

Alastair Maclean

Exhibit I

From: Alastair Maclean [Alastair.Maclean@edinburgh.gov.uk]
Sent: 04 December 2010 17:38
To: admaclean@[REDACTED]
Subject: FW: Tram note - Legally privileged and prepared in anticipation of litigation

-----Original Message-----

From: Alastair Maclean
Sent: Sat 12/4/2010 5:36 PM
To: Tom Aitchison; Donald McGougan
Cc: Jim Inch
Subject: Tram note - Legally privileged and prepared in anticipation of litigation

As discussed with Donald I attach a paper setting out my advice following the meeting with BB and CAF on Friday morning. It also covers the main points that were discussed which may be helpful.

I am aware that there is a meeting with Richard on Monday - just let me know if you need me to attend.

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Trams

Meeting with Infraco

Legally privileged – prepared in contemplation of litigation

1. Purpose

The purpose of this note is to set out:

- 1.1 in high level terms what was discussed in the meeting between Infraco and CEC on Friday 3 December 2010; and
- 1.2 the implications (if any) on the strategy set out in an earlier note of 26 November 2010.

2. General

- 2.1 The meeting was attended by Richard Walker (“**RW**”) of Bilfinger Berger (UK) (“**BB**”) and Antonio Campos of CAF (“**AC**”), Michael Flynn of Siemens who was due to attend could not as a result of adverse weather conditions.
- 2.2 Donald McGougan and Alastair Maclean attended from CEC.
- 2.3 A shorthand writer was also in attendance and verbatim notes were taken. A transcript is expected to be available on or before Friday 10 December.
- 2.4 The meeting lasted for 1.5 hours.
- 2.5 The intention was for CEC to be in “listening mode” and not for CEC to enter into negotiations at that stage.

3. Points discussed

3.1 Contract and project management

RW set out his/BB’s position. That can broadly be summarised as follows:

- 3.1.1 There was a CEC council report of 1 May 2008 which stated in paragraph 2.3 that the contract between tie and Infraco was a 95% fixed price contract;
- 3.1.2 the contracting parties knew at the time that was not the case;
- 3.1.3 the misrepresentation to CEC was potentially very significant and an investigation should be carried out by CEC;
- 3.1.4 Clause 3.1 and 3.2.1 of Part 4 of the Infraco contract stated that:
 - (a) it was a fixed price contract;
 - (b) variations could take place in accordance with the contract;
 - (c) the parties acknowledged that the price was on the basis of certain

pricing assumptions; and

(d) the parties acknowledged that those pricing assumptions were based on facts and circumstances that may not be correct and that contract changes/price increases may be required immediately after signing the contract.

3.1.5 BB shortly after signing the contract did indeed need to submit a claim for extra works. Notwithstanding the ongoing issues with the utilities, BB continued to carry on the works in order to assist the former Chief Executive of tie, Willie Gallagher ("WG"), avoid the political difficulties that would arise if a price increase occurred immediately after the contract was signed.

3.1.6 The payment issue was not resolved and then crisis point was reached. Three weeks later WG resigned.

3.1.7 The contract entitled BB to an exclusive right to use certain areas of land but in some cases they were unable to access significant parts of those areas (eg in Leith Walk) due to utilities operations. There was no or very little project management of the interface between BB and those working on the utilities.

3.1.8 The change mechanism in the contract has also delayed the process. It provides that no works are to be carried out until a price for the relevant change is agreed. The contract is more akin to a PPP contract where only 3-4 changes are made and not a project of this nature where major utility diversions are required involving hundreds of changes.

3.1.9 The contract is unworkable and the project management has been very poor.

3.1.10 In particular the contract does not properly cater for a dispute about whether or not there is a change. (It does cover disagreement as to the price or the timing implications of a change).

3.2 Present state of play

3.2.1 tie has been given an up to date design and programme which is fully costed and scheduled but they have not approved it and planning permission is outstanding.

3.2.2 In relation to the route, on a traffic light basis for each of the outstanding changes most are at amber. The average delay between service of an Infraco notice of change and tie approval is 411 days. Some changes are at green and works are ongoing in relation to those particularly on the west side.

