

REPORT FOR tie LIMITED ON CERTAIN ISSUES CONCERNING EDINBURGH TRAM PROJECT

14 December 2010

Privileged and confidential – prepared in contemplation of litigation
FOISA exempt

McGrigors LLP
141 Bothwell Street
Glasgow G2 7EQ
Tel: [REDACTED]
Fax: [REDACTED]
Email: enquiries@mcgrigors.com
Website: www.mcgrigors.com

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www.mcgrigors.com

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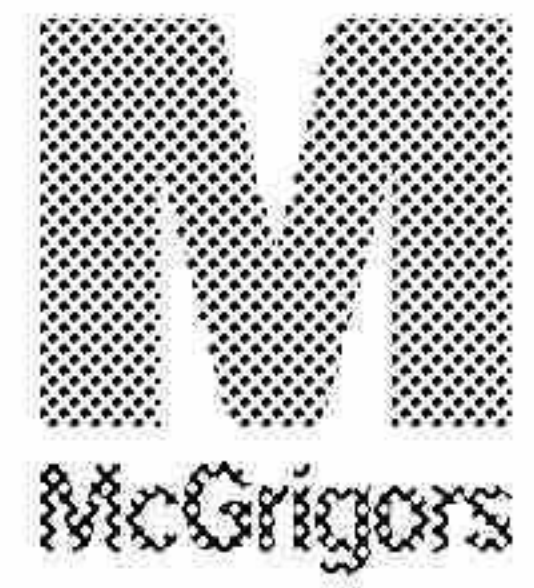


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1 Executive Summary

1.1 The purpose of this report is to consider the contractual provisions relating to termination of the Infraco Contract on the grounds of Infraco Default.

1.2 For tie to be entitled to terminate on the grounds of Infraco Default:

- (a) tie must establish that an Infraco Default has occurred;
- (b) That Infraco Default must be the subject matter of a Remediable Termination Notice which has been validly and competently formulated;
- (c) tie's determination of whether a submitted rectification plan is acceptable must have been exercised in accordance with the Infraco Contract.

Failure to meet any one of these tests will mean that a purported termination will constitute a wrongful repudiation of the Infraco Contract.

1.3 Establishing that an Infraco Default has occurred requires detailed forensic analysis; the issue will be subject to intense scrutiny in the context of any ensuing dispute, which is ultimately likely to be ventilated before the courts. The key default is Infraco Default (a), which involves proving not only a breach of the Infraco Contract, but also that the breach has materially and adversely affected the carrying out and/or completion of the Infraco Works.

1.4 The exercise referred to in the foregoing paragraph includes the compilation, review and analysis of all relevant written material as well as witness evidence. Expert input is also required in relation to technical and planning issues. That exercise has now been put in train. Its purpose is to enable an informed decision to be taken on whether tie is likely to be able to sustain an argument that an Infraco Default has occurred.

1.5 To the extent that Remediable Termination Notices have already been issued, it would be unsafe to rely on them:

- (a) Without the benefit of the outcomes of the forensic exercise referred to above; and
- (b) Because there is a material risk associated with the formulation of the Remediable Termination Notices (based on the sample which has been considered by McGrigors and Richard Keen QC¹).

1.6 Infraco is entitled to issue a rectification plan following the service of a Remediable Termination Notice. tie is required to exercise good faith in considering any such rectification plan. Good faith requires an

¹ See Appendix 2 to this report.

absence of dishonesty, fraud, irresponsibility or malice. The issue should not be pre-judged. The decision should be tie's alone, and not imposed by a third party. A decision to reject a rectification plan does not require to be justified as being fair or reasonable.

- 1.7 The Infraco Contract does not expressly provide for any time limit for the service of a termination notice following the rejection of a rectification plan. However, the elapse of time might affect tie's entitlement to rely on a Remediable Termination Notice, for example through the doctrine of personal bar, or in terms of whether the decision to terminate could be said to have been exercised fairly and reasonably in all the circumstances.
- 1.8 If tie terminates the Infraco Contract, it is entitled to enter upon the Infraco Works and expel Infraco. That is likely to provoke a legal challenge, the ultimate outcome of which may be measured in years. During that intervening period, it is unlikely that work could continue on the project – either by Infraco or by another contractor – other than with the co-operation of Infraco.
- 1.9 If tie is ultimately *successful* in the legal proceedings referred to in the foregoing paragraph, then:
- (a) The Infraco Contract will have been brought to an end;
 - (b) Infraco will have no further liability, unless tie proceeds to complete the tram project with another contractor on the basis of the same scope of works that was let to Infraco. In these circumstances, tie would be entitled to recover the additional, or "extra over", cost of completing the project, subject to the cap on liability.
 - (c) In these circumstances, Infraco would be entitled to recover the value of work carried out up to the date of termination. This will require underlying disputes to be resolved (for example, disputed INTCs, Pricing Assumption No.1, entitlement to extension of time and payment of loss and expense).
- 1.10 If tie is ultimately *unsuccessful* in the legal proceedings referred to above, then the potential exposure for tie is significantly greater. The option of electing whether or not the Infraco Contract should be treated as continuing will lie with Infraco. Infraco can choose to treat the "wrongful" termination as a tie Default and terminate themselves, but they are not obliged to do so.
- 1.11 If Infraco elect to treat the "wrongful" termination as a tie Default and termination, then Infraco will not only be entitled to payment for work actually carried out, but will also be entitled to payment for loss of profit at 10% on civils and 17% on track and systems. The Infraco Contract expresses this payment for loss of profit to be "*calculated with reference to demobilisation costs*". The meaning of this provision is uncertain, but there is a risk that tie's exposure to Infraco would not be restricted to lost profit on the costs of demobilisation.

