PROJECT CARLISLE COUNTER-OFFER MEETING

20 AUGUST 2010

Attending: Richard Jeffrey, Steven Bell and Tony Rush (tie)
Donald McGougan, Dave Anderson, Marshall Poulton, Alan Coyle, Nick Smith and Carol Campbell (CEC)

Introduction

Richard Jeffrey began by advising that, in terms of governance, **tie** were not formally seeking the approval of the Council to the proposed counter-offer at the meeting. The outline of the counter-offer to be given today is for noting only, and the presentation has been deliberately kept at a high level as it is envisaged that Alan Coyle and Stewart McGarrity will go through the proposal separately in more detail.

RJ advised that **tie** are aiming to make the submission to BSC on Monday 23 August. Clearly, it is being made on a non-binding and without prejudice basis and DLA will draft the proposal suitably in order to make this clear.

A presentation type document was then provided and Richard Jeffrey talked the attendees through the points.

Project Carlisle - Phase 1 and 2

Project Carlisle deals with delivery of the tram project as a whole, not just the contract with Infraco. It is proposed that the project will be split into two phases. Phase 1 is from the Airport to St Andrew Square. Phase 2 is St Andrew Square to Newhaven. Gogar Intermodal is not included at this stage although it is recognised that this will be required by the Scottish Ministers and would need to be an addition to Phase 1. **Tie** are of the view that it would be sensible to agree their counter-proposal in the first instance and then layer Gogar Intermodal on top.

Phase 1

The GMP to be paid to Infraco will not include any civils or systems works beyond the end of Waverley Bridge, except some £8 million worth of infrastructure enabling works at Newhaven which have already been started. All works from the Airport to Waverley Bridge excluding the on-street civils from Haymarket to Princes Street are included in the GMP. As part of the GMP, Infraco will be responsible for providing a complete assured integrated design from the Airport to Newhaven and will also supply all 27 trams. It should be noted that any utility risks over £50,000 are excluded from the GMP.

The Phase 1 proposal includes further elements which are not part of the GMP, but which are part of the deal proposed by **tie**. Those elements are: Siemens' systems work from Waverley Bridge to St Andrew Square; any additional payment to SDS; settlement of the PSSA costs; and all other costs eg. **tie**'s costs, legals, land, utility, design. The proposal also includes a new "CEO's risk allowance" which RJ has built in as a contingency.

The revised completion date for the section from the Airport to Waverley Bridge with trams running to Shandwick Place is now estimated at June 2012 and Airport – St Andrew Square is tentatively estimated at December 2012 although this is dependent on a number of factors (including any solution adopted at St Andrew Square).

The price for the works in the GMP defined scope as outlined is £270 – £290 million. On-street civils works (to be procured by **tie**) and Siemens' works to St Andrew Square are £14 million. A range of £0-14 million has been allowed for SDS, £5 - £10 million for PSSA, other costs £230 to £240 million and finally the Chief Executive's risk allowance is £20 million. This gives a total range of £539 - £588 million for Airport – St Andrew Square. The PSSA and SDS figures deal with an estimated range of settlements. The Siemens figure of £14 million would be fixed although it is not part of the GMP. This price of £539 to £588 million includes some £55 million of "sunk" costs for Phase 2 eg. 10 of the trams, utilities, design, enabling works, land etc. However, this sunk cost would be portable to Phase 2 were that to be implemented.

Phase 2

The Phase 2 price involves 5.2 kilometres of on-street works from St Andrew Square to Newhaven broken down as follows:-

Civils works	-	£45 - £70 million (£9-£14 million per kilometre)
Siemens	-	£16 million
Other costs	-	£4 - £9 million

A further CEO's risk allowance of £10 million.

This gives a total range of £75 to £105 million.

Therefore the combined Phase One and Phase Two range is £~~5~~614 - £693 million.

What does the GMP cover?

The £270 – £290 million covers all the trams; the defined scope of Infraco works, £40 million of extra costs over and above the original BSC contract costs to cover all design changes (about half of which are undisputed) and £3.5 million for EOT 1. The GMP covers all existing delays and changes, disputed and otherwise, and is a price to settle.

What are the risks?

Client changes going forward, including ~~3rd party~~ changes required under any agreements which CEC/tie may have with any 3rd party, are not included, nor are unforeseen utilities over £50k.

There could be delays to the on-street works managed by **tie**.

Important conditions included in the counter-proposal

In terms of the counter-proposal, Infraco will be responsible for completing an approved integrated design for Airport to Newhaven (Phases 1 and 2). The design for on-street track must be acceptable to **tie** at its absolute discretion and in addition Infraco will require to propose an acceptable remediation strategy for Princes Street. **t~~T~~ie** will be able to vary the scope only where this does not involve any element of "betterment" to the Infraco works. Infraco will keep any benefits arriving from any value engineering.

It should be noted that the proposal leaves open the option to pursue Infraco/SDS for design issues – this is an exception to the rule that the proposal is a price to settle.

Upsides/Downsides

[.........]Reference was made to the presentation which contained brief notes of the upsides and downsides.