3.2.3 There are substantial outstanding utility works on Shandwick Place.

3.2.4 In relation to the present relationship between the contracting parties there is a war of attrition being waged by tie. The cost of disputing the changes is possibly greater than the savings being made. Infraco have won the bulk of these. On the key issues (such as whether or not works are to progress before costs are agreed or determined) these have been awarded in Infraco's favour.

3.2.5 BB no longer trust tie.

3.3 Options

3.3.1 BB's preference is to build a tram for Edinburgh. That is what they came to do.

3.3.2 There are four options:

- (a) grind on This is not considered an option given the delays and the present state of the project/relationship which is damaging everyone;
- (b) termination by tie BB would fight this robustly and would be confident of winning;
- (c) rescope ie build the tram for part of the route with a new contract and a new project manager. BB would not, however, be prepared to take certain risks. BB would be willing to sit down for a couple of days with CEC (and tie present) to work out how to take matters forward/rescope. In relation to Project Carlisle: BB indicated the costs for taking the tram from Edinburgh airport to Haymarket would be £400m odd; but tie had expected the costs for taking the tram from Edinburgh airport to York Place to be £300m odd; and
- (d) walk away ie BB would not claim loss of profits for the remainder of the contract. BB would be willing to accept an independent arbiter's decision as to what it is entitled to up to that point. tie/CEC would need to take on the existing subcontractors and any liabilities associated with them. On a "back of a fag packet" or "finger in the air" basis BB think that £20m is owed to them. Siemens would be owed less for their equipment and the subcontractors circa £10m.

3.4 Others

3.4.1 CAF indicated that if the Infracore contract was terminated it would be willing to carry on as a contractor of tie.

3.4.2 The body language of RW and AC was very telling:

- (a) AC said nothing at all until invited to speak 10 minutes from the end and clearly did not see himself as part of the dispute or rather wanted to distance CAF from it;
- (b) RW surprisingly was very nervous, excitable and his hands were shaking. He seemed under pressure to resolve matters and appeared to see the meeting with CEC as an opportunity to do that.

4. Implications on strategy

- 4.1 Nothing said in the meeting leads to a change in the legal advice set out in the last note.
- 4.2 Short of any agreed solution or a case for termination being built on a more stable foundation, the only realistic option is to seek to enforce the contract until termination can be established as a result of a failure to perform the works.
- 4.3 However, it was clear that BB would like to have matters resolved. Whilst previous attempts between tie and BB have failed, BB did indicate that they would be keen to explore resolution further with CEC (with tie present) by way of mediation.
- 4.4 As indicated in the last note there is a danger that a mediation could lead the parties into a further entrenched position if it is carried out prematurely without the parties having their strategies agreed and having collated all relevant information.
- 4.5 tie presently appear to be in a very weak position legally and tactically, as a result of the successive losses in adjudications, and service of remediable termination notices which do not set out valid and specific grounds of termination.
- 4.6 It was also clear from the documentation produced at the meeting by RW that BB was extremely well prepared. That may well place them at a tactical advantage.
- 4.7 What the strategy should be going forward is a matter that needs to be discussed and agreed by those responsible for the project taking into account the following considerations:
- 4.6.1 legal advice;
 - 4.6.2 financial cost;
 - 4.6.3 timing; and
 - 4.6.4 deliverability.
- 4.8 I have been asked for my views on this, which I can provide from a legal perspective, although clearly it is extremely hard to do without all the information which (as a result of the project's structure) is with tie.
- 4.9 Legally we (I and our QC) would prefer tie to enhance its tactical position first (as indicated in the last note) but I am mindful that a potential window of opportunity has now opened up since the resignation of David Mackay and that BB seem to be welcoming that (and that CEC appears to be willing to enter into a dialogue).
- 4.10 Realistically there are four options:
- 4.9.1 grind on with BB and enforce performance of the existing contract;
 - 4.9.2 rescope and continue with BB on a new contract;
 - 4.9.3 walk away by BB; and
 - 4.9.4 termination by tie.