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- 1.12 If Infraco elect to treat the Infraco Contract as continuing at the conclusion of the legal proceedings, then the parties would be locked into that contract. Infraco would be entitled to insist on being allowed to complete the Infraco Contract. Infraco would be entitled to be paid for work already carried out. The underlying disputes between the parties would remain to be resolved (for example, in relation to Pricing Assumption No.1). The intervening period of delay, and its associated cost, would be tie's responsibility. Work would not have proceeded during the intervening period; the issue of any consents or approvals which had expired during that period would require to be addressed by tie.
- 1.13 An alternative approach, which is considered to be the better one, is to seek a ruling (through the DRP and/or the courts) that certain key breaches constitute Infraco Default, and if successful, use this as a basis for a Remediable Termination Notice. It is likely that tie would be entitled to require Infraco to continue with the Infraco Works in the interim, although careful consideration would require to be given to the framing of the referral in this respect. The same degree of forensic analysis would be required as referred to at paragraphs 1.3 and 1.4 above.

2 Scope of this report

- 2.1 This report considers the contractual provisions which relate to termination of the Infraco Contract on the grounds of Infraco Default.
- 2.2 Richard Keen QC has provided written opinions in relation to a number of the key issues which arise, and those opinions² are discussed in this report.

² Appendices 1 and 2 of this report

3 Termination mechanism in the Infraco Contract

3.1 The various means by which the Infraco Contract can be brought to an end were addressed in the McGrigors LLP Report on Certain Contractual Issues dated 23 March 2010 at paragraphs 1.28 to 1.35 of the Executive Summary, and paragraphs 24 to 35 in the main body of the report.

3.2 For present purposes, the relevant issue is the contractual provisions which relate to termination of the Infraco Contract on the grounds of Infraco Default. The procedural trigger for termination on the grounds of Infraco Default is the service of a Remediable Termination Notice ("RTN"); ten such RTNs have been issued by tie at the date of this report. A summary of the RTNs is at Appendix 3 to this report.

3.3 Each of the RTNs which have been issued relies on the existence of Infraco Default (a), namely:

"a breach by the Infraco of any of its obligations under this Agreement which materially and adversely affects the carrying out and/or completion of the Infraco Works³".

3.4 Separately, three Underperformance Warning Notices ("UWNs") have been issued which rely on the same factual underpinning as some of the RTNs, namely:

- (a) UWN in relation to the defects at Princes Street, which correlates with RTN 1⁴;
- (b) UWN in relation to programming issues and mitigation of delay, which correlates with RTN 4;
- (c) UWN in relation to the design of the on street trackworks, which correlates with RTN 6.

3.5 The issuing of four or more UWNs within any 12 month period constitutes Infraco Default (g). There are a number of issues which arise in connection with the deployment of UWNs: for example, whether they are to be interpreted as applying to the time period before the issue of the Reliability Certificate. These issues were touched on at paragraph 28 of the McGrigors report referred to above, and are outwith the scope of the current report. The observations in this report in relation to the forensic factual analysis which requires to be carried out to support the RTNs apply equally to the factual basis of the UWNs. Where Infraco Default (g) has occurred, tie is entitled to terminate on giving 7 Business Days written notice.

3.6 In the event that Infraco Default (a) has occurred, tie is entitled to issue an RTN⁵, which is described as a *"notice in writing to the Infraco specifying the nature of the Infraco Default."*⁶

³ Schedule Part 1 of the Infraco Contract

⁴ And, to a lesser extent, with RTN 3

⁵ A failure to maintain Required Insurances can also form the basis of an RTN under Infraco Default (f), as can suspension under Infraco Default (j), but those are not understood to be relevant for present purposes.

⁶ Clause 90.1.2

- 3.7 Following the service of the RTN, Infraco is entitled, but not obliged, to submit a comprehensive rectification plan "*setting out how it intends to remedy the Infraco Default*" in relation to which the RTN has been served.
- 3.8 tie is required to consider the rectification plan and "*determine at [its] absolute discretion...whether the rectification plan is acceptable*"⁷:
- (a) If tie accepts the plan, then Infraco proceeds to comply with it. The original RTN falls away and there will no longer be entitlement to termination on the basis of it – unless Infraco fails to comply with their plan.
 - (b) If there is no rectification plan, or tie does not accept the plan, then tie is entitled to terminate upon giving 5 Business Days written notice⁸, and thereafter expel Infraco from the Infraco Works and the Site⁹.

⁷ Clause 90.2

⁸ Clause 90.4

⁹ Clause 90.6

4 Issues arising from the termination mechanism

4.1 There are a number of issues arising from the proper interpretation to be given to the mechanism outlined above, and from the consequences which might arise from its deployment. Those issues form the subject matter of this report.

4.2 Those issues are shown in the decision tree at Appendix 4 of this report, and can be summarised as follows:

- (a) Whether tie is able to establish that there has been an Infraco Default.
- (b) Whether the RTNs which have been issued are competent, irrespective of whether the facts underpinning them are capable of being evidenced and proved.
- (c) The approach to be taken by tie in relation to Infraco's rectification plan, within the context of the provisions in relation to *absolute discretion*, as well as the decision to terminate itself.
- (d) The likely consequences if tie is successfully able to establish an Infraco Default.
- (e) The likely financial consequences if tie is not able to establish an Infraco Default.

5 Infraco Default

5.1 There are a number of key components which require to be in place if tie's entitlement to terminate for Infraco Default is to arise, which include the following:

- (a) tie must establish that an Infraco Default has occurred;
- (b) That Infraco Default must be the subject matter of a valid and competent RTN;
- (c) tie's determination of whether a submitted rectification plan is acceptable must have been exercised in accordance with the Infraco Contract.