Procurement

It was noted that whilst the counter-proposal takes account of the procurement rules it is not without risk of challenge.

Reconciliation

Appendix C of the presentation handout sets out **tie**'s reconciliation of the Carlisle counter-proposal to the original contract price. The counter proposal range is between £614 and £693 million. The original contract price is £512 million therefore the best case delta is £102~~0~~ million and the worst case is £181~~0~~ million. The minimum extras which add up to the £100 million best case delta are the additional new CEO risk allowance of £30 million; the changes included in the GMP of £44 million (some are client changes and some were allowed for in the original £512 million-roughly half of those changes are undisputed as they are definitely accepted to be a tie problem); Princes Street best case scenario settlement figure of £5 million (**tie** believe this to be tight); other costs of £55 million. The original risk allowance of £30 million is deducted from this figure.

The possible extra swing factors which make up the additional £80 million for the worst-case delta of £180 million are £20 million in agreeing the GMP at the upper end of the negotiating range; on-street costs of £25 million (this depends on the nature of the design and the extent to which CEC requires full debt reconstruction);other costs of £15 million (eg. unforeseen ground conditions, utilities); another £5 million for Princes Street and £14 million payable to SDS.

Questions and answers

Following the presentation by **tie** there was a question/answer session.

1. The first question posed by CEC related to the feasibility of a turnaround at St Andrew Square. **t~~T~~ie** explained that the Phase 1 price includes a temporary

solution for St Andrew Square but does not allow for any requirement to continue to York Place. Steven Bell advised that at approximately £9 million per kilometre the costs of the additional 450 metres to York Place would be approximately £5 million. This would take longer, perhaps between 4 and 6 months.

2. The next question related to timing and **tie** confirmed that the revised timetable has built in the usual Christmas and Festival embargos.

3. Donald McGougan ~~wondered~~ queried whether the outstanding dispute regarding SDS would be a deal breaker in so far as the consortium was concerned. Tony Rush's view was that this point was likely to be negotiated further and that the consortium may not be prepared to sign with this risk outstanding. Richard Jeffrey indicated that BB are likely feeling very exposed as a result of the SDS/BB "collusion" agreement.

4. The question of who decides whether there should be full depth reconstruction was raised. **tie** is proposing a joint process.

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5. Tony Rush pointed out that the design assumption is £9m per kilometre. If tie can prove a good value design for the project then the arguments re Infraco's failure re Princes Street.

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~~4.~~6. DM asked **tie** to outline the critical ways in which this counter-proposal differed from the current contract arrangements. **t~~T~~ie** explained that in terms of the new proposal, Infraco are responsible for producing a fit for purpose tram network with any errors being for their account. All the pricing assumptions in schedule 4 of the contract will no longer exist. With the current contract BDDI was not the final design. Essentially this is a re-pricing exercise for the completed design. The **tie** proposals are intended to give certainty. RJ advised that DLA are to propose a revision of clause 80 to the Infraco contract.

7. Richard Jeffrey advised that Gogar would potentially give Infraco another bite at the cherry in terms of attempting to obtain more cash from the project.

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~~5.~~8. Dave Anderson asked how many unforeseen utilities risks over £50k have crystallised to date, given that these risks would fall to **tie** under the counter-proposal. SB advised that there has been only one case of unforeseen utilities which ran into the hundreds of thousands. **Tie** do not believe any more will arise as most of the ground between the Airport and Haymarket has now been dug up. Any unforeseen ground conditions, contaminated land will be at Infraco's risk under the **tie** proposal.

9. Nick Smith asked how far from completion the design was as this would potentially affect risk and the GMP. Steven Bell advised that he thought it was approximately 90% complete.

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10. On the issue of whether Project Notice was working, Tony's view was that BSC are pain averse and will take the path of least resistance. The deal is

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positive for BB, but gives little for Siemens. Steven Bell said that he had noticed inconsistent results reflected in project production. Richard's view was that the different organisations are approaching the deal differently. BB appears to view project risk and litigation risk differently and his concern is that BB appear not to be guided by a single decision maker.

~~6.~~11. Nick Smith queried what the ~~present~~ ongoing costs of the project are if project Carlisle is not agreed. ~~T~~**tie** advised that the running costs for the project are presently around £2 million per month. Productivity is presently about 30% of what it needs to be.

~~7.~~12. On integration risk, the proposal requires Infraco to provide an assured integrated design to satisfy the independent competent person. It was noted that under Carlisle there would potentially be a risk of tie being unable to build certain sections and hand to Infraco in time.

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13. It was noted that the delta between the BSC offer and the tie counter-offer is approximately £90m but that this is when the negotiation begins.

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14. Finally, Dave Anderson commented that the Council would need to have consider all the factors in order to be able to make an informed decision about the viability of Carlisle versus the other options.

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Next steps

Tie advised that Andrew Fitchie of DLA was preparing the legals over the weekend with a view to submitting on Monday/Tuesday morning. RJ advised that Steven Bell, Stuart McGarrity and Dennis Murray have been through the proposal and there is no need for further verification before it is submitted at the beginning of next week.