- 4.10 In order to assess these options properly CEC/tie need to understand the risk profile of each. I would suggest that a risk/reward matrix be completed in the next few days as set out in the appendix to this note.
- 4.11 In the longer term it may be possible to terminate the contract if there is a BSC breach event and if sufficiently precise RTNs are served. McGrigors' note as to the current factual situation is awaited but for reasons articulated previously this is currently not a recommended option in the short to medium term.
- 4.12 Grinding on, assessing the design and programme of works and enforcing performance of the contract as a whole with a view to future termination or enabling a tactically better backdrop for mediation to take place is the preferred option.
- 4.13 However, there would appear to be a growing desire commercially and politically to move towards mediation notwithstanding tie's (apparently) relatively weak tactical and legal position.
- 4.14 Clearly the respective pros and cons will need to be weighed up but if the commercial preference is to seize the opportunity for an early mediation then that could be accommodated. That said, it is likely to have a financial implication with the party in the stronger position faring rather better out of it than might otherwise have been the case. Against that there are financial and other costs involved in allowing matters to continue.

5. Others

- 5.1 Given the adverse comments made in relation to the contract, alleged misrepresentation to CEC at the time of entry into the contract and management of the project an investigation should be carried out at the appropriate time to:
- 5.1.1 understand what happened, what went wrong and why;
 - 5.1.2 ascertain if there was deliberate or negligent misrepresentation to CEC;
 - 5.1.3 ascertain if there were any breaches of fiduciary duties which require to be pursued;
 - 5.1.4 ascertain if there has been any negligence on the part of tie's advisers at the time the contract was entered into or subsequently.
- 5.2 There may be a risk that BB(UK) does not speak for its parent company in Germany or Siemens but there is no suggestion that is the case.
- 5.3 Whichever option is ultimately chosen serious consideration needs to be given, if the project is to continue (which is the working assumption), as to CEC's current governance arrangements and the future project management arrangements.

Alastair D. Maclean

Head of Legal and Administrative Services

City of Edinburgh Council

4 December 2010

Appendix: Risk matrix [To be completed]

Option	Legal implications	Financial implications	Timing implications	Deliverability issues
Grind on and enforce performance of the contract	Could place tie legally and tactically in a stronger position from which to mediate	[Alan Coyle to insert]	[tie to advise]	<ul style="list-style-type: none"> •Large number of outstanding changes. •Irretrievable breakdown in relationship/war of attrition. •Significant time and effort in enforcing performance of contract both technically and legally. •Tie battle weary •Ongoing cost
Rescope and continue with BSC, with a new project manager and a new contract	Procurement issues	[£300 – 400m odd]	6-9 months	<ul style="list-style-type: none"> •Trust issues with BSC •Procurement of new project manager •Negotiation of new contract •Fundamental change to contract/new contract with BSC could trigger requirement to reprocure the works
Walk away by BB and Siemens and	None	•Existing costs (note that tie estimate BB have been overpaid to date by approx	3-9 months	•Procurement of new project manager if applicable

<p>reprocure the civils and systems works, either with tie or a new project manager</p>		<p>£40m), plus ▪[£0-50m], plus ▪Reprocurement costs</p>		<ul style="list-style-type: none"> ▪Reprocurement of works ▪Negotiation of new contract
<p>Termination by tie and if successful, reprocure the civils and systems works, either with tie or a new project manager</p>	<ul style="list-style-type: none"> ▪McGrigors report on factual basis awaited. ▪RTNs too vague and imprecise. ▪Remedies not ideal. 	<ul style="list-style-type: none"> ▪Even if successful, BSC must be paid their costs to date and no reprocurement costs can be recovered from BSC unless the whole line is built (to Newhaven). ▪Recovery of costs from BSC is capped at 20% of the construction works price (including changes) even if successful. ▪The financial downside of wrongful termination is open-ended and unquantifiable, because the contract would remain extant pending litigation (likely to take years) and tie would be liable for the costs of delay. 	<p>Up to 2 years (including court action)</p>	<ul style="list-style-type: none"> ▪Grounds need to be established ▪More stable foundation needed with more precise RTNs. ▪Procurement of new project manager if applicable ▪Reprocurement of works ▪Negotiation of new contract