5.2 Reference is made to the following extracts from Richard Keen's Opinion dated 22 November 2010 in this respect:

"If pursuant to Clause 90.4 tie give a notice in writing to the Infraco terminating the Infraco Contract in circumstances where either there is no Infraco Default; or there is no valid RTN; or tie had no contractual basis for rejecting a rectification plan, then tie's actings would amount to a wrongful repudiation of the contract." (paragraph 8)

"...irrespective of the terms of any rectification plan, a termination by tie is dependant upon tie being able to prove a relevant Infraco Default and, where required by Clause 90.1.2, that there is a valid Remediable Termination Notice relevant to that particular Infraco Default. If tie fails to establish an Infraco Default then any termination notice will be invalid. If tie establishes an Infraco Default but has not served a valid RTN relevant to the Infraco Default then again the termination notice will be invalid." (paragraph 16)

5.3 The first component identified in the foregoing paragraphs is the requirement to establish that an Infraco Default has occurred. Irrespective of whether Infraco issue a rectification plan, and irrespective of the merits or otherwise of that rectification plan, tie will only be held to be entitled to terminate following the issue of an RTN if it can succeed in proving that the Infraco Default relied upon has, in fact, occurred. See, for example, paragraph 10 of Richard Keen's Opinion:

"Tie can only be sure of termination of the Infraco Contract if they can prove an Infraco Default which results in a valid notice of termination."

5.4 Establishing that an Infraco Default has occurred requires detailed forensic analysis: the issue will be subject to intense, prolonged and extensive scrutiny in the context of any ensuing dispute.

5.5 The factual background requires to be fully interrogated, in order to ensure that all relevant information, documentation and data has been considered and tested. This involves not only a consideration of written material, but also the questioning of witnesses. This process ought to enable tie's position to be put in a robust and coherent manner.

- 5.6 The exercise should be directed not only towards supporting tie's own position, but also towards interrogating arguments which have been, or might be, advanced on behalf of Infraco in their defence.
- 5.7 Where there are issues which turn on expert opinion, that opinion should be sought: by way of example, if tie's case is that a breach committed by Infraco had a material and adverse effect on the carrying out of the Infraco Works, in that it delayed them significantly, then this will require expert planning input in order to determine the impact of the delaying event on the progress of the Infraco Works. Similarly, where the allegation is a failure in relation to design information, expert engineering evidence will be required.
- 5.8 It would appear that this forensic exercise has not been carried out in relation to the RTNs which have been issued by tie: the selection of issues which were to form the basis of the RTNs, and the subsequent production of the RTNs themselves, emanated from a series of discussions between various members of the tie team and external advisers.
- 5.9 Following those discussions, the RTNs were drafted, and then subject to review by members of the tie team and some advisers. Whilst this process involved some element of testing and challenge, with external expert engineering views being sought, it was neither preceded, nor followed, by a rigorous forensic examination based on all relevant documentation and witness evidence. Isolated items of documentation were identified, but these were few in number, and largely consisted of correspondence exchanged between the parties after the events complained of, setting out their arguments. The documents did not consist of the underlying evidence that would support the assertions made by tie. Formal independent expert evidence of the type that would be required in the context of court or other proceedings was not obtained.
- 5.10 Appendix 5 of this report consists of a worked example of the type of investigation that would be required, using RTN 3 (lack of superintendence at Princes Street) as a sample.
- 5.11 This forensic exercise has now been put in train, specifically:
- (a) Acutus have been engaged to work with tie to undertake the forensic exercise referred to;
 - (b) Robin Blois-Brooke of William J Marshall & Partners has been appointed to produce an expert report in relation to the following issues:
 - (i) The on street track design – which relates primarily to RTN 6, but also to RTN 1;
 - (ii) The Murrayfield retaining wall – which relates to RTN 7;
 - (iii) The Gogarburn retaining wall – which relates to RTN 10.

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- 5.12 The outcome of this exercise will enable an informed decision to be taken on whether tie are likely to be able to sustain an argument that an Infraco Default has occurred. Without that exercise, there is no proper benchmark against which the prospects of success can be measured.

6 Valid and competent RTNs

6.1 An RTN does not require to set out, or be accompanied by, the fully particularised forensic investigation referred to above. However, in order to constitute a valid RTN, the document must specify to Infraco the nature of the Infraco Default which has occurred. This must be done with sufficient particularity to enable Infraco to understand the assertions that are being made against it, and what it is that Infraco is being asked to rectify or remedy.

6.2 Richard Keen's Opinion of 1 December 2010¹⁰ addresses this issue, by reference to three sample RTNs. At paragraph 5 he deals with the question of what is required from a valid RTN:

"In the event of an Infraco Default involving a breach by the Infraco of an obligation which materially and adversely affects the carrying out and/or completion of the Infraco Works, a notice from tie must meet the following requirements in order to constitute a competent RTN.

First, the notice must be in writing.

Second, the notice must identify the nature, which I take to mean the character or quality, of the breach of contract which has materially and adversely affected the carrying out and/or completion of the Infraco Works.

Third, the specification of the breach complained of must be sufficient to give Infraco notice of what remedial work is required in order to rectify the breach complained of."

