NOTE OF SUBMISSIONS

on behalf of

The Scottish Ministers

in respect of

The Edinburgh Tram Inquiry

INTRODUCTION

1. The Scottish Ministers established The Edinburgh Tram Inquiry with a remit to inquire into specific matters relating to the delivery of the Edinburgh Trams project ("the project") and to report to the Scottish Ministers making recommendations as to how major tram and light rail infrastructure projects of a similar nature might avoid the failures experienced by the project.

2. In terms of "Note by Chairman for Core Participants concerning closing submissions" ("the Chairman's Note"), Core Participants are invited to address such issues within the Inquiry's terms of reference as the Core Participants wish, having regard to their particular interest. Having regard to the immense quantity of evidence that is before the Inquiry, this Note of Submissions is intended to focus on those matters in which the Scottish

Ministers were directly involved and which appeared to be of particular interest to the Inquiry, given the lines of questioning adopted in the witness statements and at the oral hearings. Should this Note omit to address a particular issue on which the Inquiry would wish to be addressed by the Scottish Ministers would welcome the opportunity of assisting the Inquiry by providing a supplementary submission.

3. The structure of the submission is as follows:

    - Chapter 1: Overview of the role of the Scottish Ministers and Transport Scotland's role in the project
    - Chapter 2: The procurement strategy
    - Chapter 3: The withdrawal of Transport Scotland from the Tram Project Board
    - Chapter 4: The role of Audit Scotland
    - Chapter 5: Reporting
    - Chapter 6: The Stirling Alloa Kincardine railway project
    - Chapter 7: Final conclusions

4. In terms of the Chairman's Note, Core Participants are directed to provide a reasoned statement indicating what they consider to have been the cause(s) for the delay, increase in cost and other failures of the project and who was responsible for, or contributed to, such delay, increase in cost and other failures. The final chapter of this submission is intended to comply with that direction.

CHAPTER 1: OVERVIEW OF THE ROLE OF THE SCOTTISH MINISTERS IN THE PROJECT

Introduction

1. The purpose of this chapter is to provide an overview of the involvement of the Scottish Ministers in the Edinburgh tram project. It is not suggested that the totality of the Scottish Ministers' involvement is set out here, as the chapter focuses more on the events that have been of interest to the Inquiry. However, the chapter is intended to assist the Inquiry by setting out the key stages of the Scottish Ministers' involvement in the Edinburgh tram project. Throughout this Note of Submissions reference will sometimes be made to the Scottish Ministers, and sometimes to Transport Scotland, depending on the context. Transport Scotland is, however, an executive agency of the Scottish Ministers and not a distinct legal entity.

Outline Business Case

2. In March 2003 the Scottish Executive published its "Building Better Transport" document [**CEC02083844**]. This confirmed that:

> "The Council has developed an Integrated Transport Initiative. Their plan seeks £375 million of central government funding. With the development of our investment strategy we are now able to guarantee the future availability of that level of funding. That support is not conditional on the introduction of congestion charging, which the Council is considering in order to reduce traffic levels in and around the city. Our commitment ensures that funding for at least the first tramline is available as soon as the Council produces a robust final business case."

3. In January 2004 the tram Bills were submitted to the Scottish Parliament for statutory approval to construct and operate lines 1 and 2. The City of Edinburgh Council (CEC) was the promoter of the scheme.

4. Although it was not the promoter of the project, the Scottish Executive engaged constructively with TIE[1] on the development of the final business case for the project. For instance, John Ramsay by letter dated 22 April 2005 issued a commentary in response to the Interim Outline Business Case, raising a number of high and low level issues that would have to be addressed by TIE [**TRS00008519**].

5. By August 2005, the Scottish Executive was satisfied with the Interim Outline Business Case. A recommendation was made to the Minister for Transport to release up to £17.85m in 2005/06 (of the previously committed £375 million total) to conclude development of the Outline Business Case [**TRS00001917**]. In early September 2005 the Scottish Ministers approved the funding which allowed TIE to award the SDS and JRC contracts. In November 2005, a consolidated note of actions was circulated within the Executive [**TRS00000232** and **TRS00000233**]. This confirmed that a phased delivery of

[1] Although it was suggested that it was the Scottish Executive's requirement that the tram project be delivered through an arm's-length company such as TIE, there was no evidence to support that. The grants were payable to CEC and there was no stipulation in relation to the use of an arm's-length company. The Scottish Ministers, however, do acknowledge that in 2002 Wendy Alexander, the then Minister of Enterprise, Transport and Lifelong Learning, wrote to CEC to express her support generally for private sector involvement: see paragraph 5.1 of TRI00000127, pdf16.

the project was acceptable and also raised issues such as the need to cap central government funding and the proper handling of optimism bias.

6. In December 2005 the Cabinet considered the tram project as part of its discussion of the Transport Infrastructure investment plan. At that time Cabinet agreed in principle to: (i) support Phase 1a of the tram scheme from Leith Waterfront to Edinburgh Airport; (ii) index link Scottish Ministers' contribution of £375m at 2003 prices using the Transport Scotland index for major rail schemes; in return CEC would contribute £45m and take revenue risk on the operation of tram and bus services; and (iii) review the scheme again following production of the draft Final Business Case [**TRS00003840**, pdf1].

7. On 1 January 2006 the newly-formed Transport Scotland assumed its new responsibilities as an executive agency of the Scottish Ministers.

8. By January 2006 the Scottish Executive had confirmed to CEC its willingness to consider indexation of its commitment of £375 million to take account of normal construction inflation [**CEC02083547**]. It was reported to CEC that this consideration would take place on receipt of a confirmed scheme from CEC and a robust business case. It was also confirmed that the increased funding was conditional on CEC committing to contribute £45 million from a range of sources.

9. In February 2006 the Scottish Executive publicly announced an increase, in line with indexation, of the £375 million grant originally offered in March 2003 to approximately £500 million.[2] In March 2006, the Draft Outline Business Case was prepared [**CEC00380898**]. Transport Scotland considered this internally [**TRS00002377** and **TRS00002389**] and updated advice was circulated in April 2006 [**TRS00002378**].

10. It is noteworthy that, at this time, it was not just Transport Scotland who were reviewing the project; there were also independent reviews of the project by the Office of Government Commerce (OGC). In May 2006, on the instructions of TIE, the OGC undertook a Project Readiness Review [**CEC01793454**]. The review concluded that the project would not satisfy the criteria that would be assessed as part of an OGC Gateway 2 review.

11. In August 2006, the arrangements for representation on the TPB were revised. This was because the project had progressed to a stage at which it was considered appropriate to move to an independent Project Board model [**TRS00002698**, **TRS00002700** and **CEC01758865**]. Under the revised model, there was a place on the Tram Project Board for Bill Reeve on behalf of Transport Scotland. Although Transport Scotland was not one of the constituencies identified by the OGC as requiring representation on a project

[2] See TRS00002128 and TRS00002138 for the advice preceding the announcement.

board[3], the intention was that Mr Reeve would be empowered by the Scottish Ministers to approve matters (subject to certain exclusions[4]) and that would assist the TPB "to act with appropriate efficiency". Importantly, it was anticipated that "a revised structure will be required to execute the construction phase of the project". The TPB was clearly alive to the possibility that the governance structures put in place from time to time might need to be revised as the project developed to reflect changes in the respective stakeholders' interests in the project.

12. In September 2006, Transport Scotland instructed the OGC to undertake a further review, aligned with the criteria for a Scottish Executive OGC Gateway 2 Review [**CEC01629382**]. The review concluded that there had been a considerable transformation in the organisation, attitude and effectiveness of the TIE team since the Readiness Review and that the majority of the recommendations from the earlier review had been fully achieved. In November 2006, again on the instructions of Transport Scotland, the OGC produced a follow-up Gateway Review [**CEC01791014**]. The purpose was to check progress that had been made against the recommendations from the Gateway 2 Review and to comment on the robustness of the project going forward. The follow-up review concluded that all of the recommendations from the Gateway 2 Review had been fully or substantially achieved.

[3] i.e. "Senior User Representative", "Senior Responsible Owner" and "Senior Supplier".
[4] The Scottish Ministers' reserved matters are set out in Appendix 3A of CEC01758865.

Final Business Case

13. In November 2006 the Draft Final Business Case was finalised. On 23 November 2006 the Chief Executive of CEC wrote to Transport Scotland requesting increased funding for the tram line to Granton. The request was declined on the basis that the indexing of the £375 million was sufficient for Phase 1a.[5] As Damian Sharp explains at paragraph 67 of his statement[6], the Partnership Agreement of the coalition administration between Labour and the Liberal Democrats allowed for the indexation increase but not for any additional capital. If the requested increase was to be made available, Transport Scotland would have had to approach the Transport and Finance Ministers.

14. In January 2007, TIE submitted a paper to Transport Scotland relating to "the Infraco Initial Tender Return Project Estimate Update" [**CEC01789822**]. The paper related to the initial cost estimates for the project. It should be noted that Transport Scotland retained and relied on the services of experienced independent professional advisers (KPMG and Cyril Sweett) to provide advice on issues relating to the tram project, including draft programmes and cost estimates.[7] Internal advice was also obtained where the Government had relevant experience, for instance in relation to testing the economic case.[8] However, it was not Transport Scotland's function to evaluate the tenders and

[5] See Bill Reeve's statement [TRI00000067] at paragraph 12 (pdf4) and TRS00003127.
[6] TRI00000085, pdf28.
[7] See Bill Reeve's statement [TRI00000067] at paragraph 19 (pdf6) and KPM00000020 as an example.
[8] TRS00002927 and see Bill Reeve's statement [TRI00000067] at paragraph 37 (pdf11).

it was not directly involved with the procurement process. It was for CEC and TIE to function as the procuring authority for the purposes of EU law and to evaluate the tenders.[9] Transport Scotland did, however, assure itself that appropriate criteria were in place for tender evaluation and that a suitable team was in place to undertake the evaluation. See, for instance, the Evaluation Methodology for tender submissions dated 11 October 2006 [**ADS00042**], which sets out a detailed methodology for the evaluation of tenders.

15. Between November 2006 and March 2007, Transport Scotland reviewed the Draft Final Business Case, which had been received in November 2006 [e.g. **TRS00003141**, **CEC01797364**, and **TRS00003162**]. Transport Scotland again had the assistance of Cyril Sweet and KPMG in assessing and analysing the draft Final Business Case. A process of clarification was undertaken with TIE. Some particular issues -- such as the allowance for risk and the calculation of the BCR -- were raised with TIE and resolved.[10] The Draft Final Business Case was also considered in December 2006 by the Major Investment Decision Making Board [**TRS00003219** and see Malcolm Reed's explanation of the MIDMB at paragraph 68ff of his statement]. During this period, Transport Scotland provided advice to the Minister of Transport in relation the Draft Final Business Case recommending that support be given

[9] See Bill Reeve's statement [TRI00000067] at paragraph 63 (pdf19). See also TRS00011024, TRS00002732, and CEC01784647.
[10] See Malcolm Reed's statement [TRI00000062] at paragraph 58 (pdf27); see also the detailed account given in Damian Sharp's statement [TRI00000085] at paragraphs 75 to 134 (pdf33 to 134).

for line 1a but not, at that stage, line 1b [**TRS00003413**, pdf3].[11] By early 2007, Transport Scotland had satisfied itself that the BCR remained positive [e.g. **TRS00003795**], and on that basis, in accordance with the previously set criteria, Ministers were advised to approve the allocation of further funding for the next phase of the programme, to cover advance works and appraisal of final bids. The business case was, however, marginal and would have to be reassessed as more information became available [see Malcolm Reed at paragraphs 38 and 39].[12]

16. On 16 March 2007 the Scottish Government enabled work to start on preparations for Phase 1a of the tram project with the release of £60 million pounds of funding.[13] An associated grant offer letter was issued on 19 March 2007 by Transport Scotland to CEC which set out a number of conditions associated with the grant offer [**TRS00003937**]. Before Transport Scotland had provided its formal response to the Draft Final Business Case on 30 March 2007 [**TRS00004145**], TIE had addressed some of the concerns that had been raised in the form of a revision to the DFBC, but the formal response identified a number of further concerns that needed to be addressed before finalisation of the Final Business Case.[14] This response

[11] Transport Scotland also prepared a draft memo for the Transport Minister to send to the Cabinet: TRS00003412 to TRS00003414. The memo and appendices developed over January and February 2007: see, for example, TRS00003493, TRS00003494, TRS00003840, TRS00003841.
[12] See Malcolm Reed's statement [TRI00000062] at paragraphs 38 and 39 [pdf19].
[13] See TRS00003840 for the preceding draft advice to Ministers and TRS00003937 for a draft of the letter to be sent by Malcolm Reed to the Chief Executive of CEC.
[14] See John Ramsay's statement [TRI00000065] at pdf34.

was carefully considered and was the culmination of numerous internal discussions.[15]

17. On 3 May 2007 Scottish Parliament elections took place. The Scottish National Party formed a minority administration. The SNP's election manifesto had included a commitment to use the funds intended for the tram project and EARL for other national priorities. The election of the SNP therefore gave rise to a "backdrop of uncertainty" against which TIE had received an instruction from the Scottish Ministers not to enter into new financial commitments on the tram or EARL projects [**CEC01555676**].

18. On 4 June 2007 the Cabinet Secretary for Finance and Sustainable Growth, John Swinney, asked the Auditor General for Scotland to carry out a high level independent review of the arrangements in place for estimating the costs of, and managing, the Edinburgh tram and EARL projects. On or about 20 June 2007 the Auditor General for Scotland published his findings in a report, *"Edinburgh Transport Projects Review"* **[CEC00785541]**. So far as the tram project was concerned, the review was generally positive.

19. On 27 June 2007, the Auditor General for Scotland gave evidence to the Audit Committee of the Scottish Parliament on the annual report and work programme of Audit Scotland. The Auditor General also gave evidence in relation to the Edinburgh tram project **[SCP00000031]**. Later that day,

[15] See Bill Reeve's statement [TRI00000067] at paragraph 46 (pdf13).

following a debate and vote, the Scottish Parliament passed a motion calling on the SNP administration to proceed with the Edinburgh tram project within the budget set by the previous administration. Funding from the Scottish Ministers was subject to an absolute cap of £500 million, with no allowance for inflation. Any cost additional to that would require to be funded by CEC. The Scottish Parliament noted that it was the responsibility of TIE and CEC to meet the balance of the funding costs [**SCP00000030**, pdf38]. Until the vote in Parliament, central government funding was going to be subject to approval of the Final Business Case. The acceptance by the Scottish Ministers of the parliamentary vote committed the Ministers to providing the funding.

20. Following the vote in Parliament, Transport Scotland relinquished its seat on the TPB. This was because the Scottish Ministers wished to ensure role clarity by making it absolutely clear that the project was being undertaken by CEC and TIE, and that Transport Scotland's involvement was only in providing the approved funding. The withdrawal of Transport Scotland from the TPB will be considered in more detail elsewhere in chapter 3 of this submission.

21. By letter dated 2 August 2007, Mr Reed advised Mr Aitchison of the key aspects that would inform the role of Transport Scotland with respect to the Edinburgh tram project going forward [**CEC01566705**]. The letter noted that Transport Scotland would relinquish its seat on the TPB and would not attend

TPB meetings in any capacity. Transport Scotland would meet with CEC on a four-weekly basis in order to receive a progress report on the project and CEC were to provide confirmation, on a quarterly basis, that the grant conditions were being complied with.

22. In September 2007, following discussions between TIE and the Scottish Ministers, it was accepted that the £500 million grant was not constrained to line 1a and any surplus could go towards line 1b [**TRS00004849**].

23. On 9 October 2007 the OGC published a Gateway 3 Review [**CEC01562064**]. The obtaining of such a report was a condition of grant funding. The report resulted in a "Green" rating, which indicated that the project was on target to succeed, provided that the recommendations were acted upon.

24. By the time version 2 of the Final Business Case had been produced, the Scottish Ministers had capped their funding at £500 million and adopted the role of funder rather than partner or facilitator. Consistent with those changes, a "light review" of the Final Business Case was undertake to check the condition precedents for scheme approval, being (i) that the scheme remained affordable, (ii) that it continued to demonstrate a BCR above 1, and (iii) that it required no on-going subsidy from government [**TRS00004991** and

TRS00004992]. The review concluded from the available evidence that these conditions had been met.[16]

Grant letter

25. By letter dated 17 January 2008, Transport Scotland made a formal offer of grant to CEC in terms of section 70 of the Transport (Scotland) Act 2001. The offer was accepted on 23 January 2008 [**CEC01221901**]. The Rail Directorate of Transport Scotland generally uses the section 70 grant model when funding major capital projects. Although section 70 is non-specific, sub-section 2 is the key driver for the model: "grants under this section shall be of such amount and subject to such conditions (including conditions requiring their repayment in specified circumstances) as Scottish Ministers may determine." Transport Scotland put in place a robust section 70 grant model for the tram project which took account of the fact that Transport Scotland did not have project management oversight [**CEC01221901**].

26. Given that Transport Scotland was not intended to have project management oversight, it would not have been appropriate, even were it possible, for Transport Scotland to have imposed operational control on a sponsored body via grant conditions.[17] However, the conditions of the grant included various conditions precedent designed to ensure that the project represented value for money for the taxpayer, including that Phase 1a of the project had to be

[16] See Malcolm Reed's statement [TRI00000066] at paragraph 67 (pdf31) and TRS00005032.
[17] Bill Reeve's oral evidence (27 September 2017, page 64, line 5).

delivered within the funding envelope of £545 million, that CEC had to be satisfied that the benefit cost ratio (BCR) was greater than one, and that the trams would not need an operating subsidy.

27. In addition to the £500m cash cap, the section 70 model introduced annual caps. These were:

- financial year to 31 March 2009 - £120m
- financial year to 31 March 2010 - £149m
- financial year to 31 March 2011 - so much of the grant as has not been defrayed or incurred in the prior financial years.

This funding split assumed completion of the trams project and an open for revenue service date within 2011.

28. In terms of supervision of the project, the conditions of grant contained requirements for four-weekly reports to be followed by review meetings and quarterly senior management meetings.[18] John Ramsay chaired the four-weekly meetings between Transport Scotland and CEC, the purpose of which was to review the report that had been submitted and to assess the basis for CEC's claim for payment for that four-week period. The quarterly meeting was at a more senior level and Bill Reeve typically led those meetings for Transport Scotland. At the quarterly meetings, senior officials from CEC

[18] Clause 16.2 of the conditions of grant [TRS00011006 at pdf13].

would be present and, exceptionally, TIE would also be present.[19] These meetings were used to take stock of progress with the project and to provide Transport Scotland with an opportunity to satisfy itself that the conditions of the grant letter were being met. At these meetings, Transport Scotland would discuss its concerns with CEC, ask questions and offer observations. However, whilst Transport Scotland could offer constructive comments, it was ultimately for CEC, as project owner, to address problems with the progress of the project since Transport Scotland's limited powers to act were defined by the terms of the grant letter.

After financial close

29. From November 2008 at the latest, Transport Scotland were aware that there were problems affecting the tram project that had arisen immediately following Financial Close in May 2008, resulting in slippage of the main programme with impacts on both service opening dates and anticipated final costs. At a Tram Budget Meeting on 3 February 2009, Transport Scotland was briefed in detail about the project programme and budget. The anticipated final cost of the project was projected to be £529.2 million. At this point in time, CEC was acknowledging that significant work was required to re-align programme and costs over the upcoming weeks, following several months of negotiations with Infraco contractors. In the August 2009 four-weekly report to Transport Scotland it was confirmed, for the first time, that it would be unlikely that the full scope of line 1a would be completed within the

[19] See CEC00475412 for sample minutes of a quarterly review meeting.

available funding envelope of £545 million [**CEC00376398**, pdf5]. On 3 August 2009, John Ramsay wrote to the Minister for Transport to advise on progress and that the project would be over budget and late with BSC asking for an additional £100 million [**TRS00017098**].

