – Pentland Ferries
Yoker-Renfrew*	Clydelink
<b>Community groups</b>	
Glenelg-Kylerhea. Open Easter – October*	Community interest group
Laga-Tobermory-Drimnin*	Community interest group

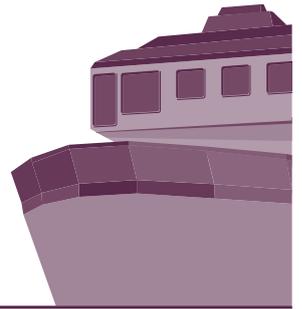
Note: This is our estimate of ferry routes within Scotland. There may be additional routes and services in operation. Due to unavailable or incomplete data, routes with an \* are not included in total passenger, car and commercial vehicle carryings figures reported in [Part 2](#).

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# Appendix 2

## Roles and responsibilities of the bodies involved in Transport Scotland's ferry operations

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### Scottish ministers

- Responsible for ferry policy and delivery. The Minister for Transport and the Islands is responsible for ferry services
- Set Transport Scotland's budget for subsidised ferry services
- Approve Transport Scotland's operational and spending decisions, including setting fares and timetables
- Contract ferry operators to operate Transport Scotland's subsidised ferry services
- Own David MacBrayne Ltd and Caledonian Maritime Assets Ltd (CMAL)

### Transport Scotland

- Implements policy and guidance relating to Scotland's ferry services
- Supports ministers to prioritise ferry projects and funding
- Sets ferry fares and timetables
- Tenders for ferry services, on behalf of ministers, to the Clyde and Hebrides, Northern Isles and Gourock–Dunoon, through three ferry contracts
- Pays subsidies to the operators of three main ferry contracts
- Provides funding for one privately operated ferry route (Tayvallich to Craighouse)
- Monitors ferry operators' performance and manages subsidy payments
- Provides loans to CMAL to support vessel procurement
- Provides grants for improvement works to piers and harbours on its subsidised ferry network

### David MacBrayne Ltd

- Wholly owned by Scottish ministers
- Reports to the Cabinet Secretary for the Rural Economy and Connectivity
- Employs two staff
- Oversees the delivery of the ferry contracts between Scottish ministers and its two subsidiaries (CalMac Ferries Ltd and Argyll Ferries Ltd)

- Its human resource subsidiary, David MacBrayne HR (UK) Ltd, provides HR, payroll and crewing services to the David MacBrayne group and employs 27 staff
- Owns two passenger vessels which are operated by Argyll Ferries Ltd

### **Caledonian Maritime Assets Ltd (CMAL)**

- Wholly owned by Scottish ministers
- Reports to the Cabinet Secretary for the Rural Economy and Connectivity
- Employs 27 staff
- Owns 32 vessels and 25 harbours on the Clyde and Hebrides network, plus Gourock Harbour
- Leases one vessel, the MV *Loch Seaforth*, from Lloyds Bank
- Charges harbour users, including ferry operators, a 'harbour due' for using its harbours
- Responsible for major harbour works
- Contracts CalMac Ferries Ltd to operate its harbours
- Leases vessels to CalMac on a 'bareboat charter' agreement. This means the vessels are leased without a crew
- Leases two freight vessels from Fortress, a private company. CMAL then lease these vessels to Serco NorthLink on a 'bareboat charter' agreement
- Procures new vessels. This includes concept design, running the tendering process and overseeing the build
- Inspects vessels twice a year, and is responsible for statutory works and owner upgrades

### **CalMac Ferries Ltd**

- Wholly owned subsidiary of David MacBrayne Ltd, created in 2006
- Employs 564 land-based staff
- Its subsidiary, Caledonian MacBrayne Crewing (Guernsey) Limited, employs 1,050 seagoing staff
- Current operator of the Clyde and Hebrides Ferry Services (CHFS) contract
- Leases 33 vessels from CMAL, including the MV *Loch Seaforth*, and decides where they should be deployed
- Operates CMAL's harbours, which includes undertaking routine maintenance
- Responsible for arranging consultation meetings with relevant councils and Regional Transport Partnerships (RTPs) and 'local community liaison' with ferry users and the wider public
- Leases out one vessel to Argyll Ferries Ltd during winter months

### **Argyll Ferries Ltd**

- Wholly owned subsidiary of David MacBrayne Ltd, created in 2011
- Employs 28 staff
- Operates the Gourock-Dunoon contract
- Leases two vessels from its parent company, David MacBrayne Ltd
- Leases one vessel from CalMac Ferries Ltd during winter months

### **Serco NorthLink**

- A subsidiary of Serco Group Plc
- Employs 265 seagoing staff and 79 land-based staff
- Current operator of the Northern Isles Ferry Service (NIFS) contract, since 2012
- Leases three passenger and vehicle vessels from The Royal Bank of Scotland on a 'bareboat charter' agreement
- Leases two freight vessels from CMAL, who in turn lease the vessels from Fortress, a private company
- Responsible for arranging consultation meetings with relevant councils and RTPs and 'local community liaison' with ferry users and the wider public