6.3 In relation to RTNs 1 and 3 (Princes Street), Richard Keen concludes that:

"...there are at least some respects in which these notices can be criticised for lack of specification. In particular the simple reference to work as being "unsatisfactory" or as being "of an inadequate standard" may be criticized as giving Infraco no reasonable notice of the rectification work they require to carry out in order to meet tie's complaint."¹¹

6.4 In relation to RTN 6 (design), the view of Richard Keen is that the RTN contains sufficient specification, but he has other concerns in relation to that RTN:

"I do not consider that similar criticisms of lack of specification may reasonably be levelled at the RTN in respect of design. However (and although I am not instructed to advise on this point) I would question whether Clause 2.3 of this RTN does properly identify what can be construed as an Infraco Default."

6.4.1 The breach relied upon in RTN 6 is a failure "to deliver a fully integrated, assured design for the on-street trackworks chainage 100000 to chainage 131247". Various contractual provisions are listed in the RTN,

¹⁰ Appendix 2 to this report

¹¹ Paragraph 9 at Appendix 2 of this report

but none of those correlate precisely with the obligation articulated in this way. The analysis of the design obligations is outwith the scope of this report, and will be the subject matter of a separate work stream.

6.4.2 RTN 6 also relies on, amongst other things, clause 7.2 in relation to the exercise of a reasonable level of professional skill, care and diligence. A failure to meet this standard would constitute negligence, but no assertion of negligence is made, nor is any particularisation given of how this duty is said to have been breached. Whilst the view of Richard Keen is that he considers sufficient specification to have been given, nonetheless there remains a risk that a court or other tribunal would find this not be the case.

6.5 Richard Keen's conclusion in relation to the three sample RTNs is as follows:

"In light of the foregoing I would have to conclude that in the event of the giving notice of termination of the Agreement in reliance upon the specified RTNs, there would be a material risk of their acting being found to be a wrongful repudiation of contract."¹²

6.6 Accordingly, there is a risk that the sample RTNs referred to in the foregoing section of this report would be held not to be competent. In other words, even if all the factual matters referred to in the foregoing sections can be addressed and evidenced, the RTNs may be held not to disclose a sufficient basis for a consequent termination.

6.7 If it were to be held that the RTN which forms the basis of a subsequent termination was incompetent on its own terms, then that termination would not be held to have been made on the grounds of Infraco Default. For the reasons explained below, that may result in the Infraco Contract remaining alive, or in being held to have been terminated on the grounds of tie Default.

¹² Paragraph 10 of Appendix 2 of this report

7 Infraco rectification plan

7.1 Infraco is entitled, but not obliged to issue a rectification plan. They have done so in relation to some of the RTNs (as brought out in the summary of RTNs at Appendix 3).

7.2 Where Infraco has submitted a rectification plan, it has done so without prejudice to their primary assertion that each RTN is invalid. That ought not to be treated as relieving tie from the obligation imposed upon it by clause 90.2 to consider the rectification plan.

7.3 tie is described in clause 90.2 as having an absolute discretion in relation to whether or not the rectification plan is acceptable. The duty in clause 118 to act "*fairly and reasonably*" is expressly disapplied from the exercise of an absolute discretion under the Infraco Contract. In other words, there is no contractual requirement on the part of tie to act reasonably when deciding whether or not the rectification plan is acceptable.

7.4 tie is required to exercise good faith when considering the rectification plan: there should therefore be no element of dishonesty, fraud, irresponsibility or malice. The question of whether or not the rectification plan is acceptable should not be pre-judged. The decision as to whether to accept the rectification plan should be tie's, and not imposed upon it by a third party.

7.5 Richard Keen addresses this point at paragraph 15 of his Opinion dated 22 November 2010, as follows:

"I turn next to consider the phrase "absolute discretion" where it appears in Clause 90.3 of the Infraco Contract. This concerns the right of tie to decline to accept a rectification plan submitted by Infraco consequent upon an RTN. Where consideration of the rectification plan is to be at tie's absolute discretion, there is a requirement that tie should act in good faith. However there is no requirement that tie's decision on such a matter should be either fair or reasonable. This is confirmed by the terms of Clause 118.1. In summary tie must give genuine consideration to a rectification plan and must decide in good faith that it is going to reject the rectification plan. Tie does not require to justify the rejection of the rectification plan as being either fair or reasonable. If however tie was to intimate in advance of a rectification plan that it had no intention of accepting it then it would not be seen to be acting in good faith and its decision to reject the rectification plan could be open to challenge."

7.6 In summary on this point, if the decision to reject a rectification plan is made in bad faith, then any subsequent termination notice could be rendered unlawful and ineffective on that basis. However, even if the decision is made in good faith, a purported termination could still be struck at if there is no Infraco Default disclosed by a competently drafted RTN.

7.7 If the rectification plan is accepted, as referred to above, Infraco will be required to implement it. If the rectification plan is not accepted, tie has an option: issue a notice of termination, or proceed with the Infraco Contract.

7.8 The Infraco Contract does not expressly provide for any time limit for the service of a termination notice following the rejection of a rectification plan. However, there are two principal ways in which the elapse of time might affect tie's entitlement to rely on an RTN:

- (a) As referred to above, the provisions of clause 118 are expressly disapplied from the way in which tie is to decide whether or not to accept a rectification plan. However, the decision as to whether or not to terminate following the rejection of a rectification plan may be subject to the provisions of clause 118. On that basis, in deciding whether or not to terminate, tie would require to "*act fairly and reasonably within the terms of this Agreement...and having regard to all the circumstances.*" The longer the period of time that elapsed between RTN and termination, the greater the possibility that the decision could be subject to challenge for not having been made fairly and reasonably. However, all the circumstances would require to be taken into account: if tie was using the intervening period to seek a ruling as to whether it was entitled to terminate, it is unlikely that a delay between RTN and termination would be treated as unfair or unreasonable – this issue is addressed in more detail below.
- (b) tie's conduct during the period between service of an RTN and service of a termination notice might entitle Infraco to proceed on the basis that no such termination notice would be served. Clause 109 provides that a failure or delay in exercising a right under the contract will not operate as a waiver, and that no waiver shall be held to have occurred other than in an express written notice. However, this clause might not be effective to prevent the operation of the doctrine of personal bar: an example of this type of scenario might be where tie allowed Infraco to proceed with their rectification plan, and Infraco did so. It might then be held that tie would be personally barred from proceeding to terminate on the basis of the underlying RTN.