Princes Street dispute

30. In February 2009, the Princes Street dispute occurred. On 17 March 2009, John Swinney and Stewart Stevenson, together with David Middleton, met David Mackay. The context of the meeting was that the internal stage of the Dispute Resolution Procedure (DRP) process in respect of two issues was already under way, including the issue of whether or not BSC was contractually obliged to commence works on Princes Street [**CEC01001220**, pdf2]. The internal stage of the DRP process would be exhausted on 19 March 2009, at which point a formal dispute resolution meeting was scheduled to take place [**TRS00016936**]. At that stage, a decision would have to be taken as to whether or not the issues should be referred to adjudication. Mr Swinney explains in his statement that the purpose of the meeting with Mr Mackay was to get an understanding of the approach that TIE would be taking in the negotiations and to impress on Mr Mackay the importance of making progress and resolving outstanding issues. Mr Swinney's approach was to highlight his concerns to Mr Mackay, but without prescribing what outcome Mr Mackay should achieve.[20] On the same day as the meeting, Mr Middleton sent an email to colleagues within Transport

[20] TRI00000149, pdf75.

Scotland summarising events [**TRS00016931**]. The negotiations between TIE and BSC proceeded and concluded on 20 March with an agreement that allowed works to recommence on 23 March 2009.

31. Mr Mackay, in some of his evidence, might be taken to be suggesting that he was, in some sense, not responsible for the Princes Street Supplemental Agreement (PSSA) because he had been directed or instructed by Mr Swinney to "sort out" the dispute.[21] According to Mr Mackay's statement, he told Mr Swinney that the only way to break the impasse with BSC was to pay more. "Personally", he goes on to explain, "I could not see any justification for paying." By the time of his oral evidence, Mr Mackay seemed to have further recollections of what took place in the course of a "regular update meeting"[22] with Mr Swinney. It was only "implied" during the meeting with Mr Swinney that breaking the impasse would cost extra money.[23] Mr Mackay's evidence was if TIE "collapsed" on the Princes Street issue, "we'd end up with supplemental agreements across all of Edinburgh". Somewhat inconsistently, Mr Mackay then went on to explain that it was only after the meeting with Mr Swinney that Alastair Richards came up with the idea of dealing with Princes Street in isolation on a demonstrable cost basis.[24] However, he did accept that "it was the right thing to do at that stage".[25]

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[21] TRI00000113 at paragraph 291 (pdf79).
[22] 21 November 2017, page 95, line 24.
[23] Ibid., page 98, line 9.
[24] Ibid., page 95, line 20 to page 97, line 6. BSC had earlier offered to undertake the works on Princes Street on a demonstrable costs basis: CEC00942256.
[25] Ibid., page 98, line 20.

32. Mr Mackay's evidence on his meeting with Mr Swinney does not appear to reflect the terms and tone of Mr Middleton's contemporaneous email. In particular, his concern in the evidence about paying more does not accord with what Mr Middleton noted him as saying, i.e. "that it could still be brought on time and budget if there is a restart soon" [**TRS00016931**, pdf2]. Nor does Mr Mackay's evidence reflect what John Ramsay was reporting to be TIE's view of the PSSA in his email of 23 March 2009 [**TRS00016963**] that, "At this stage Tie doesn't anticipate that this will lead to greater costs." Neither Mr Swinney nor Mr Mackay suggested that, in their telephone call after the PSSA had been concluded, Mr Mackay had represented that the PSSA was a deal that he felt compelled to enter into, that was going to cost CEC more, and for which there was no justification. Mr Mackay's evidence also does not appear to reflect what was being reported at the time to the TPB by, amongst others, Mr Mackay, to the effect that the PSSA: "provides an equitable and constructive way forward"; will result in "no increase in liability to tie, compared to that previously"; and "could be used in Leith Walk as well" [**CEC00888781**, pdf8-9].

33. To the extent that there is a conflict between Mr Mackay's evidence and Mr Swinney's, the Inquiry is invited to prefer that of Mr Swinney. Mr Mackay's evidence is clearly self-serving and does not appear to be supported by contemporaneous documentation. The SETE submission (as intimated on 27

April 2018) at page 98 criticises Mr Swinney's oral evidence on the PSSA. It is submitted that any such criticism should be rejected. Mr Swinney's evidence is entirely consistent when it is read in context and having regard to the fact that the DRP process in relation the Princes Street dispute was already under way when he met Mr Mackay. Mr Swinney, along with TIE and CEC, wanted the Princes Street resolved as expeditiously as possible. With Princes Street paralysed, the tram project at a standstill and rising public concern, it is submitted that it was entirely appropriate for Mr Swinney to have met with Mr Mackay and to have urged him to get the project back on track.

34. After the PSSA, Transport Scotland continued to assess the information with which it was provided and consider the appropriateness of intervening in terms of the grant conditions, for instance by issuing a cure notice. However, CEC and TIE appeared already to be doing everything they could to try and resolve the disputes and the view was taken that a cure notice would not achieve anything. The option of terminating the Infraco was discussed.[26] However, what was clear to Transport Scotland was that by 2009 the Infraco contract had broken down with both sides advancing completely different views on how the contract should be interpreted and how much it would cost to complete the tram project.[27]. The dispute resolution procedures were underway and had to be allowed to run their course in order to provide some clarity on whose interpretation of the contract was correct. Transport

[26] See Bill Reeve's statement [TRI00000067] at paragraphs 115 to 117 (pdf34).
[27] See TRS00017238 (pdf2), being an email dated 14 September 2009 in which Ainslie McLaughlin describes a conversation he has had with Bilfinger Berger.

Scotland would have taken steps, if it thought it would have assisted, but the view was taken that serving a cure notice “would have added heat but not light to the situation”.[28] By October 2009, although the estimate for Phase 1a was still officially £527 million, Transport Scotland had been told by CEC/TIE that completing it for £545 million was “untenable” [**TRS00017242**]. By December 2009, Transport Scotland were aware that two recent DRPs had gone against TIE and that the impact on programme and costs was “unquantifiable” with the result that TIE was then maintaining a current best estimate of £580 million [**TRS00017326**].

35. At the November 2009 Quarterly Review, TIE advised that a final cost of £545 million would be very difficult (albeit not impossible) to achieve, with a price of £600-£620 million being more realistic [**TRS00005121**]. The January 2010 four-weekly report stated that, "a detailed review of costs was undertaken with Transport Scotland on 10 December 2009, and updated milestones and forecasts were presented" [**CEC00472988**]**.** This was as a result of a number of TIE reviews and exercises which covered ways in which CEC could manage either to achieve additional funding or to keep the project within the available budget.[29] At a meeting between the Minister of Transport and Richard Jeffrey on 25 January 2010, the possibility of shortening the route was considered.[30]

[28] See Bill Reeve’s statement [TRI00000067] at paragraph 122ff (pdf36); see also TRS00010627.
[29] See John Ramsay’s statement [TRI00000065] at pdf24.
[30] Ibid. at pdf25; see also TRS00010627.

36. On 10 June 2010, CEC provided formal confirmation to Transport Scotland that it was "unlikely that the full scope of Phase 1a will be completed within the available funding envelope of £545m and that costs are likely to be significantly in excess of £600m and a final cost in excess of £100m more than the previous £545m target is possible" [**TRS00010733, TRS00010734 and TRS00010722**]. CEC's report to the full City Council on 24 June 2010 advised that contingency planning work undertaken by the Council and TIE had identified funding options which could require a 10% uplift on project costs up to £600m. This triggered further consideration by Transport Scotland of the steps that might be taken by the Scottish Ministers in exercise of their rights under the grant conditions, including withholding grant payments [**TRS00017807, TRS00010722**].[31] However, at that stage, CEC were trying to put in place a remedial plan in any event, involving the twin strategies of (i) a negotiated guaranteed maximum price for a truncated route, and (ii) the service of remedial termination notices [**TRS00010718**].[32] It was concluded that withholding grant funds or serving a cure notice would only exacerbate matters.

37. On 28 October 2010, Ainslie McLaughlin produced advice to Ministers that stated,

"The conditions of the Grant agreement allow Ministers to take action in

[31] See also John Ramsay's statement [TRI00000065] at pdf26 and pdf43.
[32] See Bill Reeve's statement [TRI00000067] at paragraph 125 (pdf37).

the event that the project runs into difficulties that would threaten delivery of the project. Clearly the termination of the contract constitutes such an event. There are a range of possible actions which would enable some form of direct intervention in the situation. We are discussing these with SGLD and will provide Ministers with more detailed advice in due course. However, the most obvious measure that Ministers might wish to consider is a suspension of payments for any new contracts as an interim step until they are satisfied as to the business case and governance arrangements for proceeding with further work." [**TRS00011010**]

38. Throughout 2010, there were several meetings between the Chairman of the TIE Board (David Mackay), the Chief Executive of TIE (Richard Jeffrey), and the Cabinet Secretary (John Swinney) to provide progress updates on the tram project [e.g. **CEC00263295**]. Mr Swinney received assurances from TIE that it had control of the situation, although TIE was starting to signal that the delivery date was at risk. Ainslie McLaughlin also had a number of informal meetings with Richard Jeffrey for updates on how TIE was approaching the contractual disputes with BSC.[33] Mr Swinney's trust and confidence in TIE's approach, which was based on robust enforcement of the contract through DRPs, eroded during the course of 2010 [**TRS00012495**]. TIE's approach effectively closed off any prospect of constructive negotiation with BSC, which could have allowed construction work to resume.

Mar Hall and beyond

39. By the end of 2010 the project had effectively ground to a halt. TIE's preferred plan of action, being to seek to terminate the contract, could not be

[33] See Ainslie McLaughlin's statement [TRI00000061] at paragraph 6 (pdf3).

achieved due to there being insufficient grounds for termination. Nor could TIE secure an agreement on Project Carlisle. In these circumstances, Mr Swinney had meetings with CEC and, separately, with BSC [**TRS00011248**] in November 2010 to assess progress and urge the parties to seek a mediated resolution.

40. The scale of the contractual issues can be seen in Audit Scotland's interim report issued in February 2011. There, Audit Scotland noted that, to the end of December 2010, BSC had submitted 816 notices of claim (of which 139 were later withdrawn) [**ADS00046**, paragraph 44]. BSC had submitted cost estimates in respect of 426 out of the remaining 677 notices of claim. A total of 198 had been settled at a cost of £23.8 million against a claim figure of £44 million. Infrastructure construction was largely at a standstill, with TIE estimating that 28 per cent of the infraco works had been completed against an original plan of 99 per cent by December 2010. The Audit Scotland interim report suggested that, "The Scottish Government should also consider whether Transport Scotland should use its expertise in managing major transport projects to be more actively involved and assist the project in avoiding possible further delays and cost overruns."

41. Between 8 and 12 March 2011 mediation talks took place at Mar Hall Hotel, Glasgow. Ainslie McLaughlin attended as an observer on behalf of Transport Scotland and the Scottish Ministers, although he was invited during the

course of the mediation by Dame Sue Bruce to take a more active role.[34] Dame Sue Bruce confirmed in her oral evidence that Mr McLaughlin's role at the mediation was "really to provide the view of Transport Scotland on what was going [on] and also to provide the link back to Transport Scotland and the Scottish Government Ministers. So his views were sought … He didn't have to approve [the mediated agreements], but what we sought to do to get the best possible outcome was to get as much consensus as possible."[35]

42. Mr McLaughlin spoke to Mr Swinney during the course of the mediation to advise Mr Swinney on progress and the likely level at which settlement might be achieved. As Mr McLaughlin explained, and Mr Swinney confirmed, it was not to get approval for the terms of settlement.[36] Similarly, in line with its role as funder, when the heads of terms came to be signed, Transport Scotland was not a signatory to them.

43. The grant agreement with the Scottish Ministers and CEC for the construction of Phase 1 of the Edinburgh Tram Network was due to expire on 31 March 2011. By letter dated 30 March 2011 Transport Scotland advised CEC's Chief Executive that while Ministers' obligations to make payments in support of the tram project would cease from 31 March, given the steps being taken to

[34] Ibid. at paragraph 93 (pdf34).
[35] 15 March 2018, page 12, line 5 to page 15, line 5.
[36] This is discussed in Ainslie McLaughlin's oral evidence, 26 September 2017, page 185, line 15ff. Mr Swinney confirmed in his oral evidence that the purpose of the telephone call was to provide Mr Swinney with an update on the mediation's progress; neither Mr McLaughlin nor CEC required Mr Swinney's approval for a deal to be done: 23 January 2018, page 139, line 2ff.

try and resolve the contractual dispute, Ministers were prepared, on an interim basis, to continue to make payments under the terms of the existing grant agreement while negotiations were ongoing **[TRS00011741]**. The interim arrangement was entirely at Ministers' discretion, could be withdrawn at any time, and would not extend beyond 31 August 2011.

44. On 25 August 2011, CEC voted to truncate the first phase of the tram route with it terminating at Haymarket. The outcome of the vote appears to have occurred somewhat unexpectedly.[37] By that stage, most of the infrastructure for the route to York Place had been completed. It was therefore the Scottish Ministers' preference, on the advice of Transport Scotland, for route 1 to be completed to York Place, and they were unwilling to provide further grant funding if the route was to stop at Haymarket. When CEC voted again and changed the decision so that the line was to be completed to York Place, the remainder of the central government funding (£72 million) could then be released.[38]

45. From September 2011, Transport Scotland was to play a new, and more direct, role in the delivery of the tram project [**TRS00012306**]. By that stage, TIE's involvement in the project had ceased and Turner & Townsend had been brought in by CEC. Part of Transport Scotland's function was to provide

[37] A point made by Dame Sue Bruce in her oral evidence, 15th March 2018, page 114, line 8.
[38] See Ainslie McLaughlin's statement [TRI00000061] at paragraph 19 (pdf8).

the “intelligent client expertise” that had previously been provided by TIE.[39] The new governance structure, showing Transport Scotland’s involvement, is set out diagrammatically in CEC’s Audit Committee’s report dated 26 January 2012 [**TRS00019622**, pdf7]. The Transport Scotland team consisted of about four or five people [Ainslie McLaughlin’s statement at paragraph 78].[40] However, the project remained CEC’s and no additional funding from central government was to be provided.

46. In January 2012 CEC and the Scottish Ministers entered into a Memorandum of Understanding which, amongst other things, amended the grant conditions [**TSI00000001**].[41]

Full Circle?

47. It has been suggested that Transport Scotland came full circle by re-engaging after its removal from the TPB in 2007. It may also be suggested that, had Transport Scotland been involved throughout, then the project would have enjoyed the sort of success before Mar Hall that it did after Mar Hall.

48. These propositions will be addressed in chapter 6 of this Note of Submission. In summary, however, it is the Scottish Ministers’ and Transport’s Scotland’s view that any such approach is simplistic. The project was in a completely different place in 2011, after Mar Hall, with TIE no longer involved and BSC

[39] Ainslie McLaughlin’s oral evidence, page 227, line 16.
[40] See Ainslie McLaughlin’s statement [TRI00000061] at paragraph 78 (pdf29).
[41] Ibid. at paragraph 83 (pdf30).

and CEC keen to make progress after months, if not years, of warfare between TIE and BSC.

49. Furthermore, the governance structures in 2007, and then in 2009 to 2010, were very different to those put in place in 2011. In 2007, Transport Scotland had one member on the Tram Project Board. By contrast, after Mar Hall, Transport Scotland had a presence on at least seven committees, groups or forums, which were to meet with varying frequencies (from weekly to quarterly), each of which had well-defined purposes. That degree of involvement by Transport Scotland had never been contemplated at any point prior to 2011, and would not have been appropriate when the project was principally being delivered by TIE acting as agent and intelligent client on CEC's behalf.

CHAPTER 2: THE PROCUREMENT STRATEGY

Introduction

1. This section considers the procurement strategy for the tram project. It will trace the strategy's development up to Financial Close and identify key steps taken to implement the strategy. The purpose in doing so is that the Scottish Ministers will come to submit that, in their view, one of the major causes of the problems that beset the tram project relates to the failure properly to implement the intended procurement strategy.

Early stages

2. From early on, one of the key elements of the procurement strategy was the separation of the operator contract from the construction contract. This was intended to "achieve high quality risk disaggregation and consequent benefits to contract pricing of the tram system from its construction".[1] This approach allowed revenue risk to be addressed separately from construction risk. There had been recent experience where, under a PPP model, a contractor had failed as a result of the revenue risk it had undertaken.[2] The other intended benefit arose from the early involvement of the operator in developing the tram network. This aspect of the procurement strategy had been given effect to by the appointment of Transdev plc under the

[1] "Preliminary Financial Case – Update: Line 1" [CEC00630633], pdf60.
[2] See Bill Reeve's statement [TRI00000067] at paragraph 16 (page 5).

Development Partnering and Operating Franchise Agreement (DPOFA) in 2004.

Outline Business Case

3. On 30 May 2005 TIE produced a "Draft Interim Outline Business Case" with the assistance of PriceWaterhouseCoopers LLP [**CEC01875336**]. This provided a detailed analysis of, and justification for, the procurement strategy being adopted by TIE. It proposed to further disaggregate the procurement process by appointing a designer and a utility works contractor at an early stage under direct appointments and then novating the designer to the main consortium at contract award. In this way, TIE could retain the benefit of an integrated approach with specialists in each area but reduce the contingencies which the main infrastructure contractor would otherwise apply in relation to risks outwith its control. By de-risking the project in this way, the intention was to deliver maximum value for money. However, on this approach, the risks associated with utilities work (i.e. cost and time) would remain with TIE.

4. In March 2006, the Draft Outline Business Case (DOBC) was prepared [**CEC00380898**]. This records at paragraph 6.2.2.3 that the de-risking strategy was understood and accepted by the contractors. The "unique" procurement strategy was summarised at paragraph 6.3:

> "The outcome of the Procurement Strategy will be two contracts with different private sector entities: an operating contract, the Development

> Partnering and Operating Franchise Agreement ("DPOFA") and an infrastructure (Infraco) contract. The Infraco contract will act as a "holding contract" with the design, initial construction and ongoing maintenance, vehicle provision and vehicle maintenance contracts all novated to the infrastructure provider at financial close. This outcome is not dissimilar to the approach adopted on, amongst others, Docklands Light Railway."

In respect of SDS[3], the DOBC noted at paragraph 6.7:

> "The novation of the SDS Contract to the Infraco will mean that responsibility for the design and all risk arising are transferred to the private sector system integrator (Infraco) without the normal disadvantage of an increased risk premium which bidders would apply due to uncertainty if they had to carry out all of the design work post contract award."

5. It was anticipated that the overall design process would take between 2 and 2.5 years. It was expected that the overall design work would be around 60-70% complete when the Infraco contract was signed. The aim was to identify key areas in advance and prioritise those works:

> "By the time of contract award (scheduled for July 2007) it is expected that detailed design will be significantly advanced, inclusive of completion of a majority of consents. Outstanding design work at this stage may include non-critical areas, any amendments required by consenting authorities (but not completed) and any remaining value engineering required by the Infracos."

In respect of the MUDFA works, it was anticipated that:

> "The majority of utilities work is scheduled to commence in early 2007 and end in summer 2008. This will result in significant utilities diversion works

[3] On 19 September 2005 TIE and Parsons Brinckerhoff Ltd entered into a System Design Services (SDS) agreement [CEC00839054]. The design was to be provided in three phases: Requirements Definition, Preliminary Design and Detailed Design. Work in relation to the Requirements Definition phase took place between September and December 2005.

being completed prior to commencement of Infraco works so potential conflicts between the utilities and infrastructure works will be minimised; any remaining time overlap can be managed so as to avoid conflicts on the ground." [Paragraph 6.8.1]

6. In April 2006, updated advice on the Draft Outline Business Case was circulated by Transport Scotland [**TRS00002378**]. A commentary on the procurement strategy was set out in Annex B. Transport Scotland expressed a generally positive view, noting that it had been based on lessons from other tram projects undertaken in the United Kingdom and had prioritised the early identification and reduction of risk.