### **Council, private and independent harbour owners**

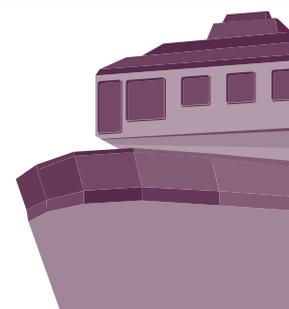
- Charge harbour users, including ferry operators, a 'harbour due' for using their harbours
- Responsible for the safe operation, maintenance and improvement of harbours

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# Appendix 3

## Audit methodology

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Evidence for our audit was based on four main components:

### 1. Desk research

We reviewed a range of published and unpublished information from Transport Scotland, CMAL and the ferry operators, including:

- the Ferries Plan, including all the underpinning reports and analysis
- corporate plans, annual reports and accounts, and board papers
- Vessel Replacement and Deployment Plans (VRDPs) and harbour maintenance schedules
- ferry and harbour contracts and contract management reports
- RET evaluation reports
- procurement documentation – which included:
  - Transport Scotland’s corporate procurement strategy and investment decision-making guidance
  - a range of CHFS2 specific documents, for example the procurement strategy, business cases, ITTs, steering group papers and gateway review reports.

### 2. Interviews

We met with a number of staff from Transport Scotland, CMAL and the ferry operators. We also spoke to a range of other bodies which are involved, or have an interest, in ferry operations including: commercial operators; Regional Transport Partnerships; councils; trades unions; VisitScotland; Highlands and Islands Enterprise; the Road Haulage Association; consultants with an interest in the ferry industry; and academics.

We also attended or observed meetings of: the Expert Ferries Group; the tripartite group; and Ferry User Groups.

### 3. Data analysis

We analysed a range of published and unpublished data from Transport Scotland, CMAL and the ferry operators, including:

- Transport Scotland's total spending on ferry subsidies and assets – from its internal Section 70 reports
- spending on individual ferry contracts (reported in [Exhibit 5](#) and [Case Studies 2, 3 and 4](#)). Data is presented by contract years, which differ as follows:
  - CHFS – 1 October to 30 September
  - NIFS and Gourock-Dunoon – 1 July to 30 June
- contract data from each ferry operator's Annual Outcome Statements (AOS), which are reported to Transport Scotland. The AOS data is available up to the contract years which ended in 2016. We have presented the data in real terms, at 2016/17 prices
- CalMac and Serco NorthLink's spending on harbour dues, paid to individual harbours.

Figures for these three data sets are all presented in real terms, at 2016/17 prices using GDP deflators at market prices (Quarterly National Accounts, June 2017).

We also used the following data sources:

- Transport Scotland's analysis of its spending on pier and harbour improvement works since 2007/08.
- The 2016 [Scottish Transport Statistics](#)  and data provided by Transport Scotland and individual operators to analyse trends in passenger, car and commercial vehicle traffic. Note:
  - The total for the CHFS network includes traffic on the Mallaig-Lochboisdale route which was introduced in 2015. This route is not included in the Scottish Transport Statistics
  - Passenger numbers on the Corran ferry are estimated
  - Due to the unavailability of data, 2016 carrying figures for routes run by Argyll and Bute Council and Highland Council were estimated, based on 2015 figures
  - Trend information excludes traffic numbers on a few routes due to unavailable or incomplete data. These routes are marked in [Appendix 1](#).
- CalMac, Serco NorthLink and Argyll Ferries' data on: number of sailings; capacity utilisation; reliability and punctuality.
- CMAL's estimate of the investment required in their harbours over the next 30 years.

## 4. Visits

We spoke to a small sample of ferry users across ten communities which rely on ferry services – Arran, Barra, Benbecula (which covered North and South Uist), Cumbrae, Dunoon, Islay, Mull, Orkney, Skye and Shetland.

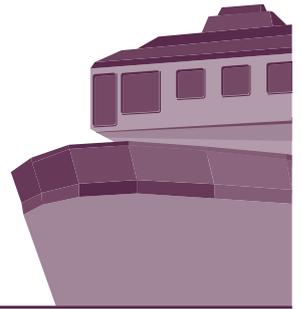
We met a range of individuals, including representatives from:

- ferry committees
- the business sector
- the tourist industry
- community councils
- hauliers
- the fishing, farming and whisky industries
- disability and access groups.

This was not a representative sample of ferry users but was used to understand the range of users' experiences and views.

# Appendix 4

## Advisory group



Audit Scotland would like to thank members of the advisory group for their input and advice throughout the audit.

Member	Organisation
Michael Craigie	Shetland Transport Partnership (ZetTrans)
Robbie Drummond	David MacBrayne Limited, Argyll Ferries Limited and CalMac Ferries Limited
Stuart Garrett	Serco NorthLink Ferries
Richard Hadfield	Transport Scotland
Kevin Hobbs	Caledonian Maritime Assets Limited
Graham Laidlaw	Transport Scotland
Paul McCartney	Peter Brett Associates
Ronald Robertson	Highlands and Islands Transport Partnership (HITRANS)
Gordon Ross	Western Ferries

Note: Members sat in an advisory capacity only. The content and conclusions of this report are the sole responsibility of Audit Scotland.