7.9 If no termination notice is served, Infraco is required to proceed with the contract¹³. If it fails to do so, that failure may be addressed in other ways: for example, by seeking an order of specific implement from the Court in terms which would require Infraco to fulfil its contractual obligations.

¹³ Clause 90.5 provides that Infraco are not relieved from the due and proper performance of their obligations by the submission of a rectification plan, nor tie's consideration of it.

8 Progressing the Infraco Works

- 8.1 If tie terminate the Infraco Contract, having determined that a rectification plan is not acceptable (or no plan having been produced by Infraco), it is entitled to enter upon the Infraco Works, and expel Infraco.
- 8.2 This course of action is likely to provoke a legal challenge from Infraco. That legal challenge might initially take different forms (for example, seeking an interim interdict, or invoking the contractual DRP). It would be open to tie to raise proceedings themselves: for example, to seek a ruling from the court in relation to whether they were entitled to terminate. Ultimately, however, the substantive issues in relation to the merits of the grounds for termination – if challenged - will come before the court for consideration whichever procedural route is adopted.
- 8.3 If proceedings were raised in the Commercial Court, tie could seek to have the disposal of the dispute fast tracked by the court, and – if successful – that approach might yield a decision within a year, given the broader public and political interest at stake. However, the success of this approach will turn on a number of factors: in particular, the extent to which detailed factual investigation is required and whether Infraco pursue delaying strategies.
- 8.4 Furthermore, given the issues at stake between the parties, the party who is unsuccessful at first instance is likely to appeal the decision. From the Outer House of the Court of Session, the right of appeal would be to the Inner House of the Court of Session, and thereafter to the Supreme Court. Whilst there are procedures available in terms of which tie could seek to have these proceedings concluded as quickly as possible, the overall process will be measured in years rather than months.
- 8.5 During the intervening period of litigation, tie would not be entitled to require Infraco to proceed with the Infraco Works: tie's position would be that the contract had been brought to an end. On that analysis, there would be no entitlement on tie's part to instruct Infraco to proceed. The provisions of clause 5 of Schedule Part 9 would not assist tie in these circumstances. That clause states:
- "Neither Party shall be entitled to suspend the performance of its undisputed obligations under this Agreement merely by reason of the reference of any Dispute to the Dispute Resolution Procedure..."*
- 8.6 Where tie had purported to terminate the Infraco Contract, Infraco's obligation to proceed with the works would not be *undisputed*: by issuing their termination notice, tie would be telling Infraco that Infraco had been terminated. By contesting the termination notice, Infraco would be telling tie that Infraco ought to be allowed to continue to perform.
- 8.7 However, if tie sought to engage others to carry out and complete what had been the Infraco Works, Infraco would be entitled to seek an interim interdict to prevent them from doing so: on balance, it is more

likely than not that the courts would grant such an interim interdict¹⁴. The court is likely to take the approach of maintaining the *status quo*: if another contractor was permitted to complete the Infraco Works, that would prevent Infraco from being entitled to treat the Infraco Contract as still remaining in place. That will be reinforced by the "lock in" philosophy which runs through the Infraco Contract. This issue is addressed in more detail below.

8.8 Reference is made to paragraph 13 of Richard Keen's Opinion dated 22 November 2010, where he summarises the position as follows:

"The time involved in such a process would be at least a year and could be a number of years. During the period of such adjudication and litigation tie would probably not be able to secure access to carry on the Works. Any attempt by tie to enter upon the Works while such a challenge was ongoing would probably be the subject of an application for interdict ad interim by Infraco. If Infraco maintained that tie's notice of termination was invalid and that they wished the contract to continue then it is probable that interim interdict would be pronounced against tie from entering up on the works..."

8.9 It is evident from the foregoing that in the event that Infraco dispute a termination notice issued by tie, the parties could be engaged in proceedings for a number of years, during which time no progress could be made in relation to the works which form the subject matter of the Infraco Contract, until all legal avenues have been exhausted. Control of whether or not the work progresses during this period would rest with Infraco: it would be *Infraco's* option to decide whether or not to accept the termination, and *Infraco's* option to decide whether or not to seek interim interdict to prevent tie from engaging others to complete the project.

8.10 An alternative approach which could avoid this outcome would be if tie were to raise proceedings – in advance of issuing a termination notice – seeking a declarator in relation to whether or not they were entitled to terminate. This would involve consideration of whether there had been an Infraco Default or Defaults and whether an RTN or RTNs were competent and valid.

8.11 A further option would be to refer certain key breaches which are considered to be Infraco Defaults to DRP for determination, and if tie succeeds, to use these as a basis for one or more RTNs.

8.12 The proceedings referred to would require to be initiated in terms of the contractual DRP: accordingly, the internal procedure would require to be followed first, unless Infraco was prepared to agree to let the issue go straight to the Court of Session. Whichever the route which initially required to be adopted, it is highly likely that parties would wish the issues to be finally determined by the Courts, rather than resting with the decision of an adjudicator.

¹⁴ It is likely that some accommodation would be made to enable sufficient work to be carried out to render the Infraco Works safe.