Draft Final Business Case

7. The Draft Final Business Case was produced in November 2006 [**CEC01821403**]. Chapter 7 provided a detailed commentary on the procurement strategy. The explanation for the strategy behind the SDS contract was explained in terms similar to that in the DOBC[4]. It was also noted:

> "7.51 It is expected that the Infraco will benefit significantly from the SDS Provider's work and its experience of the planning and utilities diversion processes. The planned novation will mean that the SDS Provider will consider issues of practicality, cost and 'constructability' more than if it were simply tie's consultant. Infraco bidders will prepare their bids on the basis of the emerging SDS designs and the successful bidder will be required to adopt the SDS Provider's design as at the date of Infraco

[4] Paragraph 7.50 of the draft Final Business Case replicates paragraph 6.7 of the DOBC.

> contract signature. Variations to this design could be introduced with the agreement of tie, but at the risk of the Infraco."[5]

8. As at the time the Draft Final Business Case was prepared, the expectation was that the overall design work to Detailed Design would be 100% complete when the Infraco contract came to be signed. However, it was explained at paragraph 7.53 that, by identifying key risk areas and prioritising SDS activities, TIE was seeking to complete the key elements of the Detailed Design prior to selecting the successful Infraco bidder in summer 2007. This was to enable Infraco bidders to firm up their bids based on the emerging Detailed Design and thereby reduce the scope and design risk allowances that their bids would otherwise make provision for.[6]

9. In respect of the programme, the following was noted:

> "11.3 The programme is based on the assumption of 'right first time and on-time' delivery of activities with very little float within the programme. Many key criticalities and dependencies have been used to identify the critical path for the scheme. The criticality of much of the design activities mean the need for on-time delivery is particularly true for SDS design work and the project team are currently actively pursuing improved performance in this area and critically reviewing these elements of the programme."

10. On 21 December 2006 CEC was asked to approve the Draft Final Business Case. A report by the Director of Finance and the Director of City

[5] In the Final Business Case, this last sentence was changed to read: "Variations to this design could be introduced with the agreement of tie, but at the risk of the Infraco unless they represent changes to tie's Employer's Requirements, which are a cost to the public sector."
[6] By the time of the Final Business Case, it was accepted that this was no longer possible.

Development [**CEC02083466**] provided an Executive Summary of the Draft Final Business Case which stated at paragraph 1.77:

> "The objectives of the Procurement Strategy are summarised as follows:
>
> - Transfer design, construction and maintenance performance risks to the private sector.
> - Minimise the risk premia (and/or exclusions of liability) that bidders for a design, construct and maintain contract normally include. Usually at tender stage bidders would not have a design with key consents proven to meet the contract performance obligations and hence they would usually add risk premiums for this.
> - Mitigation of utilities diversion risk (i.e. potential impact of delays to utilities diversion programme on Infraco works)."

11. The Executive Summary expressed the view that the procurement strategy, when fully implemented, would be effective in transferring a very significant number of risks to the private sector. However, it was noted that the strategy was also predicated on delivering value for money and certain risks were to be retained in the public sector where they could be effectively managed. In a discussion of risks retained by the public sector, it was noted at paragraph 1.84 that, as the project moved towards construction, the most significant risks which could impact on the delivery of the project on time and within the capital cost estimates were:

> **"Utility diversions** – TIE must manage the interface between utility diversions and the follow on works by Infraco. A significant delay in the hand over of worksites to the Infraco could result in significant financial penalties … A prompt start to utility diversions is a key element of the mitigation of this risk"
>
> **Changes to scope or specification** – A great deal of care has been taken in defining the scope and specification of the tram project

throughout the Parliamentary process and during design development with input from TEL and Transdev and extensive consultation with CEC and Transport Scotland. However significant unforeseen changes to scope and specification could have a very significant impact on the deliverability of the project…

Obtaining consents and approvals – Responsibility for the preparation and application for most necessary consents and approvals has been passed to the SDS provider and this risk will pass to the Infraco at the point of novation. However tie and the other stakeholders must continue to ensure there are clear strategies and effective processes to deliver all consents and approvals"

12. CEC approved the Draft Final Business case in December 2006.

13. In March 2007, Transport Scotland provided comments on the Draft Final Business Case [**TRS00004145**]. There, it is noted that in respect of the procurement strategy:

"The broad arrangements set out within DFBC with respect to the development of the project procurement strategy are not only well known and understood but have effectively been endorsed by Transport Scotland on a number of previous occasions. Our main comments regarding procurement now appertain to the associated risks and consequences of failing to achieve the planned convergence and closure within the required timescales.

Many of these risks relate to progress of design and perhaps interfacing utility design to core infrastructure. It will also be interesting to understand how infrastructure contract bidders are being able to input to design development over the coming period (a key part of the strategy) whilst maintaining programme and managing the ability to achieve novation." [pdf5]

In relation to paragraph 11.3 of the Draft Final Business Case, the following comment was made:

> “Section 11.3 highlights that "only little float exists within the programme", which can be acknowledged after a review of the schedule. It appears that the programme provided describes only a "Best Case" scenario with no real feasible mitigation of delay or additional time for any secondary works required. This is a very critical programme issue and if the key early milestones cannot be achieved the delay will be extended to months.
>
> The programme with its dates and planned work flow for the SDS Design, INFRACO and MUDFA works is based on a large number of assumptions, as detailed in section 11.7. Additionally, Tie highlight in section 11.3 that "the programme is based on assumptions of 'right first time and on-time delivery'". Edinburgh Tram Network Project is a unique project in Scotland. Therefore the assumptions and preconditions appear optimistic.” [pdf9]

14. In April 2007 CEC and TIE provided Transport Scotland with a combined response to Transport Scotland’s comments on the Draft Final Business Case which identified the steps that were to be taken to address the various issues that had been raised [**TRS00004273** to **TRS00004276**].

Final Business Case

15. In August 2007, Transport Scotland withdrew from the Tram Project Board, for reasons set out elsewhere in this submission. It had no substantive involvement in the decisions taken by TIE and CEC between the date of its withdrawal and Financial Close in May 2008. This was consistent with the role that Transport Scotland adopted in August 2007 in terms of which, as independent principal funder, Transport Scotland would not be involved in executive decisions relating to the delivery of the project.

16. On 9 October 2007, the OGC provided CEC with its TIE Project Gateway 3 review. It was reported that the designer had completed preliminary design and that 65% of detailed design had been completed. The review recorded that both infrastructure bidders had stated that they would prefer an early appointment of the preferred bidder in order to optimise the time available for due diligence and final negotiations. Both bidders had also expressed concerns that the planned preferred bidder period, which would include due diligence on the designs and the novated contracts, was tight. In light of these concerns, the OGC recommended that the preferred bidder should be appointed as soon as possible and that the programme during the preferred period be monitored closely at senior level. The OGC also recommended that TIE should actively consider "the necessary consequences of any areas which cannot be finalised by contract signature and novation and how (and when) full certainty will be established".

17. On 15 October 2007 the OGC review team produced a further report, "Tie Project Risk Review" **[CEC01496784]**. The report noted that a number of risks remained with the public sector, including: the outturn price and delivery programme of MUDFA works (including the risk of delays in MUDFA works introducing consequent delays to Infraco works); that the design and approvals processes delayed the programme; and that the SDS novation process was not fully effective. It further noted that:

> "The programme will also be at risk to changes in scope but more importantly vulnerable to delays due to tasks for which CEC and tie are

responsible notably MUDFA works and approvals. The alignment of the SDS design going forward with the InfraCo programme will have a major effect on this aspect."

The report also recorded assurances from the TIE commercial team that 70% of the costs of both bidders were fixed.

18. On 22 October 2007 TIE appointed BSC preferred bidder.

19. On 25 October 2007 CEC's approval was sought for version 1 of the Final Business Case in respect of phase 1a (Airport to Leith Waterfront) [**CEC01649235**]. A report was provided by the Director of Finance and the Director of City Development **[CEC02083538]**. The report explained that the assumptions of the Draft Final Business Case held good for the Final Business Case. At paragraph 4.30, the report noted:

"The detailed contractual apportionment of risk and responsibility between the public and private sector remains the subject of structured negotiations up to and beyond the selection of a preferred bidder. The procurement strategy aims at an outcome on risk retention and transfer which is balanced, transparent and market aligned, while taking account of the relationship between affordability and the true cost of a risk transfer position for CEC."

20. Appendix 3 to the report discusses the major risks facing CEC as set out in the Final Business Case. The main risk in respect of utilities was identified as being delays from MUDFA in handing over sites to Infraco, leading to claims and significant additional costs. The delays arising from interface between MUDFA and utilities companies was also identified as a potential source of

claims being made against CEC. It was also noted that, because the Infraco contract was a substantially fixed price contract, any scope changes post financial close would be at CEC's expense. The importance of keeping changes to a minimum and ensuring that there were in place clearly defined, tight change control procedures was emphasised. At paragraph 5 of Appendix 3 the following comment was made:

> "It is recognised that designs are not yet complete and some design assumptions may be different to the aspirations of CEC and/or other third parties (e.g. Forth Ports). If the designs are built into the contract at contract close and the decision is made to change them at a later date, this will lead to additional costs and potential delay. In order to reduce this risk, further work will be done on the tram designs prior to contract close in the context of available funding."

21. On 20 December 2007, TIE entered into the "Wiesbaden Agreement" [**CEC02085660**] agreeing a construction price of £218,262,426. Transport Scotland was not involved in, nor consulted about, the terms of the Weisbaden Agreement. Under the Wiesbaden Agreement, the BBS price for civils works was stated to include any impact on construction costs arising from the normal development and completion of designs based on the design intent for the scheme as represented by the design information drawings issued to BBS on 25 November 2007. It was further stated, for the avoidance of doubt, that "normal development and completion of designs means the evolution of design through the stages of preliminary to construction stage and excludes changes of design principle, shape and form and outline specification". Included in the appendix was a clarification document relating

to consents dated 12 December 2007 [pdf127]. This set out the principles governing the allocation of responsibility for obtaining consents. It is noted that, “BBS will be entitled to a [Compensation Event] where a consent is not provided by the authority providing the consent by the date that it is shown as required on the programme.” This entitlement was subject to various provisos, including that the consent is one that SDS were due to obtain in accordance with their contract with TIE.

22. Also on 20 December 2007, CEC’s approval was sought for version 2 of the Final Business Case. The accompanying report, provided by the Director of Finance and the Director of City Development [**CEC02083448**], recommended staged approval for the award by TIE of the contracts for the supply and maintenance of the infrastructure works (Infraco) and tram vehicles (Tramco) *“subject to price and terms being consistent with the Final Business Case and subject to the Chief Executive being satisfied that all remaining due diligence is resolved to his satisfaction”*. The report explained that version 2 of the Final Business Case was materially unchanged from version 1 of the Final Business Case approved in October 2007 in respect of the scope, programme and estimated capital cost.

23. Paragraph 7.53 of version 2 of the Final Business Case notes that, in respect of SDS, the original assumption that Detailed Design would be 100% complete at financial close was not achievable due to a number of delays,

largely outwith TIE's control. It goes on to note that the development of Detailed Design had allowed bidders to firm up their bids and to reduce the provisional scope allowances which they would have otherwise included for design risk. As was the case with version 1, it was noted that, *"Following novation of SDS, after completion of the design due diligence process at Financial Close, the design risks pass to Infraco …"*.

24. On 18 February 2008 Bilfinger Berger produced a Design Due Diligence Summary Report, based on design information received by BBS as at 14 December 2007 **[CEC01449100]**. The Executive Summary stated:

> "Contrary to … tie's original intention for this project stage, the design is incomplete and will require significant further development. Several sections are currently under re-design and the final concepts of these are unknown to us. According to the SDS document tracker more than 40% of the detailed design information has not been issued to BBS at all by the above mentioned cut-off date. …
> Not a single design element has received final approval and has been issued for construction…
> The latest available SDS programme is version V23. This shows a slippage of more than a year compared to the programme in the SDS agreement. …
> In accordance with tie's original procurement concept a complete and issued for construction design would have been novated to the Infraco. The current design is far from meeting these requirements and, as [a] consequence, a novation is considered to present significant and unforeseeable risks to the project".

25. On 13 and 14 May 2008 TIE entered into the following suite of contracts:

- The Tram Supply Agreement (Tramco)
- The Tram Maintenance Agreement
- The Infrastructure Contract (Infraco)

- The Novation of the SDS Agreement
- A Minute of Variation (Minute of Variation 1) (whereby parties agreed that CAF should become a member of the Infraco)
- The Novation of the Tram Supply and Tram Maintenance Agreements (whereby parties agreed that Bilfinger and Siemens would take over the rights and liabilities of TIE under the Tram Supply and Tram Maintenance Agreements)
- CEC provided a Guarantee in favour of the Infraco BSC of TIE's financial obligations under the Infraco contract

Conclusion on procurement strategy

26. The procurement strategy was never intended to transfer all risk to Infraco. Such an approach would have resulted in massive risk premia that may have given rise to potentially severe affordability and value for money issues from CEC's perspective. Rather, the fundamental concept was to identify the various areas of risk and to allocate those risk areas to the private or public sector, depending on which was best placed to deal with it. This approach was informed by lessons learned from other tram projects in the UK and was endorsed, at times with constructive criticism, by Transport Scotland, the OGC and Audit Scotland.

27. The key risks were identified and discussed by a number of different bodies, including CEC, Transport Scotland and the OGC. They were well-understood. It was also understood that, if the aspiration of securing a fixed price contract was to be met, there had to be a clear allocation of those risks as between the private and public sectors. For that to happen, the terms of the Infraco contract had to be clear and unambiguous.

28. A central feature of the procurement strategy was to complete SDS design, or at least a major part of it in respect of critical areas, in advance of entering into the Infraco contract, at which point the SDS contract would be novated to Infraco. The intention of doing so was to afford CEC maximum flexibility while the design was being developed, while at the same time crystalising as much of the design as possible so that tenderers' prices would not require to reflect a large allowance for unknown and unquantifiable risks associated with a complete absence of design.

29. TIE's approach was summarised by Alex Macaulay as follows in his oral evidence[7]:

> "I'll take you back to the concept of the procurement. It was envisaged this would be a design and build contract, and in awarding a design and build contract, one has the option of simply lumping the design and the implementation into one contract and dealing with it as a totality. We were going through a World Heritage site. We were going past several thousand front doors of property in the middle of Edinburgh. So therefore it was viewed at the time of the procurement workshop that design was a significant risk. In other words, if at the stage of going for a design and build contract, the tendering organisation didn't really have a good definition of what they were tendering for, then there was a potential for inflated costs in their tender price. So having the design carried out in advance was seen as a major benefit. Having done that, there was -- the whole issue of integration between the different elements that were being procured, and it was intended -- I don't know whether it ever happened, but the objective was that the design company would transfer to the successful design and build contractor, thereby providing continuity of knowledge of the various design problems and issues that had come up during the design period, and at the time that the main contractor was

[7] 6 October 2017, page 80, line 13ff.

tendering, they would have sight of a fairly well advanced, hopefully 100 per cent well advanced, design, and would then be able to provide a much firmer price in his tender. So in my view, the two elements of it were fundamentally important. The first one is to get as much of a design as possible done in advance before the main contract was awarded, and secondly, having awarded the main contract, to transfer that design risk to the main contractor."

30. Design novation in the context of design and build contracts is not uncommon. But in any particular case, success for the employer depends on the anticipated transfer of risk actually being achieved. However, the contractor will only accept design risk (without a large risk premium) if the design is complete and of sufficient quality. Otherwise, the contractor, especially if it is in a strong position, will either refuse to accept the risk outright, introduce qualifications to protect its position, or increase its tender price to reflect the fact that the risk it originally priced for is not the risk it is being presented with at novation.

31. This was the position with the Infraco contract. On the morning of 20 December 2007, being the day on which the Wiesbaden agreement was signed, Richard Walker emailed TIE to say [**CEC00547740**]:

"We still have issues with accepting design risk. We have not priced this contract on a design and build basis always believing until very recently that design would be complete upon novation. With the exception of the items marked provisional which we have now fixed by way of the 8 million we cannot accept more drain [sic] development other than minor tweaking around detail. Your current wording is too onerous. Trust we can find a solution."

32. The Infraco contract did not, and was not intended to, transfer all design risk to BSC. Instead, the "solution" that the parties agreed was to introduce the design pricing assumption in Schedule Part 4. By doing so, TIE was able to implement its procurement strategy by achieving design novation, while at the same time BSC was able to protect its position in respect of design. Perhaps unsurprisingly (in retrospect), this hybrid solution early on gave rise to conflict between BSC and TIE and, when tested in the DRPs, came to be interpreted in a number of different ways, the most extreme of which left TIE facing a notified departure for any design development.

33. At the heart of the design pricing assumption in Schedule Part 4 lies a distinction between "normal design development" and "changes of design principle, shape and form and outline specification". This had been introduced as part of the Wiesbaden agreement. However, the Infraco contract did not provide a mechanism for determining whether something was "development" or a "change". As such, disputes were always liable to arise and, depending on the precise nature of the dispute, could require expert evidence in order to be resolved. But not only was the contract itself prone to create disputes, the terms of clause 80 of the contract also meant that the contractor was not required to progress work until the dispute in question was resolved. The pricing assumption relating to design, in conjunction with clause 80, gave rise to multiple claimed, but disputed, notified departures and an absence of progress with the works.

34. The Draft Final Business Case had also indicated that the risk of obtaining approvals would pass, along with SDS, to the Infraco on novation. However, that did not occur and the risk of approvals not being obtained in accordance with the programme fell on TIE.

35. So, while the procurement strategy was sound, it was not implemented as had been intended. The risks associated with the strategy were not adequately managed or programmed ahead of financial close. The manner in which TIE attempted to close off these risks ahead of financial close gave rise to an ineffective transfer of risk and a contract that had the inherent potential to bring works to a halt in the face of multiple disputes.

36. If the advance works (i.e. MUDFA and SDS) had been progressed before financial close to the extent that had been anticipated in terms of the overall procurement strategy, BSC would have been better placed to price and accept the risk associated with the novation of all design work without the need for qualifications based on pricing assumptions.

CHAPTER 3: WITHDRAWAL OF TRANSPORT SCOTLAND FROM TRAM PROJECT BOARD

Introduction

1. The decision to withdraw Transport Scotland from the Tram Project Board (TPB) was an issue that was touched on by a number of witnesses. Some of the points that were made, however, came to underline why there was a need for role clarity as the project entered the delivery phase. Previously, during the development and procurement phases, Transport Scotland had played a facilitating role that was variously described as a "partner"[1], "family"[2], "promoting"[3], or "joint working"[4] role. But that support was not provided as a function of Transport Scotland having a seat on the TPB; the fact that many witnesses considered it was demonstrates how confusion could arise in respect of what exactly was involved in Transport Scotland fulfilling its role as major funder.

2. Until the announcement that a grant capped at £500m would be made available to CEC, there had only been "in-principle funding support"[5] from the Scottish Executive and there was no settled position on which party would bear the cost of any overruns. While the announcement of the funding cap brought clarity to that issue, there remained a risk that, if Transport Scotland

[1] John Ramsay [**TRS00004511].**
[2] Graeme Bisset [**TRS00004079**, pdf85].
[3] John Ramsay [**TRS00004511].**
[4] OGC, Follow-Up Report, November 2006 [**CEC01791014**, pdf3].
[5] Draft Final Business case at paragraph 1.1 [**CEC01821403**, pdf5].

was actively involved in the governance of the project, the efficacy of the project's management could be undermined. Furthermore, if cost overruns occurred while Transport Scotland was actively involved in project governance, Transport Scotland could be seen as partly responsible for those overruns with further calls for central government funding being made.

3. The decision to withdraw Transport Scotland from the TPB was taken to ensure that there was absolute role clarity between those responsible for delivering the tram project and those funding it. It also made certain that there was no basis on which CEC could look to the Scottish Ministers for additional funding above the £500m cap. The withdrawal of Transport Scotland from the TPB did not attract any objections at the time and the loss of expertise and influence that some witnesses have claimed resulted from Transport Scotland's withdrawal was, in reality, limited.

Background

4. Elections to the Scottish Parliament took place on 3 May 2007. The Scottish National Party fought the election with a manifesto commitment to "seek national best value for our capital spending, with £1.1 billion of current planned expenditure on EARL and Edinburgh trams redirected." On 17 May 2007, the SNP formed a minority government.

5. On 4 June 2007, the (then) Cabinet Secretary for Finance and Sustainable Growth, John Swinney, asked the Auditor General for Scotland to carry out a high-level review of the arrangements in place for estimating the cost and managing the Edinburgh Tram and Edinburgh Airport Rail Link (EARL) projects. On 20 June 2007 the Auditor General for Scotland published his report.[6] The debate in the Scottish Parliament on the future of the tram project took place on 27 June 2007.

6. Contributions to the Parliamentary debate split along party lines. Many of the views in favour of the tram project were reflected in a contribution made during the debate by David McLetchie MSP:

> "However, let us not forget that the project as originally conceived in the two bills that were passed during the previous session for tramline 1 and tramline 2, has been scaled down considerably. That has been euphemistically described by the promoters of the scheme as "phasing". We now have phase 1 a, phase 1 b, phase 2 and phase 3. However, there is not a penny piece in the pot for the later phases.
>
> It is interesting that although the project has been scaled down, the financial contribution of the Scottish Executive has not. The contribution was set by the previous Executive at £375 million, index linked, and the promoters of the scheme were supposed to find the balance that would be required to complete the two lines in their entirety. However, as we know, that will not now happen.
>
> However, there has been no corresponding pro rata reduction in the financial commitment of the Scottish Executive. Instead, it was confirmed that the full funding allocation would be made available to the City of Edinburgh Council for the construction of phase 1 a from Leith to the airport. We simply cannot go on like this in relation to the tram project, which is why, on publication of the Auditor General's report last week, the

[6] The role of Audit Scotland is considered in more detail in chapter 4.

Conservatives said that not a penny more of public funding should be committed by the Scottish Executive to the project. It is, in our view, time to volley the ball back into the court of TIE and the City of Edinburgh Council, and to make it clear to them that as promoters of the scheme it is their responsibility to bridge any funding gap, and that they alone are responsible for deciding whether to proceed with the project and how that gap will be funded." [**SCP00000030**, pdf20]

7. After the debate, the Scottish Parliament approved the following resolution by 81 votes to 47 votes:

   "That the Parliament notes that the Edinburgh Trams project and EARL were approved by the Parliament after detailed scrutiny; further notes the report of the Auditor General for Scotland on these projects and, in light thereof,
   (a) calls on the Scottish Government to proceed with the Edinburgh Trams project within the budget limit set by the previous administration, noting that it is the responsibility of Transport Initiatives Edinburgh and the City of Edinburgh Council to meet the balance of the funding costs and (b) further calls on the Scottish Government to continue to progress the EARL project by resolving the governance issues identified by the Auditor General before any binding financial commitment is made and to report back to the Parliament in September on the outcome of its discussions with the relevant parties." [**SCP00000030**, pdf38]

8. The Scottish Executive accepted the clear will of the Scottish Parliament in respect of the tram project as expressed in the resolution. It confirmed that funding of £500m would be made available for the tram project. Importantly, in accordance with the call in the resolution to proceed with the project within the budget limit set by the previous administration, it was made clear that no funds beyond the £500m would be made available. In this way, it was made clear beyond any doubt that it was CEC that would be liable to meet any cost overruns.

The status quo

9. In questions to the Transport Scotland witnesses and to Mr Swinney, it was suggested that the vote in the Scottish Parliament and the subsequent announcement did not alter the *status quo*: the funding that had been promised by previous administrations was simply confirmed, albeit a precise figure had never been finally fixed.[7] The suggestion was then made that, since there had been no change to the *status quo*, there was no need to alter the governance arrangements and, in particular, there was no need to withdraw Transport Scotland from the TPB.

10. However, until confirmation that a £500 million grant would be made available to CEC, there was only "in-principle funding"[8] and no settled position on which party would bear the cost of any overruns. The decision of the Scottish Ministers to accept the will of the Scottish Parliament converted the "in-principle funding", which was under threat at the time, into an unqualified commitment while simultaneously clarifying the position on liability for cost overruns.

[7] See, for instance: the Interim Outline Business Case [**CEC01875336**] dated May 2005 at paragraph 8.3.4 on page 125 which refers to funding assumptions; and Advice to Ministers dated 3 February 2006 [**TRS00002128**] at paragraph 11 under "Expectations of and Conditions on CEC".

[8] **TRS00002128**, pdf2: "there will be no release of significant capital funds for utilities diversion works or main construction until CEC and tie have presented satisfactory updates of the business case for Phase 1."

11. The prior uncertainty around the funding of cost overruns was captured in an internal TIE email from Stewart McGarrity to Graeme Bissett and others dated 5 December 2006, which sets out notes on various questions from Councillor Allan Jackson [**TIE00090098**]. One question raised was, “If the project goes over budget who pays?” In his notes, Stewart McGarrity says that, “Despite my best efforts TS and CEC have steadfastly refused to agree on this issue over the past 9 months. See paragraph 1.76 of the DFBC Exec Summary which clearly states this as an outstanding issue. The answer for now is that they (CEC/TS) will make this determination sometime between now and financial close.”[9]

12. A similar point was made by both Donald McGougan, CEC’s Director of Finance, and Andrew Holmes, CEC’s Director of City Development, in their report to CEC dated 21 December 2006, in which they recommended approval of the Draft Final Business Case. Paragraph 4.36 of the report noted that, “Funding from Transport Scotland also carries some risk with the agreement on issues such as cost sharing, indexing and payment schedules still to be finalised” [**CEC02083466**].

13. Graeme Bisset explained how TIE/CEC and TS had been approaching the issue. When it was suggested to Mr Bisset that the central government funding had been capped even before Mr Swinney’s announcement, his

[9] The DFBC is the Draft Final Business Case [**CEC01821403**]. See also paragraph 9.44 [pdf144].

recollection was there was considerable jockeying for position and negotiation between TIE, CEC and Transport Scotland on the issue of funding.[10] Under reference to risk 269 in the principal risk register contained in the TPB papers, Mr Bisset said that the matter as to which funder would be liable for costs overruns was open until Mr Swinney's announcement brought "admirable clarity" to the situation.[11] Damian Sharp in his witness statement at paragraph 72 also refers to the on-going discussions between TIE and Transport Scotland in relation to the issue of who would be liable for overrun costs.[12]

Effect of announcement of funding cap

14. Tellingly, those involved in the tram project viewed the announcement of the funding cap by Mr Swinney as being of real significance, marking a step-change in how risk was to be dealt with. The "partnering" or "family" approach that had characterised the relationship between Transport Scotland on the one hand and TIE and CEC on the other during the development phase of the project was to come to an end.[13] Evidence demonstrating that the parties involved considered the fixing of a funding cap signalled an important change is set out in the following paragraphs.

[10] 31 October 2017, page 19, line 4ff; page 33, line 3.
[11] 31 October 2017, page 24, line 2; page 25, line 25.
[12] TRI00000085, page 32.
[13] The extent of Transport Scotland involvement during the development phase of the project can be gleaned from the Draft Final Business Case [**CEC01821403**] at paragraphs 1.84 [pdf18], 1.86 [pdf19], 3.44 [pdf30] and 6.6 [pdf74]. See also Damian Sharp's witness statement [TRI00000085] at paragraph 16 (pdf6).

15. In respect of CEC officers:

15.1. On 20 July 2007, Jim Inch, CEC's Director of Corporate services, produced a briefing paper for CEC's Chief Executive on governance arrangements. At paragraph 2.6, he comments on the need for greater scrutiny in the context of "the funding cap set by Transport Scotland, and a greater financial risk to be borne by the Council" [**CEC01566497**, pdf2].

15.2. The Highlight Report to the Internal Planning Group meeting for 27 July 2007 noted that, "the position on funding has changed dramatically" as a result of "the Parliamentary decision to proceed with the tram project" [**CEC01566496**, pdf12].

15.3. On 23 August 2007, Mr Aitchison, CEC's Chief Executive, reported on the "revised funding situation" and the "greater financial risk that will now be borne by the Council" [**CEC02083490**].

15.4. A highlight report to CEC's Internal Planning Group ("IPG") on 30 August 2007 [**CEC01566861,** paragraph 4.1] expressed the view that, "The outcome of the Government decision to make the Council 'Funder of Last Resort' significantly changes the risk profile of the Council. Consequently it will be incumbent upon the Council working with tie to determine the risks inherent in the bespoke Infraco Contract (including novation of the Tramco and SDS contracts) and assess what headroom is to be recommended for budgeting purposes."

15.5. Gill Lindsay addresses the impact of the funding cap in her statement where she says, "following the change of Government, Central Government would fund the scheme to a ceiling only, contrary to the initial funding agreement when the structures were put in place."[14]

15.6. CEC's "B team" also considered the funding cap had brought about a significant chance in the risk profile. Rebecca Andrew in her oral evidence explained why the decision in 2007 had caused her concern: "The capping essentially meant that the Council was liable for 100 per cent of any overspend on the project, whereas previously we had been hoping to negotiate a proportional responsibility. So if the Council was funding 10 per cent of the project, it would fund 10 per cent of the overspend. Once it took the full brunt, that was a significant financial risk for the Council."[15]

15.7. Colin Mackenzie was asked in oral evidence whether the Scottish Government's announcement of the capped funding "changed things for

[14] TRI00000160, pdf 8.
[15] 13 September 2017, page 49, line 4.

the Council in any way?" He answered, "In my view it did. It signified that a line had been drawn in the sand by Transport Scotland…"[16]

16. In respect of CEC elected members:

16.1. Jennifer Dawe, the Leader of the Council at the time, speaks in her witness statement to the change in risk profile brought about by the capping.[17] She revisited the issue in her oral evidence, where she explained that, until the announcement in 2007, the view was taken that CEC's contribution was effectively fixed. She explained that, because of the change in the risk profile, the Infraco contract was "sold" to the CEC members as a fixed price contract.[18]

16.2. Gordon Mackenzie expressed strong views about the significance of Mr Swinney's announcement: "With hindsight, in my view, transferring risk from the Scottish Government, a much larger organisation with a multi-billion pound budget, to CEC, does not just transfer the risk; in some respects, it multiplies the risk as there is, proportionately, a far greater risk to the smaller body".[19]

17. In respect of the Tram Project Board:

[16] 26 October 2017, page 12, line 6ff.
[17] TRI00000019, paragraph 212ff.
[18] 5 September 2017, page 94, line 19ff. This echoes a point made by Stephen Reynolds in his oral evidence to the effect that the cap on funding announced by Mr Swinney provided an imperative for the project to be brought in on time: 11 October 2017, page 31, line 11ff.
[19] See statement [TRI00000086] at paragraph 12 [pdf6]

17.1. The issue of risk-sharing was a live issue for the TPB until Mr Swinney's announcement. The need for "a funding contract to be established by TS and CEC including risk allocation" was a repeated agenda item [e.g. **CEC01628134**, item 14.5 and **CEC01565001,** pdf18].

17.2. Item 5.5 in the minutes for the meeting of the TPB on 12 July 2009 noted, "The additional risk to CEC was discussed in detail. It was agreed that the Project Risk Register needed to be strengthened for the additional funding risk to CEC. Further, [James Stewart] requested that the impact on costs arising from any delays to the procurement programmed should be detailed at the board" [**CEC01565001**, pdf7].

17.3. The change in risk allocation can also be seen in the manner in which the entries for risk 268 and risk 269 on the Primary Risk Register evolved from late 2006 through to September 2007. In an early version of the Risk Register, the need to reach an agreement with Transport Scotland on financial overrun costs was described as a "potential showstopper" [**CEC01355258**, pdf18]. The minutes of the July 2007 meeting of the TPB note that there was detailed discussion of "the additional risk to CEC" and that "the Project Risk Register needed to be strengthened for the additional funding risk to CEC" [**CEC01565001**, pdf7]. By the time of the TPB meeting in September 2007, risk 268, which had already absorbed risk 269, dropped off the risk register entirely [**USB00000006**, pdf27]. The meeting papers also included a draft paper on changes to governance [pdf32], which identified various reasons for the need to change the existing governance structures, including the changes in funding responsibilities brought about by Mr Swinney's announcement and the fact that the project had evolved and was approaching the construction phase.

17.4. It should also be recognised that the capping of the budget and the transfer of risk was welcomed by the TPB at the time: "The decision to provide £500m and transfer the risk to the Council also produced a very positive atmosphere [at the TPB]. Everyone seemed very clear about the task ahead and the focus on getting on with delivery" [Damian Sharp's emailed record of the meeting, **TRS00004547**, pdf2].

18. In respect of TIE**:**

18.1. William Gallagher spoke about the fact that one of the benefits of Mr Swinney's announcement was that it "focused everybody's minds". From that point in time, CEC really understood it would be meeting the costs of any delay, if the project overran. As a result, the approvals process improved up.[20]

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[20] See William Gallagher's statement [TRI00000037] at paragraphs 177 and 359 (pdf53 and pdf120).

18.2. Matthew Crosse referred to the TPB risk register and refers to the fact that the "expectation when we started the project before May 2007 elections was that we would have two funders and it was assumed that any cost overruns would be shared by TS and TIE. As soon as the TS contribution had been capped then CEC was responsible for cost overruns and CEC were concerned about this in the months leading up to signature".[21] Mr Crosse also refers to CEC having to "take on the risks of the project" after the elections in May 2007.[22]

19. Transport Scotland were fully aware of the significance of this change:

19.1. Malcolm Reed, though not aware of the background to any arrangements that had been made before he was in post, considered that, because it was a jointly-funded project, his assumption was that any cost overruns would have been considered and managed jointly. He was of the view that, "the status of the tram project had changed fundamentally with the Ministerial decision that financial risk for the project should lie entirely with CEC".[23] In July 2007, he expressed the view that, "we need to withdraw from active engagement in the delivery of this project and – crucially – in any decision-making that could compromise the new arrangements for allocation of financial risk for this project" [**TRS00004547**].

[21] See statement [TRI00000031] at paragraph 155 (pdf52).
[22] See statement [TRI00000031] at paragraphs 155 and 142 (pdf52 and pdf47). See also 17 October 2017, page 124, line 19ff.
[23] See statement [TRI00000066] at paragraphs 30 and 123 (pdf14 and pdf57).

19.2. John Ramsay produced a paper after the parliamentary vote and ministerial announcement on funding [**TRS00004511**]. In it, he commented as follows:

> "Following on from the question of funding limits, ministers also made it perfectly clear that this is a CEC project not the Executive's. We have therefore assumed that our role has now changed from being that of a fully supportive and promoting funding partner to that of major funder or banker."

19.3. Matthew Spence of Transport Scotland also produced a paper for Mr Swinney after the parliamentary vote, which set out the proposed redefined role for Transport Scotland [**TRS00004581**]. At paragraph 16, he underlines the need in discussions with CEC around the funding cap "to ensure a clear and defined risk transfer to the Council".

19.4. Damian Sharp explains in his witness statement at paragraph 148 that, before Mr Swinney's announcement, there was a clear understanding within Transport Scotland that, whatever might be said officially to TIE and CEC, the Scottish Ministers were in practice at risk for a share of any cost over the expected £545 million outturn cost.[24]

20. Audit Scotland echoes these views. In its 2011 Report, it comments at paragraph 70 that the capping of the grant and the withdrawal of Transport

[24] TRI00000085, pdf64.

Scotland from the TPB "changed the emphasis of its role in the project to managing grant funding" [**ADS00046**, pdf38].

Reasons for withdrawal of Transport Scotland from TPB

21. As can be seen, until the vote in the Scottish Parliament in June 2007 and Mr Swinney's subsequent announcement, there had been a degree of ambiguity as to the nature and extent of the funding that the Scottish Ministers were prepared to make available to CEC. There had been both a hope and an expectation among TIE and CEC that the Scottish Ministers would shoulder a *pro rata* share of any cost overruns. As long as Transport Scotland remained on the TPB, the Scottish Ministers would in practice be accountable for decisions taken by the TPB which might result in an overspend. There would be a direct link between representation on the TPB and liability for decisions taken by the TPB.[25] The imposition of the absolute cap on funding meant that the Scottish Ministers were not so exposed.[26] Were Transport Scotland to continue to be represented on the TPB, this would mean that the principal funder could continue to have an executive role without being financially accountable for the decisions made.[27] The corollary of this is that, were there to be a large overspend resulting from decisions taken by the TPB in which

[25] Damian Sharp refers in his statement [TRI00000085] at paragraph 152 (pdf66) to the risk management principle that, "'You should align your governance with the risk allocation', not the other way round."

[26] This is a point made by Damian Sharp in his witness statement at paragraph 149 (pdf64) where he explains that, because CEC was to be liable for cost overruns, it was, in theory, no longer necessary to monitor the project in the same way since the power of the TPB to take decisions that cost the Scottish Government money had gone.

[27] Damian Sharp described this was "wanting to have your cake and eat it": 5 October 2017, page 115, line 16.

Transport Scotland still participated, the Scottish Ministers could find themselves under considerable political pressure to contribute to that overspend.[28]

22. This is the context in which the decision to withdraw was taken. It was a "political" decision[29], in the sense that it was a decision made by the Cabinet Secretary, who is a politician[30].

23. The evidence before the Inquiry confirms that the decision to withdraw Transport Scotland from the TPB was taken for two related reasons: firstly, to ensure that, during the delivery phase of the project, there was clarity of roles as between those responsible for delivering the trams project and those funding it; and, secondly, to ensure that there was no basis on which CEC could look to the Scottish Ministers for funding above the £500m cap. This is reflected in the Advice to Ministers from Malcolm Reed dated 6 July 2007 [**TRS00004523**]. His recommendation on Future Governance and the Role of Transport Scotland was in the following terms:

> "1. The Parliament's decision places the risk of any cost overruns on the Tram Scheme with the City of Edinburgh Council, and makes it clear that responsibility for managing and delivering the scheme rests with the promoter.

[28] This point is made by Malcolm Reed in his statement [TRI00000064] at paragraph 128 (pdf62) and was echoed by Bill Reeve in his oral evidence: 27 September 2017, page 153, line 15ff. A similar point is made by Stewart Stevenson in his statement [TRI00000142] at paragraph 55 (page 30) and by Damian Sharp in his statement [TRI00000085] at paragraph 150 (pdf150).
[29] CEC01561047 at pdf8.
[30] See Ainslie McLaughlin's oral evidence, 26 September 2017, page 211, line1.

2. To achieve this clarity of roles, and ensure that situations could not arise subsequently in the governance of the project which might generate further calls on central funding, I propose that Transport Scotland's future engagement with the Edinburgh Tram Project should be on the basis of revised grant conditions and once these conditions are in place Transport Scotland staff should withdraw from active participation in the governance of this project."