- 8.13 The observations above in relation to the likely length of such proceedings raised after termination would apply equally to those proceedings raised before termination. Similarly, the requirements for proof, and the need for a rigorous and detailed forensic analysis, as well as expert evidence, would also apply. The difference would be in relation to the issue of whether tie would be entitled to require Infraco to continue with the Infraco Works in the interim.
- 8.14 As explained above, clause 5 of Schedule Part 9 provides that parties are not entitled to suspend the performance of "*undisputed obligations under this Agreement merely by reason of the reference of any Dispute to the Dispute Resolution Procedure...*". This would require careful consideration to be given to which RTN or RTNs were made the subject matter of proceedings: to the extent that Infraco's obligations were disputed in the proceedings, work would be unlikely to be able to progress in relation to those obligations. If far reaching RTNs such as RTN 6 (design) and RTN 9 (course of conduct) were referred to DRP, this might well have an impact on the extent of the work that tie could require to be executed during the course of proceedings.
- 8.15 The better course is probably to concentrate on underlying material breaches which are tested through DRP, which – if upheld – could form the basis of new RTNs.
- 8.16 The forensic analysis referred to above requires to be carried out in order to identify the areas in which tie has the greatest prospect of establishing that an Infraco Default has occurred, as well as what would be the most appropriate material breaches and/or RTN(s) to take to DRP, having regard to the issue of work progressing in the interim. That work would, in any event, be subject to the existing disputes with Infraco in relation to, for example, its obligation to proceed with disputed work in terms of clause 34.1.

9 Consequences of termination if tie is able to establish Infraco Default

- 9.1 In the event that tie is able successfully to establish that the termination was validly executed on the grounds of Infraco Default, then the provisions of clause 90 will apply.
- 9.2 In terms of clause 90.7, tie will be entitled to complete the Infraco Works using other contractors (although for the reasons explained above, this is only likely to be able to happen once proceedings have run their course, if Infraco seek to prevent others being engaged to complete the Infraco Works whilst those proceedings are ongoing).
- 9.3 The Infraco Contract also provides for other ancillary entitlements on tie's part in the event of termination for Infraco Default: for example, tie will be entitled to use Infraco's Equipment, Temporary Works, goods and materials, as well as drawings and design information. tie will also be entitled to an assignation of certain sub-contracts.
- 9.4 Beyond these issues, there are two principal elements of the financial reckoning to be carried out in the event of termination for Infraco Default¹⁵:
- (a) Payment to Infraco by tie for work done – clause 90.12;
 - (b) Payment to tie by Infraco in relation to the costs of completing the work – clause 90.14.
- 9.5 The payment to tie will be subject to the cap on Infraco's liability in clause 77.7 which provides, amongst other things, that the liability of Infraco on termination is capped at 20% of the Construction Works Price (as adjusted to take account of matters such as tie Changes, Notified Departures and extensions to the ETN). Liability under the Parent Company Guarantees is included within that cap. Liability under the Retention and Performance Bonds falls outwith the cap.
- 9.6 Clause 90.12 provides for the payment to be made to Infraco:
- "As soon as may be practicable after termination of this Agreement pursuant to Clause 90.1 the Parties shall agree as at the time of such termination:*
- 90.12.1 the amount (if any) which has been reasonably earned and not yet paid pursuant to this Agreement by the Infraco in respect of work actually done by it under the Agreement..."*
- 9.7 The effect of this provision will be to draw a line in the sand for the work done as at the date of termination; however, for all work done up to that date, Infraco will be entitled to payment.
- 9.8 The timing of that payment is addressed below. In relation to the *extent* of that entitlement, there are substantial disputes between the parties that already exist in this respect, which include matters such as the following:

¹⁵ There are also other ancillary provisions, such as payment for goods and materials in terms of clause 90.12.2.

- (a) All outstanding and disputed INTCs will require to be resolved. In some cases, this will turn on resolving Estimates. In other cases, there will be the more fundamental issue of determining whether there has been a Notified Departure, which will in turn require the underlying dispute in relation to design development and the proper interpretation to be given to Pricing Assumption No. 1 to be resolved.
- (b) Outstanding issues in relation to extension of time will require to be resolved, in order that Infraco's entitlement to the payment of loss and expense for the relevant period can be determined.
- (c) The evaluation of that loss and expense will require to be resolved.
- (d) Any issues in relation to Compensation Events will require to be resolved.
- (e) Liability in relation to Princes Street will require to be resolved.

In each case, where a negotiated agreement cannot be reached, the dispute will require to be resolved by way of proceedings. In the first instance, this may be through the contractual DRP mechanism (which is expressed as surviving termination), and thereafter through court proceedings.

9.9 In terms of clause 90.14.1, tie is entitled to recover from Infraco:

"the costs of completing the Infraco Works, not including any amount calculated as due to the Infraco pursuant to Clause 90.12 up to and including the Service Commencement Date in accordance with the terms of this Agreement (whether or not the Infraco Works are completed under a separate contract) and all other costs and expenses properly incurred by tie, less such sums as would have been due to the Infraco if the Infraco had completed the Infraco Works up to and including the Service Commencement Date..."

9.10 There is a broadly equivalent provision in relation to the additional costs of the Maintenance Services in terms of clause 90.14.2.

9.11 The effect of these provisions is that tie would be entitled to recover from Infraco the *additional* costs of having the work completed. In order to arrive at an understanding of the sums that would have been paid to Infraco for completing the Infraco Works, it will be necessary to resolve some of the underlying issues that have been referred to above: for example, the proper interpretation to be given to Pricing Assumption No.1 will inform the way in which payment for design development would have been made to Infraco. That will be set against the sums due to any new contractor under a freshly negotiated contract.