Mr Reed expands on this in his statement at paragraph 122[31]:

"This requirement for clarity of future roles was my fundamental reason for agreeing with the Cabinet Secretary's view that TS should not be represented at the TPB, in any form, and I would have recommended that course of action even if Mr Swinney had not clearly expressed his view."

It was Mr Reed's "professional view … that it would be imprudent for TS to continue to be on the TPB in the new circumstances."[32]

24. It is of interest that, in his evidence to the Public Audit Committee given in 2011, David Middleton, who was Malcolm Reed's successor as Chief Executive of Transport Scotland, explained that the Edinburgh tram project was "unique among major transport projects in Scotland … in that the project owner is the City of Edinburgh Council and we have played the role of funder [**SCP00000028**, pdf25]". Mr Middleton expressed the view that it was good governance for Transport Scotland to withdraw from the board when the project approached the delivery phase, once funding had been confirmed.

[31] TRI00000066, pdf57.

[32] Damian Sharp agrees in his statement [TRI00000085] at paragraph 150 (pdf65) that keeping a Transport Scotland seat on the TPB "would have blurred the distinction in roles between the parties".

Otherwise, in the absence of role clarity, there would be a potential for conflicts of interest as the TPB (including Transport Scotland) would be making recommendations to Transport Scotland [**SCP00000028**, pdf3].[33] Thus, two different former Chief Executives of Transport Scotland, both civil servants with extensive experience of transport projects, agree that the withdrawal of Transport Scotland from the TPB was appropriate. Ainslie McLaughlin, similarly experienced in major infrastructure projects, also expressed the view that the decision to withdraw Transport Scotland from the TPB was "a perfectly reasonable decision to come to in terms of ensuring clear and effective project delivery structures."[34]

25. Mr Swinney discussed the advice he received from Mr Reed in his oral evidence.[35] There, he emphasised the importance that he perceived of achieving "this clarity of roles", particularly during the delivery phase of the project. As has been noted above, Transport Scotland's involvement in the tram project prior to the general election was more in a partnering capacity; going forward, its role was to be confined to that of major funder. Mr Swinney was, he explained, drawing on the lessons he had drawn from observing other capital projects where uncertainties about leadership and responsibility for operational delivery had given rise to opportunities for projects to get into

[33] Stewart Stevenson makes the same point at paragraph 43 (pdf25) of his witness statement.
[34] See statement [TRI00000061] at paragraph 14 (pdf6).
[35] 23 January 2018, page 26, line 12 to page 32, line 22.

difficulty.[36] Mr Swinney was challenged by Counsel to the Inquiry, who suggested that this reasoning was not recorded in any papers. However, as Mr Swinney noted, he was taking a decision in response to advice received and it is clear that the advice does highlight the desirability of achieving clarity of roles. If the implication of this line of questioning was that there may have been other reasons for Mr Swinney's decision, which had not been disclosed in the contemporaneous documents or in his witness statement, then what those other reasons might have been was never put to Mr Swinney.

26. Mr Stevenson, who spent his professional life in project management, gave similar evidence, although his recollection was that mitigating the risk of future funding requests was not the reason for the decision. Under reference to the advice received from Mr Reed, he says the reason for withdrawing Transport Scotland was not the possibility of future calls on funding but "was to ensure clarity of responsibility".[37] However, Mr Stevenson went on to discuss the potential exposure that Transport Scotland could have to further calls on funding if Bill Reeve remained on the TPB.[38] In his oral evidence, Mr Stevenson explained that, as a project enters the delivery phase, unforeseen problems arise; if Transport Scotland retained a position on the TPB, there

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[36] The same point is made in Mr Swinney's statement [TRI00000149] at paragraph 64 (pdf21). Mr Stevenson makes the same point at paragraphs 29, 44 and 63 of his statement [TRI00000142], where he refers *inter alia* to the SAK rail project, the lack of coherence in its governance arrangements, and the potential for conflicts of interest, were Transport Scotland to remain on the TPB. Mr Stevenson revisits the relevance of SAK in his oral evidence: 20 March 2018, page 26, line 6 to page 41, line 21.

[37] See statement [TRI00000142] at paragraph 68 (pdf35); see also paragraph 5 (pff3).

[38] Ibid., paragraph 71 (pdf37).

would have been a real danger of Transport Scotland being drawn in delivery issues which were properly matters for CEC.[39]

27. Mr Swinney responded to the advice from Malcolm Reed by agreeing that Transport Scotland should "scale back" its direct involvement in the project [**TRS00004536**]. Mr Swinney was seemingly criticised on the basis that the instruction to "scale back" was ambiguous. However, it should be noted that Mr Swinney was agreeing with the specific advice that had been tendered to him that, "Transport Scotland's future engagement with the Edinburgh Tram Project should be on the basis of revised grant conditions and once these conditions are in place Transport Scotland staff should withdraw from active participation in the governance of this project." The fleshing out of Transport Scotland's scaled back role would naturally take some time to work out through revisions to the grant conditions. As Mr Reed explains in his statement at paragraph 130 that: "It was simply a question of shaping a new working relationship with CEC and TIE, to be expressed through revised conditions of grant"[40]. Mr Stevenson puts the matter from his perspective at paragraph 57 of his statement[41]: "What you see from these documents is civil servants looking at how a Ministerial decision can be applied in practice. Ministers set policy, Ministers challenge, Ministers review, Ministers carry responsibility, but Ministers do not manage the task of implementing public policy. Transport Scotland are delegated to do that on behalf of Ministers."

[39] 20 March 2018, page 8, line 11.
[40] TRI00000066, pdf62.
[41] TRI00000162, pdf31.

28. It was also suggested to Mr Swinney that a change in the nature of Transport Scotland's involvement had never featured before. However, it was a matter that had been under consideration by the TPB. When the revised governance structures for the TPB were put in place in August 2006, the associated papers noted that, "It is anticipated that a revised structure will be required to execute the construction phase of the project" [**CEC01758865**, pdf1]. In a paper produced for the TPB for its meeting in March 2007, Graeme Bisset recommended that TIE, CEC and Transport Scotland should take a fully arms-length approach to funding, albeit that would negate the "family relationship between TS, CEC and tie" [**TRS00004079**, pdf85].

29. In July 2007, before Mr Reed had written to CEC confirming that Transport Scotland would withdraw from the TPB, Mr Inch produced a briefing paper for the Chief Executive of CEC on governance arrangements in which he concluded that, "Against the background of the funding cap set by Transport Scotland and a greater financial risk to be borne by the Council, it is imperative that far more rigorous financial and governance controls are put in place by the Council" [**CEC01566497**, pdf2].

30. Mr Aitchison then provided a report to elected members dated 23 August 2007 [**CEC02083490**], in which he commented that the "greater financial risk" for CEC brought about by the funding cap made it "imperative that rigorous

financial and governance controls are in place to manage the next crucial phases of the project" (paragraph 9). The "revised funding situation" had highlighted "the need to re-assess current governance arrangements associated with the project" (paragraph 5). Following the change in "the risk profile for the Council, the role of the Tram Project Board requires to be considered afresh" (paragraph 13). The "dynamics of the project" had changed as a result of the cap, making it appropriate to establish a dedicated "Tram Sub-Committee". His second recommendation was that members note that the cap on funding "requires revised governance structure for the project and the relationships between the various companies and agencies promoting it".

31. It is clear, therefore, that the confirmation of funding and the associated cap triggered a reconsideration by all interested parties in the governance structures for the tram project. This is the context in which the decision to withdraw Transport Scotland should be seen.

32. The governance structure for the tram project developed over time as the project progressed. It was never contemplated, and none of the witnesses has suggested, that a particular form of governance structure should have been in place early on and that this should have remained in place throughout all phases of the project.[42] In this regard, it is of interest to consider the role

[42] Ainslie McLaughlin in his oral evidence commented that, at the time of the withdrawal of Transport Scotland, with funding agreed subject to finalisation of the business case, it

that it was originally envisaged that the Scottish Executive would play on the TPB. In an email to various recipients connected with the tram project dated 19 September 2005, Damian Sharp set out what he considered the Executive's role on the TPB would be:

> "As principal funder of the Edinburgh Tram Network, the Scottish Executive will participate fully in the Tram Project Board. It will play its part in bringing issues to the TPB for consideration and will work with the other members of the TPB to resolve issues brought to the TPB. In particular, the Scottish Executive will expect the TPB to be the forum in which issues relating to the business case, scope and cost of the Tram Network will be discussed and, wherever possible, resolved. The Scottish Executive will continue to have wider discussions with tie ltd, CEC and other parties about the Tram network but will keep the TPB informed of progress with discussions."

The focus of the Executive's involvement relate to the business case, scope and cost, being matters relating to procurement rather than delivery. As has been noted above, it was always anticipated by the TPB that, even after the restructuring of the TPB in August 2006, there would be further revisions to the structure as the project entered the construction phase.

Reaction to withdrawal

33. Many of the witnesses were invited by Counsel to the Inquiry to express views on the withdrawal of Transport Scotland from the TPB and took up that

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would have been quite normal to review the governance arrangement as the project moves from one stage to another: 26 September 2017, page 206, line 18; page 224, line 21. He also makes the point that, since the project was moving to the delivery phase, he did no know how Transport Scotland would have been involved as part of the TPB if not being party to decisions relating to the delivery of the project: 26 September 2017, page 223, line 25.

opportunity. Some expressed regret at Transport Scotland's withdrawal. However, it is notable that not a single contemporaneous objection or complaint about the withdrawal has been placed before the Inquiry. Bill Reeve comments in his witness statement that he did not recall any "howls of protest" at the time. Mr Swinney was not aware of anyone expressing any concerns that withdrawing Transport Scotland from the TPB would lessen Transport Scotland's ability to supervise or monitor or influence the tram project.[43] In the absence of any contemporaneous complaints or objections, an inference may be drawn that those best placed within TIE and the CEC did not express an adverse view on Transport Scotland's withdrawal because they understood and accepted that the outcome of the debate in the Scottish Parliament had brought about a significant change and that it was appropriate for governance arrangements to change in light of that.

34. Bill Reeve in the course of an internal discussion within Transport Scotland raised some concerns about the risk arising from the withdrawal of Transport Scotland [**TRS00004547**],[44] but he acknowledged that a balance had to be struck between Transport Scotland's involvement and the benefits of role clarity. He understood the rationale for the decision and considered it reasonable, bringing the trams project more into line with trams projects

[43] See statement [TRI00000149] at paragraph 89 (pdf31).

[44] Damian Sharp observes in his statement [TRI0000085] at paragraph 154 (page 67) that Mr Reeve was new to working in central government and, as a result, did not share Mr Sharp's views on the risk that Transport Scotland's involvement in the TPB would result in claims being made against the Scottish Ministers.

elsewhere in the UK[45] Although he had raised concerns, this was "a point in the middle of a debate" and there were further discussions about Transport Scotland's revised role. Ultimately, he was not uncomfortable with the decision that was taken; it was a matter of judgment, with something to be said for a number of courses of action.[46]

35. At the TPB meeting in July 2007, three members expressed support for Bill Reeve to continue as a member of the TPB, although that view was not shared by Willie Gallagher [**TRS00004547**, pdf2]. Importantly, however, all members of the TPB agreed in principle that Transport Scotland should have a "more focused role" [**TRS00004547**, pdf5] or a "more stream-lined oversight process" [**TRS00004541**, pdf1]. Clearly, so far as the TPB was concerned, the outcome of the parliamentary vote and Mr Swinney's announcement had had an impact on the role that Transport Scotland should play going forward. At the time of the TPB meeting in July 2007, the precise nature of that role was still being worked out.

36. The minutes of a July 2007 meeting of the TPB [**CEC01566662**] record discussions in this way at item 5.4:

> "TS role: the board discussed the future role of TS in relation to the project. [James Stewart] highlighted that despite the recent funding announcement, TS would remain responsible to assure prudent spending of taxpayers' money. This should require continued attendance at the TPB, although less detailed scrutiny outwith the board. It was confirmed

[45] See statement [TRI0000067] at paragraphs 79 and 82 to 84 (pages 23 and 24).
[46] 27 September 2017, page 155, lines 7 to 21.

> that current periodic reporting would continue. DJM [David Mackay] stressed that any TS representation at the TPB had to be empowered to make decisions on behalf of the Executive."

37. Malcolm Reed comments on this in his witness statement at paragraph 133 [**TRI00000066**, pdf64]. In his view, to suggest that "less detailed scrutiny outwith the board" was necessary actually inverted what was required to ensure prudent spending of public money: "I would consider detailed scrutiny to be more relevant than high-level oversight in achieving that objective." Mr Reed also points out that, in the minutes of the next TPB meeting on 9 August 2007 [**CEC01561047**], Mr Stewart seems to have modified his position and is noted as having said that Transport Scotland's withdrawal from the TPB was the same approach as that applied by the Department for Transport (DfT) in England. Mr Reed also points out that Partnerships UK (PUK) was a partnership between the public and private sectors, and notes that, although the Treasury was the major public sector shareholder, the Scottish Government was also a shareholder in PUK. Mr Reed observed that, "If Mr Stewart felt strongly about the composition of the TPB then, as PUK's Chief Executive, he would have access to his Scottish shareholder in the person of the Cabinet Secretary for Finance and Sustainable Growth, Mr Swinney."

38. For Mr Swinney's part, he was of the view that the arrangements that came to be put in place addressed Mr Stewart's concerns: "the points that matter, which are the scrutiny of expenditure and guaranteeing that the provisions of the Scottish Public Finance Manual are properly exercised, are all covered by

the letter from Malcolm Reed of 2 August 2007 and the process of reporting to Transport Scotland".[47]

External views on withdrawal

39. It is of note that Mike Heath, of Partnerships (UK) and who was involved in the OGC reviews, was supportive of the decision that Transport Scotland should take a lesser role in the project:

> "I think it was very sensible at the time. Complex projects require the simplest overall governance structure and reporting to both CEC and TS with inevitably different emphasis in their reporting requirements would have been unnecessarily burdensome and introduced potential decision delay and risk. The relationship between CEC and TS could be managed perfectly satisfactorily off line." [**TRI00000044**, pdf32]

When asked about the benefits of greater involvement by Transport Scotland, Mr Heath went on to say:

> "See above. TS may have been able to introduce other expertise but short of becoming directly involved with the contractor once things started going wrong it is hard to see where the benefits would have outweighed the considerable dis-benefit of undermining both the management team and any agreements they had reached preceding its involvement. My understanding of the agreement between CEC and TS was that SG's cost risk was capped so its Involvement would have imported both financial and reputational risk." [**TRI00000044**, pdf32]

Mr Heath returned to this in his oral evidence:[48]

> "I think in my written evidence I have said that I thought that Transport Scotland's withdrawal -- and this is a personal opinion -- was positive for the project because the risks of having a project reporting to two different

[47] See John Swinney's statement [TRI00000149] at paragraph 113 (pdf42).
[48] 21 September 2017, page 62, line 10ff.

groups of people, with two potentially diverging sets of objectives, I think I have said in my written evidence that if you're not careful, people get much better at reporting than they do at doing, and so if you remove that risk by getting Transport Scotland to behave as if it was an independent fund, overseeing the project, overseeing its investment and having clearly defined processes of an independent assessor to confirm milestones for payment, produces some certainty that wouldn't have been there if they were part of project teams.

With their responsibility for the 500 million of the public purse, their independence, I think, through an independent assessor, would be extremely valuable. I do understand that perhaps there was some expertise that did reside within Transport Scotland that could have assisted the project later on when it got into difficulties. But I'm still firmly of the view that that could have been done, as I have said in my written evidence, off-line, but from a basic set of arrangements between the parties, I thought Transport Scotland taking a very clear clinical view as a funder was the best thing that could have happened and I think that was the view of the project team."

40. This reflects what was said in the OGC Gateway 3 Review [**CEC01562064**], at paragraph 7 where it notes that one of the changes made since the last review was, "Major change to the governance for the project which has resulted in a more focused strategy whereby CEC has sole responsibility for the procurement and risk of any cost overruns and Transport Scotland being the major funder". The conclusion reached was, "The review team believes all of the above changes have been extremely positive and will contribute to the likelihood of success of the project."

41. It is also significant that Audit Scotland in its 2011 Report made no adverse comment on the decision to withdraw Transport Scotland from the TPB. This is considered in more detail in chapter 4.

Effect of withdrawal: loss of expertise

42. Some witnesses expressed regret at the withdrawal of Transport Scotland from the TPB. In particular, the suggestion is made that the withdrawal of Transport Scotland led to a loss of expertise.[49] This suggestion, however, does not bear up to scrutiny.

43. Transport Scotland had one place on the TPB, being Bill Reeve in 2007, an experienced civil servant. Being a member of the TPB involved attending four-weekly meetings, in advance of which relevant papers were circulated. There appears to be a misplaced assumption that, had Mr Reeve remained on the TPB, significant Transport Scotland resources would have been made available to TIE and CEC throughout, even though Transport Scotland was a relatively new organisation and had its own projects to manage. It also overlooks the fact that one of the key reasons CEC established TIE was to allow TIE to recruit relevant private sector expertise as and when required, free from public sector salary constraints. The extent to which TIE availed itself of external expertise was not explored in the evidence in any detail, but the sheer scale on which TIE employed external consultants can be seen from the spreadsheet of consultancy services circulated by Stewart McGarrity

[49] This view was by no means universal. For instance, in his oral evidence Stuart McGarrity did not accept, when asked, that Transport Scotland had expertise that was not replicated within TIE, although he did suggest that Transport Scotland did have a "broader perspective": 14 December 2017, page 98, line 19

in August 2010[50]. In addition, TIE also had extensive in-house commercial and technical expertise, as evidenced by the TIE witnesses who gave evidence. By contrast, while Transport Scotland had in-house heavy rail expertise, it had no in-house expertise in light rail.[51]

44. During the early stages of the project and the procurement process, Transport Scotland had provided a "higher level supportive and promotional role" [**TRS00004511**], using its own in-house resources and external consultants when scrutinising material provided by TIE and CEC. But that work was not directly related to, or channelled through, Transport Scotland's position on the TPB. There was no evidence to suggest that it was ever intended that Transport Scotland's "supportive and promotional role" would extend into the delivery phase of the project. Had Transport Scotland remained on the TPB, TIE and CEC could not simply expect to access Transport Scotland's in-house expertise or that of their external consultants (e.g. Cyril Sweet and KPMG). Indeed, in the OGC Follow-Up Report of November 2006 it is recorded that, "We understand that the resources available to the Project at Transport Scotland have little spare capacity to deal with the inevitable peaks of activity leading up to contract selection and award" [**CEC01791014**, pdf6]. As Mr McLaughlin suggested, with only one representative on the TPB, it was

[50] CEC00114442 (email) and CEC00114443 (spreadsheet); and CEC00114358 (email) and CEC00114359 (spreadsheet). The spreadsheets are not identical and have various tabs. The "V1 Full Pivot" tab has 80 individual entries for consultants, which do not include TSS (Scott Wilson/Turner Townsend) and senior counsel.

[51] Matthew Crosse, when asked about Transport Scotland's presence on the TPB, suggested that it was a "useful foil" that brought "commercial experience": 17 October 2017, page 73, line 4.

not "credible that a continuing representation on the Board from Transport Scotland would have substantively improved the delivery of the project in terms of the capability and capacity that was already in existence with tie."[52] Damian Sharp made a similar point when he compared the limited involvement of Transport Scotland personnel with the "60-odd people in tie at that time".[53]

45. It is notable that not a single witness gave a concrete example of where the alleged "loss of expertise" had had a material impact on the project. Those witnesses that offered views did so at such a level of generality that little, if anything, can be taken from them.

46. Nor is it the case that Transport Scotland's withdrawal prevented CEC or TIE seeking "off line" guidance from Transport Scotland as and when required. This point was made by Richard Jeffrey to the Public Audit Committee at a hearing on 23 February 2011: "We should not confuse the lack of involvement of Transport Scotland through formal governance procedures with it not being involved in the project at all. We have kept Transport Scotland regularly updated and have had conversations with it around various issues that the project has faced. Some of those conversations have been helpful" [**SCP00000032**, pdf23]. At the same hearing, Donald McGougan,

[52] 27 September 2017, page 2, line 9.
[53] 5 October 2017, page 133, line 10: "When I was involved, Transport Scotland, there were essentially three of us and some – and parts of some technical advisers, and only one of – only one of the three was full-time on the tram project."

when asked if Transport Scotland had "washed its hands of the project", replied: "I can say that Transport Scotland is absolutely actively involved in monitoring the process, and we have regular discussions with it about the best way forward" [**SCP00000032**, pdf27]. Mr Jeffrey added that he considered Ainslie McLaughlin to be "an open door".

47. The reality is that one of the reasons TIE was established was to allow it to recruit relevant expertise without public sector pay constraints. This is a point made by Damian Sharp, who explains how TIE built up their pool of expertise (including specifically in light rail) over time to assist in the procurement process.[54] Any suggestion that the withdrawal of Transport Scotland from the TPB resulted in a loss of commercial and/or technical expertise is simply not made out on the evidence, ignores the scale on which TIE availed itself of the services of external consultants, disregards TIE's in-house resources and, perhaps most importantly, fundamentally misunderstands Transport Scotland's role within the tram project.

Withdrawal of Transport Scotland: loss of influence

48. Some witnesses also suggested that the removal of Transport Scotland led to a loss of influence or loss of "political connection". Again, this alleged effect must be viewed with a degree of circumspection.

[54] See Damian Sharp's statement [TRI00000085] at paragraphs 48 to 52 (pdf21 to pdf23).

49. If Transport Scotland, whilst on the TPB, sought to intervene directly in the contractual disputes that had arisen between TIE and BSC, then that could have undermined TIE's position and led to the sort of blurring of roles that can jeopardise a project. It could also have led to Transport Scotland becoming embroiled in decisions, the potential effect of which could have been to escalate costs. Having been involved in those decisions, the political pressure for the Scottish Ministers to share the financial consequences of those decisions would have been increased.

50. To the extent that there was any suggestion in the evidence that the Scottish Government could and should have used its wider negotiating power to bring BSC to heal, then that is also rejected. There are strict rules on the procurement of public contracts, which must be adhered to by all public authorities.

51. Mr Jeffrey made the criticism that, when Transport Scotland and the Minister spoke to BSC, they did so in a "listening and neutral capacity". In his view, Transport Scotland should have played a "more interventionist role".[55] Quite how Transport Scotland could have intervened directly (bypassing TIE) in a contract to which it was not a party or what any such intervention could have achieved is never explained by Mr Jeffrey. However, it is submitted that Mr Jeffrey's criticisms miss the point. Transport Scotland and Mr Swinney were able to open up a line of communication with BSC which may well not have

[55] 8 November 2017, page 12, line 11 and page 13, line7.

been available, had Transport Scotland remained on the TPB and been perceived as partisan.

52. The suggestion was also made that BSC's behaviour was influenced by the fact that Transport Scotland was no longer on the TPB. This was rejected by Richard Walker in his oral evidence[56] and by Dr Jochen Keysberg in his oral evidence also[57].

Revised grant conditions

53. The removal of Transport Scotland from the TPB coincided with revised conditions of grant. Mr Reed's letter setting out Transport Scotland's role going forward was sent on 2 August 2007 [**CEC01566705**], and variations to the March grant conditions were contained in a letter from Transport Scotland to CEC dated 22 August 2007 [**TRS00004780**]. Revised grant conditions in respect of the majority of the funding were not finally agreed until January 2008. Mr Reed's letter made it clear that no further funding (beyond the interim grant of £60 million) would be made available until the Financial Close milestone had been reached. The criteria for assessing that was threefold: (i) receipt of a copy of the Final Business Case as endorsed by CEC; (ii) confirmation that a standard OGC Gateway 3 review had been successfully completed; and (iii) receipt of relevant on-going information via the four-weekly report. Within item (i), there were three elements that had to be within

[56] 15 November 2017, page 167, line 19ff.
[57] 16 November 2017, page 94, line 15.

the approved Final Business Case, being an affordability assessment for Phase 1a within a maximum capital cost of £545 million, a BCR greater than 1, and no projection of a requirement for an ongoing subsidy during the operational phase [**CEC00021548**].[58]

54. One point that was made to witnesses in the course of evidence was that the revised grant conditions relied on CEC being satisfied with the Final Business Case rather than with any separate assessment being undertaken by Transport Scotland. It will be recalled that Transport Scotland had provided CEC and TIE with comments on the draft Final Business Case in March 2007, so the issues with the draft Final Business Case that had concerned Transport Scotland had been identified. In April 2007 CEC and TIE produced a combined response to Transport Scotland's comments which addressed each of the issues that had been raised [**TRS00004273** to **TRS00004276**]. More importantly, by the time of the Final Business Case, the decision to make the £500 million available had already been taken. Had Transport Scotland intervened at that stage to say funding was not to be made available, that would have gone against the express will of the Scottish Parliament, as accepted by the Scottish Ministers. It was for that reason that it was appropriate for CEC, as project owner, to confirm that it was satisfied

[58] By the time the Final Business Case was approved, the EARL project had been cancelled, which meant that the tram would not be competing with heavy rail passengers travelling to and from Edinburgh Airport. This raised the BCR comfortably above 1: see Damian Sharp's witness statement at paragraph 102. The draft Final Business Case had assumed that EARL would go ahead; as a result, the business case had been described as marginal and sensitive to assumptions [TRS00003840, paragraphs 8 and 14].

with a Final Business Case that met the conditions precedent referred to above. That approach was consistent with the arrangements that had been put in place after Summer 2007.

55. The requirement for the successful completion of an OGC Gateway 3 Review also provided independent assurance that the Final Business Case was suitable [**CEC01562064**]. The remit of the Gateway 3 Review is set out in Appendix 1 to the Review, and includes:

- Confirm that the latest version of the full business case shows that the benefits plan is still valid
- Confirm that the objectives and desired outputs of the project are still aligned with CEC's vision for the project
- Assess the evidence provided by TIE to demonstrate that all the necessary procurement process requirements were followed throughout the procurement and evaluation process
- Confirm that the recommended decision for the Infrastructure Supplier, if properly executed within the planned suite of agreement, including the novation of the tram supply and design contracts and future interface with the operating contract, is likely to deliver the specified outputs/outcomes on time, within budget and provide value for money
- Confirm that there are plans for risk management, issue management and change management (technical and business), and that these plans are shared with suppliers and/or delivery partners.

Conclusion

56. There were, therefore, good reasons for withdrawing Transport Scotland from the TPB. As a result of the Scottish Parliament's vote, an unqualified commitment to funding had been made. As such, it was no longer Transport Scotland's role to approve the Final Business Case as a condition precedent of releasing the funding. At the same time, the funding cap meant that the

Scottish Ministers would not be liable for any cost overruns. A continued presence on the TPB would mean Transport Scotland participating in decisions for which they would not be accountable.

57. Until the elections in May 2007, Transport Scotland had adopted a partnering role during the development and procurement phases of the project. However, with funding confirmed, the project was entering a new phase. The decision to remove Transport Scotland promoted unambiguous role clarity. The need for Transport Scotland to continue to be represented on the Tram Project Board ceased in June 2007 following Parliament's decision that the Scottish Government's contribution would be capped at £500 million. With the funding confirmed it was appropriate that the governance arrangements were restructured to be consistent with the Scottish Public Finance Manual guidance on the management of grant agreements. To reflect this, Transport Scotland chaired a Quarterly Review meeting with CEC to oversee progress on the project. As Transport Scotland was neither the promoter of the project nor the client to the contracts it did not have the same oversight role for the trams project as it had (and has) for Scottish Government transport projects.

58. It was a decision that was, to an extent, supported by TIE[59] and was not met with any protests or complaints at the time.

[59] See Geoff Gilbert's statement [TRI00000038] at paragraph 203 (pdf76): "At the time, TIE looked at it as being a good thing that TS were not involved." See Damian Sharp's statement [TRI00000085] at paragraph 156 (pdf68).

CHAPTER 4: AUDIT SCOTLAND

Introduction

1. Audit Scotland featured in the evidence twice. It was first involved with the Edinburgh tram project when, on Mr Swinney's invitation, it produced a Report in June 2007 that reviewed the Edinburgh tram and EARL projects [**CEC00785541**]. Their second involvement related to the writing of an interim Report on the Edinburgh tram project in February 2011. Counsel to the Inquiry raised a number of issues regarding the Audit Scotland Reports, which the Scottish Ministers wish to address.

Suitability to carry out the 2007 Review

2. The question of whether or not Audit Scotland was suitable to carry out the 2007 review was raised by Counsel to the Inquiry. It is submitted on behalf of the Scottish Ministers that, in the particular circumstances, it was.

3. The project was already due to be reviewed by Audit Scotland, as part of a wider review. As is noted in paragraph 1 of the Report [**CEC00785541**], the Auditor General had, as at that time, made a commitment that Audit Scotland would undertake a review of major capital projects in Scotland in its then current work programme: "On that basis, the Auditor General agreed to bring forward a more focused review of Edinburgh trams and EARL as part of the

planned work."[1] Scrutiny of major capital projects was, or should have been, familiar territory for Audit Scotland.[2]

4. Moreover, and most importantly, Audit Scotland was completely independent of the tram project and EARL. The same could not be said of Transport Scotland. Although there may have been some advantages in Transport Scotland undertaking the review, in that it had greater familiarity with the project, that would have to some extent involved Transport Scotland scrutinising itself. Mr Swinney, in asking the Auditor General to carry out the review, was looking for "an objective opinion on the project" and a "dispassionate view" for the benefit of the Scottish Government and the Parliament.[3] Transport Scotland's lack of complete independence could have left the resulting report vulnerable to claims of bias. Indeed, there was a perception amongst some that the Audit Scotland report had been commissioned simply as means of providing evidence to support the "political" decision to stop the trams[4]; however, during the subsequent debate in the Scottish Parliament, the independence of the Auditor General was praised [**SCP00000030**, pdf14, 15].

[1] This is a point made by Mr Swinney in his statement [TRI00000149] at paragraph 72 (pdf25).
[2] Ibid. at paragraph 72 (pdf25).
[3] Ibid. at paragraphs 72 and 68 (pdf25 and pdf23).
[4] See the reference to Tavish Scott in the record of the parliamentary debate: SCP00000030, pdf14.

Timescale for production of the 2007 Report

5. So far as the timescale for the Audit Scotland report is concerned, this must be viewed in context. At the time of the Scottish elections, work in respect of utilities and design had commenced[5], but the outcome of the elections had put the whole future of the tram project in doubt. A decision confirming whether or not the project was to proceed had to be taken quickly, as everyone involved with the project needed to know where they stood and, among other factors, the MUDFA works were due to start in July and Parliament was about to go into recess for 2 months.[6] TIE had also expressed concern that the longer there was uncertainty as to whether the project would proceed, the greater the risk that potential contractors would become disillusioned with the project and it would lose key members of staff [**CEC00785541**, paragraph 67]. In Mr Swinney's view it "was a short timescale but it was a necessary timescale"[7].

6. Clearly, producing the report in 16 days must have been challenging for Audit Scotland, but there is no evidence to suggest that the Auditor General or those involved in drafting the report considered that they had too little time to

[5] Utilities works had been somewhat curtailed until the outcome of the elections: see Graeme Barclay's oral evidence (7 November 2017, page 9, line 14) and Andrew Malkin's oral evidence (7 November 2017, page 175, line 14). Counsel to the Inquiry suggested this was red herring in terms of delay on the basis that McAlpines said that there were no designs ready: see Graeme Barclay's oral evidence, 7 November 2017, page 68, line 4. See also paragraph 67 of the Audit Scotland June 2007 Report.
[6] See John Swinney's statement [TRI00000149] at paragraph 75 (pdf26).
[7] Ibid.

complete the requested review, which was to be “high-level”[8]. The audit used standard methodologies and the process of “triangulation”[9].

Change in governance after 2007 Report

7. The Auditor General concluded that the tram project had a “clear corporate governance structure”. The suggestion was made by Counsel to the Inquiry that, given the Auditor General’s views on governance, Transport Scotland did not need to, and perhaps should not have, changed the governance structure in August 2007. That suggestion is not accepted by the Scottish Ministers.

8. As set out in more detail in chapter 3, the decision to remove Transport Scotland from the tram project board was taken by the Cabinet Secretary after the vote in the Scottish Parliament.

9. It is true that Audit Scotland’s assessment of the governance of the project was based on a structure in which there was a Transport Scotland official on the TPB, but there is nothing in the Report to suggest that Audit Scotland was of the view that the presence of Transport Scotland on the TPB was a critical or even a necessary element of a good governance structure. However, as would be expected, the governance structures on the project were reviewed at key stages throughout, and changed to better suit the project management,

[8] See Graeme Greenhill’s statement [TRI00000041] at paragraphs 20 and 71 (pdf11 and pdf32).
[9] Ibid. at paragraphs 13 to 15 (pdf7 to pdf9).

risks and funding in place from time to time. Indeed, it had always been anticipated that the governance structure that had been put in place in August 2006, being that which was reviewed in 2007 by Audit Scotland, would require to be revised to execute the construction phase of the project [**CEC01758865**, pdf1].

2011 Report

10. In the 2011 Report, Audit Scotland notes the withdrawal of Transport Scotland from the TPB without adverse comment [**ADS00046**, pdf31, 38]. The 2011 Report goes on to note the following at paragraph 68:

> "The Office of Government Commerce (OGC), amongst others, has published a range of guidance on managing successful projects including the role of project boards. There is significant variability in the way project boards are constructed and the composition of individual boards must suit the circumstances of the project. The OGC has, however, defined three roles which should be represented on project boards [reference is made to]. The current membership of the TPB includes these three roles."[10]

11. It is not suggested that the absence of Transport Scotland from the TPB contravened the guidance issued by the OGC. Mr Greenhill confirms this in his statement[11]: of the elements of the tram project that Audit Scotland did look at, and at the points in the project when the Reports were published, he was of the view that the project reflected good practice guidance.

[10] This comment is made under reference to *Managing Successful Projects with PRINCE2*, OGC, 2009. The three roles per the 2009 Guidance is Senior Responsible Owner, Senior Supplier Representative, and Senior Users Representative.
[11] TRI00000041 at paragraph 94 (pdf42).

12. There is, therefore, no suggestion in the evidence before the Inquiry that Audit Scotland, having approved the governance structure in 2007, considered the removal of Transport Scotland from the TPB to be contrary to best practice or detrimental to the project.

13. On the section headed “Key issues for the project”, the 2011 Report says the following [**ADS000046**, pdf9]. :

> “Although Transport Scotland already monitors project spend, the Scottish Government has significant financial commitment to the project and it needs to consider Transport Scotland’s future involvement in providing advice and monitoring the project’s progress. In particular, if CEC decides that an incremental approach should be taken to delivery of Phase 1a, there may be implications for the conditions of the grant which would require to be considered.”

What is being recognised here is that, if CEC decided not to complete Phase 1a in its entirety, there would have to be discussions with Transport Scotland since such a decision would have implications for the grant conditions. It would, in fact, be a breach of the grant conditions.

14. The 2011 Report goes on say:

> “The Scottish Government should also consider whether Transport Scotland should use its expertise in managing major transport projects to be more actively involved and assist the project in avoiding possible further delays and cost overruns.”

This comment is not related to governance issues; rather, the suggestion of active involvement in project management is a pragmatic response to the fact that the Infraco contract that had become deadlocked.

Conclusion

15. So far as all those involved in the project were concerned, the vote in the Scottish Parliament, and its acceptance by the Scottish Ministers, materially changed the risk profile for CEC and Transport Scotland in relation to the costs of the tram project, and in particular the costs that would be incurred during the construction phase. The Scottish Ministers' unqualified commitment to provide the capped grant meant it was appropriate for Transport Scotland to discontinue its partnering role and to adopt the role of independent funder. To assist in achieving that clarity of roles, the Transport Scotland seat on the TPB was given up. There is no evidence to suggest that such a decision was contrary to issued guidance or that Audit Scotland's approval of the governance structures in place in early 2007 was dependent on the presence of Transport Scotland on the TPB. The evidence suggests otherwise, since there was no criticism of the decision to withdraw Transport Scotland from the TPB in the 2011 Report.

CHAPTER 5: REPORTING

Introduction

1. The nature, frequency and quality of reporting to Transport Scotland after Transport Scotland's withdrawal from the TPB in 2007 featured in the written and oral evidence of a number of witnesses. Counsel to the Inquiry explored the adequacy of reporting from both sides (TIE/CEC as the generators of the reports and Transport Scotland as the recipients).

2. While some concerns were expressed in the evidence about the quality of the reporting, it is the Scottish Ministers' position that any deficiencies in the reporting did not affect the Scottish Ministers' ability to perform their role, through Transport Scotland, as the major funder from August 2007 until after the change in the governance in 2011. Indeed, there was no evidence to suggest, and no such suggestion was made, that payments had been made to CEC that were not due under the terms of the grant conditions.

Formal reporting requirements

3. The requirement for information should be seen in the context of Transport Scotland's role after August 2007, where it had ceased to be a promoting partner and had instead become principal funder of the project. In its role as principal funder, Transport Scotland required information to ensure that the money advanced to CEC was being spent legitimately in accordance with the

grant conditions[1]. Transport Scotland also required information as a basis for providing advice to the Scottish Ministers on the progress of the tram project[2]. Transport Scotland did not, by contrast, need information to make, or contribute to, any executive decisions in relation to the tram project, given their withdrawal from its governance in 2007. The reporting requirements were aligned with the purposes for which such information was needed. It is submitted that, as the decision for Transport Scotland to withdraw from the governance was (the Ministers submit) justified, the reporting requirements were appropriately designed for Transport Scotland's role as the central government funder of the tram project.

4. The reporting regime after August 2007 was set out in the revised grant conditions [**TRS00004780** and **CEC00021548**]. The underlying principle, even before withdrawal, was that Transport Scotland did not seek, by means of grant conditions, to impose operational control on sponsored bodies, in this instance CEC and its delivery agent TIE[3]. The reporting regime from 2007 required CEC to comply with Transport Scotland's standard reporting procedure.[4] In short, the regime included (i) a four-weekly report in

[1] Ainslie McLaughlin's oral evidence (26 September 2017, page 159, line 18); Bill Reeve's oral evidence (27 September 2017, page 94, line 23).
[2] John Ramsay's statement [TRI00000065_C] at pdf 36.
[3] Bill Reeve's oral evidence (27 September 2017, page 64, line 5).
[4] The first "Promoter Team Period Progress Report" was produced in April 2007 to comply with the terms of the March 2007 grant conditions [TRS00004182]. As is set out in the January 2008 grant conditions, this original reporting pack was adapted for use under the new grant conditions as "Delivery Organisation Period Progress Reports". See TRS00011006, pdf33: "The template has been designed for Promoter Reporting from Period 1 (FY 07/08) i.e. 1st April 2007 onwards."

accordance with specified templates in Annex 2 to the Schedule to the grant conditions (which included Project Financial Summaries[5]), followed by a four-weekly regular meeting between representatives of Transport Scotland and CEC; and (ii) a quarterly meeting of senior managers from Transport Scotland and CEC, subsumed into quarterly review meetings. In terms of the grant offer, CEC was obliged to ensure that CEC and TIE took all reasonable steps to provide information comprehensively and timeously when requested by the Scottish Ministers [**CEC00021547**, paragraph 16.1, pdf13].