9.12 That entitlement on tie's part is predicated on the Infraco Works being *completed*. In other words, if the project is abandoned, and tie does not proceed to complete the remainder of the Infraco Works left

unfinished at the time of termination, then no right to recovery will arise. Richard Keen addresses this point at paragraph 12 of his Opinion dated 22 November 2010:

"Infraco may simply accept tie's notice of termination. Infraco then walk away from the works. In that event Infraco will be entitled to recover payment under the contract for all work done to date. Tie will not be able to recover any payment from Infraco in respect of the incomplete portion of the works unless or until tie undertakes the completion of the Infraco Works. The Infraco Works would involve the construction of the entire Edinburgh Tram Network."

9.13 If tie proceeds with a different, or truncated, scheme – in other words, one which is not the same as the Infraco Works – then there is a substantial risk that tie would be held not to have completed the Infraco Works, and therefore the entitlement to make recovery from Infraco would not arise. The key question here is likely to be the completion of the physical works (including design). If the same physical works were let to a different contractor on different commercial terms, then this would be likely to come within the ambit of completion of the Infraco Works.

9.14 Clause 90.16 provides for interim certificates to be issued if a sum *"as calculated under [Clause 90.14]...notwithstanding that the Infraco Works have not been completed"*. This is likely to be interpreted as a cashflow mechanism, which allows money to be released whilst the Infraco Works are progressing towards completion. If a different scheme was being constructed, then this would not release any interim payment.

9.15 The position is summarised by Richard Keen at paragraph 10 of his Opinion as follows:

"...Infraco will have to be paid for all work done to date in accordance with the terms of the Infraco Contract. Tie will only be able to recover the additional cost of completing the Infraco Works once they have carried out and completed those works. The sum which tie can then recover for the additional cost of completing the Infraco Works will be subject to the Liability Cap as specified in Clause 77.7. If tie does not complete the Infraco Works after it has terminated Infraco's engagement under the Infraco Contract tie will have no claim against Infraco. In other words the contract does not allow a claim of damages against Infraco for breach of contract even though the partially completed works for which they have been paid may be worthless in their existing form."

9.16 There is an argument available to tie that if the Infraco Works are not completed, Infraco's entitlement to recover *"the amount...which has been reasonably earned...in respect of work actually done"* does not arise either. The parties are required to agree the value of this sum as soon as practicable after termination¹⁶, but clause 90.13 states that:

"If tie enters upon the Infraco Works...and expels the Infraco in accordance with...Clause 90..., tie shall not be liable to pay the Infraco any money under the Agreement (whether in respect of amounts certified

¹⁶ Clause 90.12

by tie's Representative or otherwise including any sums determined under Clause 90.11 unless or until tie's Representative certifies that an amount is due to the Infraco under Clause 90.15."

- 9.17 An amount can only be certified under clause 90.15 after completion of the Infraco Works, and on that basis, it would appear that Infraco would not be entitled to any payment in its favour until that time. The reference in this wording to clause 90.11, however, is an odd one: that would appear to be mistaken reference to clause 90.12, which is the clause which deals with payment to Infraco. 90.11 is a provision which states that no compensation is to be paid by tie to Infraco for termination on Infraco Default.
- 9.18 If Infraco was able to establish that there was an unequivocal and irreversible intention *not* to proceed with the Infraco Works, then Infraco might be entitled to seek payment of sums already earned at that stage. That intention could encompass the letting of a contract for a truncated scheme, coupled by a public announcement that the remainder of the scheme was being shelved indefinitely.
- 9.19 In summary, even where tie have been able to make out a valid termination for Infraco Default, Infraco will be able to walk away from the project at the end of proceedings, with no further liability unless tie proceeds to complete the tram project on the basis of the same scope of works that was let to Infraco. If the Infraco Works do not proceed with another contractor, it is likely that Infraco will be entitled to recover the value of work actually done prior to termination.
- 9.20 If tie does proceed to complete the Infraco Works, it will be entitled to recover the additional cost of doing so from Infraco, subject to:
- (a) Infraco's entitlement to recover the value of work already carried out by them;
 - (b) The cap on liability in clause 77.7.
- 9.21 In the event that tie is ultimately successful in establishing that the termination had been validly carried out on the grounds of Infraco Default, then it is likely than an order would be made requiring Infraco to be responsible not only for their own litigation costs, but also for those of tie. These would be subject to the being audited in the usual way, and there is a likelihood that tie would recover only a proportion of the actual costs which they had incurred, with the remainder being irrecoverable from Infraco.

10 **Consequences if tie are not able to establish Infraco Default**

10.1 If Infraco challenges a termination by tie, and is ultimately successful in establishing that the termination was not properly carried out, then tie's potential exposure is likely to be significantly greater than if it had made out a case to be entitled to terminate for Infraco Default.

10.2 At common law, if a party to a contract purports to terminate that contract without lawful excuse, then the other party is entitled either to affirm the contract, and treat it as continuing – or to treat the contract as having been ended, or repudiated, by the other party and claim damages for that repudiatory breach. The damages will be calculated by reference to seeking to restore the "innocent" party in financial terms to the position that it would have been in had the contract been performed. If the "innocent" party would have made a profit in the event that the contract had been allowed to run its natural course, then they are entitled to recover that lost profit from the other party.

10.3 The Infraco Contract purports to restrict the entitlement to treat a wrongful termination as a repudiatory breach. Clause 77.10 provides that:

"The Parties acknowledge and agree that the only rights available to them to terminate this Agreement are those expressly set out in this Agreement and that neither Party shall to be entitled to exercise a right to terminate or rescind or accept the repudiation of this Agreement under any other right whether arising in common law or statute or otherwise howsoever (other than for fraud or a fraudulent misrepresentation)."