Use of Transport Scotland reports as briefings for the TPB

5. While the reporting obligations, under the revised grant conditions, were incumbent on CEC as the beneficiary of the funding, it is clear that the information reported to Transport Scotland ultimately originated in TIE and was being passed to Transport Scotland by CEC. Indeed, the reports prepared for Transport Scotland also formed part of the standard papers produced by TIE to the TPB ahead of TPB's monthly meetings.[6] They thus served a double function: (a) compliance with CEC's reporting obligations to Transport Scotland, and (b) providing a means of conveying information to the TPB. Accordingly, the TPB knew what was being reported to Transport Scotland. None of the TPB members expressed any concerns, either at the

[5] The reporting packs were accompanied by Project Financial Summaries, which were in an agreed form as set out in the January 2008 grant conditions. An example of Project Financial Summary can be found at TRS00010497.
[6] See John Ramsay's statement [TRI00000065] at pdf53 and TIE00896978 as an example. Richard Jeffrey confirmed this: 8 November 2017, page 45, line 9ff.

time or in their evidence to the Inquiry, that the reports being given to Transport Scotland were not accurate or complete.

6. Counsel to the Inquiry explored aspects of the reports for Transport Scotland, with particular reference to adjudication decisions and the recovery programme, both with John Ramsay of Transport Scotland and with Richard Jeffrey of TIE. If the reporting to the TPB is perceived to have been inadequate because of the incorporation of the reports addressed to Transport Scotland, that should not be taken to mean that they were inadequate for Transport Scotland's purposes, even if they did not comply in all respects with Transport Scotland's format requirements. Transport Scotland and the TPB were playing very different roles in the project.

Informal reporting

7. In addition to the formal reporting in terms of Annex 2, there was evidence before the Inquiry that, in practice, informal channels of communication also existed between Transport Scotland and CEC/TIE. These channels were used by Transport Scotland to obtain additional information or "intelligence" on a regular basis as a supplement to formal reporting. The purpose was to understand better the information contained in formal reports, and to keep abreast of developments which were relevant to Transport Scotland's role after 2007. They were also used to keep up to date on particular urgent

developments, such as the resolution of the Princes Street dispute in February and March 2009.

8. There were also occasional meetings and/or telephone discussions between Ministers with a portfolio interest in the tram project, John Swinney and Stewart Stevenson, and senior officials from CEC and TIE, including in relation to particular crises, such as the Princes Street dispute in early 2009. It is submitted that the use of such informal reporting was, in the circumstances, a legitimate practical necessity. The tenor of the evidence from those witnesses who were involved in such informal reporting, whether as providers or as recipients of information, was that it was helpful in filling information gaps. The fact that there are, as Counsel to the Inquiry noted, limited records of such informal reporting no doubt reflects the urgency with which the meetings and discussions took place and the restricted scope for all informal exchanges of that kind to be minuted, rather than any desire not to record them.

Concerns over quality of weekly reporting

9. Four-weekly reports were submitted to John Ramsay at Transport Scotland, who also met with CEC representatives at four-weekly meetings. Mr Ramsay, as the primary initial recipient of the relevant information on behalf of Transport Scotland, needed to understand the position quickly in order to brief senior colleagues and to advise the Ministers. It is not surprising, therefore,

that he was the witness who was most critical of some aspects of the formal reporting to Transport Scotland. It is notable that, despite his criticisms, Mr Ramsay nevertheless considered that the reporting requirements on CEC, as they were put into practice, met the needs of Transport Scotland and were consistent with Transport Scotland's change in role in relation to the project in 2007.[7] His concerns focused on how those reporting obligations were in fact being discharged from his point of view as the recipient of the four-weekly reports. When Mr Ramsay was asked to identify any hypothetical extra controls to protect the Scottish Ministers' position after 2007, he did not refer to any additional reporting requirements, or any powers better to enforce the reporting requirement already incumbent on CEC.[8]

10. Mr Ramsay's evidence on this matter touched on a number of themes. The quantity of information was not matched by its quality. It was sometimes open to easy misinterpretation[9] or wrong[10]. There were barely any changes month after month to some items, even though it was apparent, from other sources, that there had been relevant developments. Commercial sensitivity

[7] John Ramsay's oral evidence, 28 September 2017, page 40, line 19 to page 41, line 5.
[8] In terms of the 2008 grant conditions [TRS00011006], it was an Event of Default for CEC to give any fraudulent written information (clause 13.1(a)) or to agree a Cure Plan in response to a Cure Notice (clause 13.1(e)). In terms of clause 13.2.1, the Scottish Ministers could issue a Cure Notice in response to a failure "to supply the Reports and comply with the Application procedures".
[9] Stewart McGarrity confirmed that different figures were being reported to Transport Scotalnd rather than to CEC because these were the approved risk allowance, rather than highly uncertain scenario planning: 14 December 2017, page 95, line 17. Richard Jeffreys in his oral evidence agreed that the headlines were not reported in the requested format and the milestones were presented in an unclear and confusing manner: 8 November 2017, page 48, line 2.
[10] See email from Tom Hickman to Susan Clark dated 16 November 2008 [TIE00248213].

was the perceived reason for TIE's reluctance to be more forthcoming with information, but in Mr Ramsay's view this led to the monthly reports being out of step with the actual progress and discussions between parties. In any event, there was no evidence of any leaks of commercially sensitive information by Transport Scotland or its framework consultants. In relation to adjudications between TIE and BSC, the reports did not allow Transport Scotland to assess the impact of the outcomes of dispute resolution procedures on the anticipated final cost and the expected open for service date for the tram network.

11. In the light of those concerns, it is quite understandable that Mr Ramsay was perceived within TIE, by Richard Jeffrey and David Mackay, as a difficult person who was asking impossible questions. However, what it demonstrates is that Mr Ramsay was aware of potential shortcomings in the information he was receiving and was taking steps to address them. In that regard, it should be recalled that, in terms of condition 8.2 of the Grant Conditions [**TRS00011006**, pdf6], CEC was obliged to "supply and procure that TIE shall supply to the Scottish Ministers such documents and information which they may reasonably require in connection with the Grant and the Project". If Mr Ramsay considered he required further information in order to give context to or supplement the information contained in the four-weekly reports, he was perfectly entitled to ask for that information, however irritating those requests may have been to CEC and TIE.

Legal advice

12. John Ramsay in his witness statement refers to a "report" obtained by Dundas & Wilson in 2009.[11] The context for the advice was the "hundreds of claims" made by BSC, "a very public dispute about Princes Street" and the Princes Street Supplemental Agreement (PSSA).[12] The reason for getting the advice was a concern that the Scottish Ministers, as principal funders, might be exposed. Mr Ramsay recounts in his statement that, "The subsequent report from Dundas & Wilson advised us that, while their view was that the Infraco contract that had been let was not fit for purpose, there was no apparent exposure for Scottish Ministers."

13. The letter of advice from Dundas & Wilson was dated 15 June 2009 [**TRS00031282**]. The advice noted that a "brief review of the Infraco Contract" had suggested that "although it contains extensive Dispute Resolution Procedures, [the form of the contract] may tend to encourage disputes". Beyond that, however, the advice focussed on the legal effects of the PSSA rather than providing any analysis of the fitness for purpose or otherwise of the Infraco contract.[13]

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[11] TRI00000065, pdf41.
[12] TRS00031282, pdf1.
[13] Notably, the advice does not make any comment on the provisions of the Infraco contract which subsequently proved most problematic, i.e. Schedule Part 4 and pricing assumptions. The advice gives no basis for concluding who, TIE or BSC, may have been correct in the arguments they maintained with regard to the proper construction of those provisions, in 2009 or subsequently.

14. Mr Ramsay revisited the Dundas & Wilson advice in the course of his oral evidence.[14] He explained that he had not asked Dundas & Wilson to consider whether the Infraco contract was fit for purpose but they had taken the opportunity to do so. However, as noted above, when the terms of the advice given by Dundas & Wilson are considered, it did not contain any comment on whether or not the Infraco contract was fit for purpose. Rather, after a "brief review", it identified that the contract might encourage disputes. That the contract "might encourage disputes" would have been apparent from the fact that there were already "literally hundreds of claims".

15. Later in his oral evidence, Mr Ramsay identified a specific feature of the PSSA – that it brought about a move from a fixed price contract to one in which there was no fixed price element – as being an example of the PSSA, as opposed to the Infraco contract, being not fit for purpose.[15] There is some uncertainty, therefore, on the evidence before the Inquiry, whether Mr Ramsay's evidence reflects, by way of a gloss, Mr Ramsay's understanding of Dundas & Wilson's advice on the Infraco contract or Dundas & Wilson's advice on the PSSA. Either way, the Scottish Ministers had not received from Dundas & Wilson definitive or formal advice on the fitness for purpose of the Infraco contract. Had definitive advice to this effect been given, it would have been recorded in writing and circulated within Transport Scotland. In this regard, it is a matter of note that there is no record whatsoever of Mr Ramsay

[14] 27 September 2017, page 222, line 24ff.
[15] 27 September 2017, page 228, line 23.

having been advised in 2009, formally or otherwise, that the Infraco contract was, in some (unspecified) way, not fit for purpose.

16. In the SETE submissions intimated on 27 April 2017 at page 74, some reliance is placed on the Dundas & Wilson advice. The entire paragraph, from which SETE quotes parts, is in the following terms:

> "A brief review of the Infraco Contract suggests that the form of contract, although it contains extensive Dispute Resolution Procedures, may tend to encourage disputes. In particular the Change Mechanisms seem to be derived from and may be more appropriate to a PFI/PPP structure rather than a traditionally funded major infrastructure project. The provisions relating to Change and the strict time limit encourage notification of Changes which if not accepted may create a hostile atmosphere and divert management from the important task of delivery."

It is suggested that this advice contradicted certain (unidentified) advice that TIE had received from DLA. It is also suggested that, had the advice been made available to TIE/CEC, "coming as it did immediately prior to the period in which TIE engaged in a number of DRPs under the contract, it is reasonable to assume that this advice … may have had a significant impact on TIE/CEC strategy". What impact the advice may have had on TIE/CEC strategy is not identified and, tellingly, no attempt is made to identify what it is about the content of the advice that may have had a "significant impact". The advice offers no commentary on the proper construction of the contract and contains no commentary on the Dispute Resolution Procedures other than noting that they are "extensive". The Scottish Ministers submit that the assumption the Inquiry is invited to make by SETE is entirely without merit and lacking in any evidential basis, and should be disregarded.

Conclusions

17. Despite the concerns on Mr Ramsay's part about the quality of reporting to Transport Scotland, there was no evidence, either from the Transport Scotland witnesses, or from Mr Swinney and Mr Stevenson, to suggest that there was any particular issue on which, as a result of the perceived weaknesses in CEC's reporting, Transport Scotland or the Scottish Ministers had acted under a material error. There was no evidence to suggest that money had been paid out that was not due under the grant conditions. And, finally, there was no evidence as to how Transport Scotland or the Ministers would have acted differently, at any time after the withdrawal in 2007, if the formal reporting had not contained the defects which were suggested to exist by Counsel to the Inquiry.

CHAPTER 6: THE STIRLING ALLOA KINCARDINE RAILWAY PROJECT

Introduction

1. The Inquiry has heard some evidence in relation to the Stirling Alloa Kincardine Railway Project ("the SAK project"). Understandably, in the context of an inquiry about a different project, there was little detail in the evidence about precisely how the project developed over time, what problems it faced and the reasons for TIE's removal from the project. Nevertheless, this chapter considers what evidence there was. There may have been a suggestion in some of Counsel to the Inquiry's questioning that, having removed TIE from the SAK project, the Scottish Ministers ought not to have funded the tram project, or should have taken some other unspecified action, knowing that TIE were being entrusted by CEC to deliver it. That suggestion is not accepted by the Scottish Ministers, for the reasons set out in this chapter.

TIE involvement in the SAK project

2. The SAK project was being delivered on behalf of Clackmannanshire Council. Initially, TIE was not involved, but after the project had run into difficulties TIE undertook a management role on behalf of the Council.[1] According to Steven Bell, a project manager from TIE was allocated to support the Council. He summed up TIE's role as follows:

[1] Malcolm Reed said that he thought TIE became involved to operate a management contract on behalf of the Council: 28 September 2017, page 181, line 11.

> "The governance arrangements and approach in relation to tie's input was to report on the emerging difficulties and propose or comment on the entitlement under the contract, which I think was an NEC contract for the contractor to make his claim. And to support Clackmannan Council to ensure there was a fair valuation of any such claim."[2]

3. Some details about the history of the SAK project can be found in the Audit Scotland report entitled, "Review of Major Capital Projects in Scotland: How government works" [**CEC01318113**]. The report dates from June 2008 and notes that Jacobs Babtie, a firm of contract management consultants, was retained by the Council to oversee construction work and was later the nominated project manager for the contract. TIE is described as providing "project management services to the council, overseeing the contracts with Jacobs Babtie and First Nuttall as the council's agent, and managing contacts with Network Rail and others". So far as the Audit Scotland report is concerned, the relationship between Jacobs Babtie, as the Council's project manager, and TIE, as provider of the project management services, is not explained.

4. The evidence before the Inquiry indicates that many of the problems facing TIE had been inherited from the earlier management regime[3], and related to emerging disputes related to ground conditions[4]. Alex Macaulay confirmed in his witness statement and his oral evidence that TIE were brought into the SAK project at a late stage and that many of the of decisions that resulted in

[2] See Steven Bell's oral evidence, 24 October 2017, page 11, line 4ff.
[3] This point was made by Damian Sharp in his oral evidence, page 108, line 15.
[4] Steven Bell's oral evidence, 24 October 2017, page 10, line 3ff.

increased costs had already been taken.[5] From the papers submitted to the TIE Board, it would appear that a “major setback” arose at the start of 2007 in relation to the contractor’s progress with the signalling design.[6] The effect of that setback on costs and programme was not explored in the evidence before the Inquiry.

5. The Audit Scotland report notes that, “In June 2007, because of a range of concerns about the project, Transport Scotland took a direct role in the project management on behalf of the Council and commissioned a technical audit. The resulting audit report revealed project liabilities significantly greater than previously reported.” New arrangements were put in place in terms of which TIE was removed from the project and Transport Scotland took over the “day-to-day project management” in August 2007. The Audit Scotland report does not identify what role the previous project manager, Jacob Babtie, played in the new arrangements.

Implications for the tram project

6. Bill Reeve was asked whether the removal of TIE from the SAK project gave rise to any concerns about TIE’s ability to deliver a large infrastructure project.[7] Mr Reeve explained that the problems on the SAK project “were different in nature to the things we were seeing on the tram project at the

[5] See Alex Macaulay’s witness statement [TRI00000053] at paragraph 65; see also his oral evidence on 6 October 2017, page 91, line 8ff.
[6] USB00000028, pdf4 and CEC01676326, pdf5-6.
[7] This paragraph and the next is derived from Mr Reeve’s oral evidence on 27 September 2017, from page 20, line 19 to page 39, line 4.

time." He explained that the context of the SAK project was different in that it involved delivering an asset on behalf of Network Rail, which was refusing at the time to become involved in rail enhancement projects, having taken over from the failed Railtrack. As a result of Network Rail's refusal to become involved, the Scottish Executive looked to an alternative body to take the project forward and it was for that reason that TIE became involved. However, as matters evolved, it was considered that Transport Scotland should be involved since it had statutory powers that TIE did not. As Mr Reeve explained:

> "Transport Scotland had just been established, with newly devolved statutory powers in relation to the rail industry, the heavy rail industry in Scotland, and Network Rail included within that, and it seemed appropriate in the light of the difficulties on the Stirling-Alloa-Kincardine project to take account of our new existence, the powers that we had, the working relationship we were developing with Network Rail, and to simplify those project arrangements."

7. Mr Reeve also referred to the Audit Scotland's 2007 Report on the tram and EARL projects. The positive conclusions that Audit Scotland reached on the state of the tram project "accorded with our own judgement at the time". Mr Reeve went on to explain:

> "I think our observation was that the level of engagement [in the tram project] was different and the priority attached by tie to the tram project was different than that of Stirling-Alloa-Kincardine. So I think the tram project was exactly the sort of project that tie had been set up to deliver, whereas the Stirling-Alloa-Kincardine project was an add-on; and I think actually we saw some advantages in tie not being distracted by other heavy rail projects to allow it to focus on the principal project it was established for, which was the tram project."

8. Malcolm Reed addressed the SAK project in his statement at paragraphs 99 and 100.[8] His recollection was that the problems with the project included supply chain weaknesses and issues of cost control, and project management failures by the contractor. "Consequently, there was a concern, not specifically about the TIE input, but about the overall effectiveness of the governance arrangements for SAK."[9] In his oral evidence, he explained that he had no general concerns about TIE but he did have specific concerns about the role TIE was playing in the SAK project.[10]

9. Damian Sharp expressed the view that TIE had inherited many of the problems with which it was faced during its tenure, and that the real issue was a tendency by TIE to under-report problems on the SAK project.[11] However, Transport Scotland did not have the same concerns at the time in relation to the EARL and the tram project.[12] Steven Bell, in his oral evidence, agreed that Mr Sharp had raised issues about TIE's reporting on the SAK project, but these were then addressed[13].

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[8] TRI00000066, pdf46.
[9] This point was repeated in his oral evidence on 28 September 2017, page 180, line 21: "it was the whole governance structure, not just TIE's role, that was causing us concern."
[10] Page 181, line 1ff. Audit Scotland identified the increase in costs in the SAK project as being due to *inter alia*, "Weak project governance and mis-aligned roles and responsibilities" [CEC01318113, pdf23].
[11] See Damian Sharp's oral evidence, 5 October 2017, page 108, line 23.
[12] Ibid., page 117, line 17. The individual reporting on behalf of TIE to Transport Scotland in respect of the SAK project was Richard Hudson, who did not feature in the tram project.
[13] 24 October 2017, page 12, line 7ff.

10. Tom Aitchison had no recollection of concerns being expressed over TIE's role in the SAK project and cannot recall anyone raising it with him as an issue.[14]

11. Audit Scotland summarises in its 2008 Report what it considered to be the cause of the cost overruns on the SAK project:

> "Increase in the scope of the project and underestimating of costs at appraisal and outline design. Weak project governance and mis-aligned roles and responsibilities." [**CEC01318113**, pdf23]

12. As far as the evidence discloses, TIE would not have been involved in estimating costs at the appraisal and outline design stage of the project. So far as project governance is concerned, this reflects what Malcolm Reed said in oral evidence to the effect that he did not feel there was "any alignment of interest" between TIE and Transport Scotland.[15]

Conclusion

13. The nature of the SAK project and the role that TIE played in it were sufficiently remote from TIE's involvement in the tram project that Transport Scotland did not consider what had happened there rendered TIE unsuitable to deliver the tram project. There was no basis in the SAK project for the Scottish Ministers to refuse to fund the tram project, or insist that TIE also be removed from it, had that even been possible.

[14] See statement [TRI00000022] at paragraph 266 [pdf89].
[15] 28 October 2017, page 181, line 5.

TIE was acting as a third party consultant in the SAK project, whereas in the tram project it was acting as CEC's delivery agent. As such, it had the power to recruit whatever expertise was required in order to deliver the tram project. TIE's role in the SAK project was quite different.

CHAPTER 7: FINAL CONCLUSIONS

Introduction

1. In his Note to Core Participants of 15 March 2018, the Chairman of the Inquiry stipulated that each Core Participant's written submission should provide a reasoned statement, vouched by their interpretation of the evidence, indicating what the Core Participant considers to have been the cause(s) for the delay, increase in cost and other failures of the project and who was responsible for, or contributed to, such delay, increase in cost and other failures. Whilst it is, of course, ultimately for the Inquiry to determine these matters, the Scottish Ministers offer the following observations.

No single cause

2. The Edinburgh tram project was a major and highly complex undertaking. As several witnesses pointed out, fitting a tram system into a world heritage site was never going to be easy. In the view of the Scottish Ministers, the difficulties encountered by the tram project were not due to a single point of failure but rather a series of factors which cumulatively led to the project running significantly over budget and time.

Identified risks

3. One notable feature that emerges from the evidence is that the risks that eventuated during the delivery phase of the tram project had been identified

during the development and procurement phases. For instance, the following major risks had been identified to a greater or lesser extent by TIE[1], CEC[2], Transport Scotland[3] and the OGC[4] before Financial Close:

- An ineffective novation of design risk to Infraco
- The potential for changes in scope, design and specification to have very significant impacts on the deliverability of the project
- Delays in the design and approvals processes
- The need for third party consents
- Delays in the MUDFA works, especially where ground conditions were not well known and utility records are poor
- The impact that delays in utility diversions would have on the programme
- Delays to the MUDFA works brought about by the need to get utility companies' cooperation
- The potential that the MUDFA works would require to be redone if the swept path did not coincide with the finalised design

4. Although strategies were put in place to manage these risks, the combination of a failure to implement the procurement strategy, a disadvantageous (from CEC's perspective) contract and an apparent lack of effective management gave rise to circumstances where CEC was forced, in effect, to start afresh with the project after the Mar Hall agreement with a revised contract and a new project management team.

[1] CEC01821403 (Draft Final Business Case); see also the Principal Risk Register that was included as part of the TPB papers.
[2] CEC02083466
[3] TRS00004145
[4] CEC01496784

Procurement strategy

5. The Scottish Ministers have already made submissions in relation to the failure by TIE to properly implement the chosen procurement strategy. In summary, the de-risking strategy was intended to bring about two key outcomes: (i) a fixed price contract in which the price was not inflated with the inclusion of large provisions for unquantified risks; and (ii) the substantial completion of MUDFA works to provide programme certainty. Neither outcome was achieved. Despite indications that the procurement strategy should be put on hold to allow design and MUDFA works to catch up, no such decision was made.[5]

6. TIE was essentially seeking a design and build fixed price contract but, in doing so, failed to provide BSC with sufficient information to allow it to accept design risk[6] to the extent that the procurement strategy had required. Although the Infraco contract was notionally fixed price, this was only achieved by introducing a range of pricing assumptions in Schedule Part 4. The most important of these was pricing assumption one which BSC had introduced and on which it came to rely.

7. The evidence from the TIE witnesses was that it was their view that pricing assumption one achieved the required transfer of design risk. Be that as it

[5] Trudi Craggs' oral evidence, 6 October 2017, page 106, line 2 to page 108, line 2.

[6] For example, it is unsurprising that bidders refused to offer a fixed price in circumstances where (a) TIE had not produced a final foundation design, and (b) there was insufficient ground information available to allow bidders to price the foundation design risks.

may, BSC clearly took a diametrically opposed view on the correct interpretation of the pricing assumption and how it should be applied in practice. Given the manner in which pricing assumption one is drafted, it is perhaps unsurprising that it gave rise to more than one interpretation. But, given the fundamental role it played in relation to design risk transfer, it was inevitable that pricing assumption one would come under close scrutiny. Both sides formed their views, and entered multiple DRPs, on the basis of legal advice and the fact that it became highly contentious was probably inevitable.

8. BSC's interpretation of the pricing assumption, if correct, put TIE into a very weak position. It meant that TIE would be taken to have novated the unfinished design over to BSC, who then had control over the design and its development. But BSC would, at the same time, be required to warrant that that finished design was fit for purpose, so changes made to the design to achieve that standard would be at TIE's risk. If right, this would mean that the insertion of Schedule Part 4 in effect changed the contract from a "Fixed Price" contract to a "Design and Re-measurable" contract.

9. Another important aspect of the procurement strategy was the need to complete advance MUDFA works. TIE appears to have failed to understand the criticality of the civil engineering element of the project and, as a consequence, the delivery timetable was never realistic. TIE did not allow itself sufficient time to assess the risks, nor how to properly plan to mitigate

those risks, before entering into the Infraco contract.[7] The programme that TIE was promulgating in the run-up to Financial Close had very little float and assumed a "right first time and on-time" delivery of activities.

10. Although the civil engineering element was relatively straightforward from a technical standpoint it was nevertheless complex in terms of the logistics of working on a live road network with significant uncertainties associated with utility diversions and ground conditions. However, even where TIE did attempt to de-risk the contract by completing advanced MUDFA works, it did so on the basis of a conceptual foundation design that had not been completed and was not based on an adequate understanding of the ground conditions. As a result much of the diversion worked proved nugatory when the final design was determined, adding significantly to the cost and delays that subsequently transpired.

11. The debate about which should have been completed first, the MUDFA works or the design, is relevant. In all cases, the design should have been completed first. This would then determine what utilities need to be diverted, to what extent and the associated costs. If it was found to be too expensive or time consuming to divert the utilities, then at that point the design should have been looked at again to see if it could be amended to mitigate the

[7] In that regard, it should be noted that there was no evidence to support the suggestion that, if the Infraco contract was not entered into when it was, the Scottish Ministers would withdraw funding. This point is accepted in CEC's submission intimated on 27 April 2018 at paragraph 4.9 on page 149.

amount of diversion works required. During the course of the project, this approach did not appear to have been undertaken by TIE or the utility companies.

Form of Contract

12. The decision to use a bespoke contract, as opposed to a standard form contract, may also have exacerbated matters.[8] Generally speaking, standard form contracts are well understood. While the use of a standard form contract does not ensure a project will be dispute free, there is usually sufficient understanding of how such contracts operate that disputes on fundamental issues of interpretation do not arise.

13. In respect of the Infraco contract, the evidence has demonstrated two aspects in which the drafting of the bespoke Infraco contract had a direct effect on the success of the tram project. The first is the terms of Schedule Part 4 and, in particular, the design pricing assumption. This has been discussed above.

14. The second relates to the terms of Clause 80. There appears to be some dubiety about the genesis of Clause 80, but its effect was significant, as noted by Andrew Fitchie:

> "This revised draft [of Clause 80] removed the ability to instruct works under a Notified Departure to proceed until BBS's estimate of the fees had

[8] See, e.g., Duncan Fraser, 12 September 2017, page 9, line 11.

been agreed or, if not agreed, referred to the Dispute Resolution Procedure ("DRP")."[9]

15. The combination of the pricing assumptions in Schedule Part 4 and the terms of Clause 80 meant that a disgruntled contractor would have the ability to stymie all progress and this is what appears to have happened when the project completely ground to a halt in 2010.[10] Of course, had relations between TIE and BSC been better and a more collaborative approach taken, then the strictures of the contract may have been dispensed with. However, the point is that the drafting of the Infraco enabled BSC effectively to hold CEC to ransom. In this regard, there was some evidence to suggest that Bilfinger Berger may have underpriced the contract and had adopted a strategy of seeking a price increase through variations, but the Scottish Ministers are not in a position to say whether or not that is accurate.[11]

16. Another aspect of the Infraco contract that may have been causative of delay was the misalignment that existed between SDS design, the Employer's Requirements and Bilfinger Berger's proposals for civil works. Had there

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[9] Andrew Fitchie's statement [TRI00000102_C_29] at paragraph 2.155 (pdf30).

[10] A note prepared by Colin Mackenzie and Nick Smith in April 2009 [CEC00900405] discusses the DRPs. The conclusion was: "It now appears that the contract terms which tie negotiated are capable of manipulation to an extent by BSC… Given that design etc were not complete, it was perhaps inevitable that assumptions would have to be made and that there would therefore always be scope for argument."

[11] PBH00035854. Discussed by Steve Reynolds, 11 October 2017, page 52, line 12 to page 57, line 22.

been better alignment, there would have been fewer Notified Departures and changes to the contract price post contract award.[12]

Failure of leadership

17. CEC was ultimately responsible for the project as project owner. The funding cap that Ministers imposed was, in part, intended to encourage CEC to "step up to the plate" and take responsibility for the project. However, CEC did not provide clear leadership and effectively abrogated responsibility for taking critical decisions to TIE. This is most clearly evident in the decision to award the Infraco contract. It was clear that there had been extended post-tender negotiations between TIE and the contractor which had resulted in an increase in price and adjustments to the contractual risk profile. That might have been expected to ring alarm bells of itself but yet there was no rigorous challenge or testing by CEC of TIE's recommendation to award the contract.

18. Indeed, in the run-up to contract award, a number of the "B team" raised "red flags", recommending steps be taken to protect CEC's position. The following are examples of the red flags:

- Duncan Fraser emailed Andrew Holmes on 23 August 2007 stating that external resources were required to consider the bespoke Infraco contract and whether it succeeded in transferring risk [**CEC01567522**, pdf4].
- Colin Mackenzie emailed Gill Lindsay suggesting that it may not be in CEC's best interests to instruct DLA along with TIE [**CEC01567522**, pdf2].

[12] Scott McFadzen's oral evidence, 14 November 2017, page 165, line 24 to page 166, line 12.

- Nick Smith was directed, but then refused, to review the draft Infraco contract, on the basis he did not have adequate time or experience of such contracts [**CEC01567527**, **CEC01564795**].
- In September 2007 CEC drafted instructions for Turner and Townsend to review, amongst other things, the proposed risk allocation under the draft Infraco contract, but no such instructions were ultimately issued [**CEC01652669**].[13]
- Duncan Fraser emailed Andrew Holmes in November 2007 to point out the extent to which design work was behind schedule and suggesting a risk premium might be required [**CEC01383667**].
- Appendix 3 to the Highlight Report for the IPG meeting on 11 December 2007 reflected "collective view of the B team". It raised a number of issues that were still to be resolved and queried whether the Council was "well informed enough at this stage in proceedings [and] whether a report [to Council] on the 20th December 2007 is appropriate given the outstanding issues." [**CEC01398245**, pdf97]
- Nick Smith emailed Gill Lindsay on 22 January 2008 suggesting that DLA should confirm that CEC will only be required to pay compensation for late design approvals in a limited set of circumstances [**CEC01395085**].
- The letters from Andrew Holmes to Willie Gallagher dated 28 March and 3 April 2008 expressing extreme disappointment in TIE's failure to ensure that SDS had completed all the prior approvals prior to the bidding process [CEC01493318 and CEC01493639]
- Emails passed between the B team on 10 and 11 April 2008 identifying risk arising from the failure to obtain prior approval for the Russell Road Bridge [**CEC01401109**]. The perception was that CEC was being backed into a corner and that the £3 million allowance for SDS might be used up almost immediately on the Russell Road Bridge.

[13] See also the Notice in the Official Journal for consultancy services to review the contract dated September 2007 [TIE00678245].

- CEC00906940 – Report by CEC Chief Executive for Financial Close May 2008
- The terms of the draft Report on Terms of Financial Close in the email dated 2 May 2008 which queries at item 8.4 TIE's assessment of risk in relation to delay with consents and approvals. There, it is commented, "Given delay to date it is foreseeable that further delay could have major cost impact" [CEC01222041, pdf4].

19. These red flags were not acted on. The Scottish Ministers do not go so far as to suggest that, if any single one had been, the tram project would not have encountered the issues that it did. However, when looked at in the round, these red flags show that there was real disquiet within CEC about the overall direction of travel. The procurement strategy, and the associated de-risking, was not going to be achieved, yet CEC proceeded anyway.

20. Duncan Fraser provided a clear summation of the issues that concerned him as Financial Close approached:

> "I have explained the context of my role as co-ordinating the legal, financial, and particularly the technical aspects of the tram. And to that end, I thought it was important that in my liaison with my directorate and decision-making group that I had a role to raise issues which I thought were for them to consider so they can make informed decisions.
>
> One particular concern -- and I think we all shared this -- was the importance of getting the funding right and the budget right, and looking at matters that may affect that. So there were some concerns because the original intention of the fixed price contract was to have all the utility works completed and all the design work approved. This turned out not to be the case, and while there was substantial completion of MUDFA, there was still some critical issues where there was potential for delaying the Infraco contract.

With regard to the technical approvals, I would argue they were substantially incomplete -- we can go into that in more detail, but perhaps less than 10 per cent. In the context of the fixed price contract, that has high significance in terms of risk and risk transfer.

And the fixed price contract, the concept is for the risk to be transferred to the contractor. Now, that is true in as far as the scope that is set out for the subcontractor is clear and concise, and on which the contractor then prices the fixed price element of that contract… However, what this also means is that from the employer's point of view, the person letting the contract, the risk transfers to them if you have preliminary sums, provisional sums, and you vary the contract. And this is important because you will pay much more for instructing work later than the scope of work that was assumed when the contract was entered into. And the primary concern there is delay and disruption.

Now, we were conscious that at the time of the letting of the contract, that the contractor had to rely upon the preliminary design -- outline design -- and a very small element, less than 10 per cent, of the detailed design. So it seemed as if to me the scope change could be argued.

Secondly, we were using a form of fixed price contract that hadn't been used before and therefore terminology within the contract had never really been tested in terms of contract law. We know that there was a general agreement -- there is no dispute that there was a delay in the technical approvals. But we also know there were substantial changes being made through the approvals process, so the designs were changing significantly to get to a point of approval.

Disruption, on the on-road section, if I could explain, and maybe it seems obvious but it is worth stating, is that when we are in a live city centre, it was very, very important that we kept the traffic running as freely as possible while accepting there is going to be some disruption. The relevance of that is that should there be a programme of works that was disrupted by designs not being available to be constructed, this could have a very significant influence on the contractor's programme and it could be severely disrupted.

> Now, sometimes we can accelerate the work, but that isn't an easy option here, because you couldn't have more than a couple of sections on-road going, to allow the other sections of the road to facilitate the traffic movements in the city. So it was seen as a very sensitive matter if there was any delay or disruption. So my intention was just to highlight to the directorate and Tie, the importance and significance of any changes that would occur during the contract period."[14]

While it is clearly a matter for the Inquiry, Mr Fraser's analysis would appear to provide a clear insight into fundamental issues concerning risk that came to beset the project.

Programme and contract management

21. CEC chose to rely heavily on TIE to deliver the project; however, it appears that TIE failed to put into place the resources and internal management structures required to run a complex infrastructure programme on the scale of the tram project. There was an apparent failure to manage the programme, something that is of particularly importance when delivering civil works in a complex environment. TIE's senior management also appear to have failed to put into place proper mechanisms to assess risk and encourage critical challenge. There was little evidence to suggest that TIE demonstrated credible expertise in managing challenging commercial negotiations and relationships.

[14] Duncan Fraser gave a very useful summary of contractual and programming issues in his oral evidence: 12 September 2017, page 5, line 19 to page 10, line 13.

22. Once the contract was underway, and despite the transferal of risk back to CEC for design changes, TIE continued to represent and operate the contract as though it was a fixed price contract. This set the tone for the contract and soured relationships between CEC, TIE and BSC which ultimately contributed to the contractual disputes spinning out of control.

23. The difficulties were exacerbated by incomplete utility records and the fact that the tram works were to undertaken on busy streets.

Transport Scotland's role

24. It is the Scottish Ministers' submission that there is no credible evidence to suggest that the withdrawal of Transport Scotland from the TPB had any direct or indirect consequences in terms of costs and delay for the project. The reasons for Transport Scotland's withdrawal from the TPB and the alleged loss of expertise are discussed in some detail in chapter 3 of this Note of Submissions. For the reasons set out there, it was not anticipated that the Scottish Ministers would have, and would not have been appropriate for them to have, the same degree of involvement during the delivery phase of the project as they had during the development phase. Once the Scottish Ministers had decided to accept the will of the Scottish Parliament to support the project with a capped contribution, it became a matter for CEC to satisfy itself that the business case remained positive and that Phase 1a remained affordable. At no stage in the evidence was it suggested that either the

Scottish Ministers or Transport Scotland had acted in a way that was contrary to the Scottish Public Finance Manual.

25. It is also the Scottish Ministers' submission that there is no credible evidence to suggest that the manner in which they operated between 2007 and 2011 had any adverse impact on the project in terms of costs and delay.[15] Transport Scotland administered the grant, as they were obliged to, in accordance with the grant conditions. Both Transport Scotland and the Scottish Ministers offered "off-line" assistance.

26. It has been suggested that matters came full circle with Transport Scotland's reengagement in the project in 2011 after its removal from the TPB in 2007. The proposition may be advanced that, had Transport Scotland been involved throughout, then the project would have enjoyed the sort of success before Mar Hall that it did after Mar Hall.

27. Such an approach, it is submitted, is simplistic. The project was in a completely different place in 2011, after Mar Hall, with parties keen to make progress after months, if not years, of conflict between TIE and BSC. The arrangements post Mar Hall were intended to be, and were, collaborative by involving the contractor. The new governance arrangements allowed for short reporting lines with a quick escalation of problems to executive level.

[15] See, for instance, Graeme Bissett's statement [TRI00000035] at paragraph 90 (pdf35).

Any emerging issues were identified early on by Turner & Townsend and addressed. The change of personnel and, in particular, the removal of TIE, clearly allowed new relationships to be built with BSC based on mutual trust and confidence. This new approach was supported by the contractual arrangements that were put in place after Mar Hall. The issues that resulted in the deadlock under the original contractual arrangements no longer arose.

28. Furthermore, the governance structures in 2007, and then in 2009 to 2010, were very different to those put in place in 2011. In 2007, Transport Scotland had one member on the Tram Project Board. That member attended monthly oversight meetings. The project was being delivered by TIE as agent for CEC. There was very little that a single Transport Scotland representative could have done to address the fundamental issues that beset the project, even had they been foreseen. By contrast, after Mar Hall, there was a new contractual landscape and mindset, with revised budgets and programmes. Importantly, TIE had been removed entirely from the project. Transport Scotland had a presence on at least seven committees, groups or forums, which were to meet with varying frequencies (from weekly to quarterly), each of which had well-defined purposes. That degree of involvement by Transport Scotland had never been contemplated at any point prior to 2011, and would not have been appropriate when the project was principally being delivered by TIE acting as agent and intelligent client on CEC's behalf.

29. In any event, the precise contribution of Transport Scotland under the new governance arrangements from 2011 onwards was not the subject of detailed scrutiny by the Inquiry. Those witnesses who addressed it were in no doubt that the role was beneficial, but described it in terms of assistance and not as the sole or dominant factor which made all the difference to the success of the tram project after Mar Hall. Transport Scotland were "always there in one form or another" and "brought good advice on project management"[16]; provided "good quality of support" in the collaborative meetings and fostered a culture of asking challenging questions[17]; "provided a sounding board for all that happening in the project"[18] and acted as an interface between the Joint Project Forum and external parties, such as Network Rail, SEPA or the utility companies [**CEC01890994**, 4.1, pdf6].

30. Even if the sole representative of Transport Scotland on TPB could have made a similar contribution prior to 2011, Transport Scotland's role would not have been decisive, on its own, in preventing the project from getting into trouble. It was clearly the end of the enduring conflict between TIE and BSC, and the adoption of a collaborative approach to the project under the post Mar Hall governance arrangements, that accounted for the project's later success. Any "full circle" suggestion would ignore the differences between Transport Scotland's involvement prior to 2007 and since 2011, as well as the broader

[16] Vic Emery's oral evidence, 13 March 2018, page 120, line 9ff.
[17] Colin Smith's oral evidence, 14 March 2018, page 150, line 14ff.
[18] Colin Smith's oral evidence, 14 March 2018, page 176, line 4ff.

context in which Transport Scotland participated in governance during those two periods.

11 May 2018