10.4 Clause 77.11 goes on to state that:

"Both Parties acknowledge and agree that the express rights provided in this Agreement in relation to termination and the calculation and payment of amounts due following such termination are exclusive and are in place of (and not cumulative with) any other rights or remedies which might arise as a consequence of such termination or expiry. Each Party hereby waives all other rights and remedies arising from such termination, whether express or implied, arising by common law (including in delict), by statute or otherwise howsoever provided that nothing in this Clause 77.11 exclude[s] the right of either Party to claim remedies expressly conferred on them by this Agreement."

10.5 If these clauses bite, they create a contractual regime whereby the contract can only be brought to an end prematurely under one of the specific contractual mechanisms – and in the current factual circumstances being considered, that would be either for Infraco Default or for tie Default. Unless tie can bring themselves within these contractual parameters, they cannot force the contract to an end, even on the basis of the payment of damages.

10.6 Richard Keen's Opinion dated 22 November 2010 addresses these issues at paragraphs 3 and 4, and he concludes at paragraphs 8 and 9:

"...However such a wrongful repudiation of the contract cannot bring the Infraco Contract to an end even if the Infraco might wish that it did so. That is because, pursuant to Clause 77.10, the Infraco cannot accept a wrongful repudiation in order to terminate the Infraco Contract.

Subject to issues of fraud and insolvency (for which there is separate provision) and to the provision in Clause 89 for voluntary termination (which cannot apply at the present time) it would follow that the Infraco Contract can only be terminated pursuant to Clause 88 and Clause 90. Accordingly tie can only terminate the Infraco Contract if it proves an Infraco Default. Infraco can only terminate the contract if it proves a tie Default. In the absence of the foregoing both parties are locked into the Infraco Contract."

- 10.7 Unless tie can successfully establish an Infraco Default – the option of electing whether or not the Infraco Contract continues following the service of a termination notice by tie will lie with Infraco. If Infraco were expelled from the site, it would be entitled eventually to treat this as a tie Default giving rise to an entitlement to terminate in terms of tie Default (b) – but they would not be *obliged* to terminate. Richard Keen deals with this at paragraph 5 of his Opinion:

"Clause 88 deals with the termination of the Infraco Contract by reason of a "tie Default". A tie Default is defined as including,

A breach by tie of any of its material obligations under this Agreement which substantially frustrates or renders it impossible for the Infraco to perform any material part of its obligations under this agreement for a continuous period of 45 Business Days.

In the event of such a breach of contract by tie Infraco is not obliged to proceed with termination. Clause 88.1 provides that the Infraco may serve a termination notice. If such a notice is served by the Infraco then the relevant tie Default may be capable of rectification pursuant to Clause 88.3. In the absence of rectification a termination notice will lead to termination of the Infraco Contract pursuant to Clause 88.3. In the event of such termination tie will not be liable to Infraco for common law damages for breach of contract. Such a remedy is excluded by Clause 88.6. However tie will come under an obligation to pay Infraco in accordance with the provisions of Clause 88.8 of the Infraco Contract."

- 10.8 The provisions of clause 88.8 in these circumstances would entitle Infraco to payment which would include the following:

- (a) The value of all work carried out prior to termination. As explained above, this would include sums to which Infraco are entitled for matters such as loss and expense, Pricing Assumption No. 1 and so on;
- (b) Amounts payable in relation to preliminary items in terms of clause 88.8.1;
- (c) The cost of materials or goods which have been reasonably ordered, following which title will pass to tie in terms of clause 88.8.2;

- (d) The reasonable cost of removing Infraco's Equipment from site in terms of clause 88.8.3;
 - (e) All other expenses properly, demonstrably and reasonably incurred by Infraco arising from the termination, including payments made to sub-contractors to terminate sub-contracts, provided that the sub-contracts were entered into on reasonable commercial terms – all in terms of clause 88.8.4;
 - (f) Loss of profit at 10% on civils and 17% on track and systems, described as being "*calculated with reference to demobilisation costs*" in terms of clause 88.8.5. There is no contractual definition of the distinction between "civils" on the one hand, and "track and systems on the other". Furthermore, it is not clear what the reference to demobilisation costs is intended to mean: on one reading, it purports to restrict any loss of profit claim in the event of termination for tie Default to the profit that would have been made on the costs of demobilisation. However, that would appear to be an odd provision: Infraco would be entitled to recover their proper expenses in relation to demobilisation in any event in terms of clause 88.8.4.
- 10.9 If, contrary to the opinion of Richard Keen, the contractual mechanisms which purport to restrict the ability to end the Infraco Contract on the basis of repudiatory breach are not effective, that would mean that Infraco would be entitled to treat the contract as at an end, and seek damages for breach of contract.
- 10.10 Infraco's entitlement in these circumstances would include the following:
- (a) Payment for the value of all work carried out prior to termination. As explained above, this will include sums to which Infraco are entitled for matters such as loss and expense, Pricing Assumption No. 1 and so on;
 - (b) The payment from tie of damages so as to put Infraco in the position that it would have been in had the contract been performed. This will be calculated by reference to any profit that Infraco would have made on the remainder of the Infraco Works had they been allowed to continue to completion.
- 10.11 For the reasons explained above, Infraco is entitled to choose to treat the Infraco Contract as continuing notwithstanding the service of a termination notice (which ultimately is held not to have been valid). The consequences of its so doing would include the following:
- (a) Infraco would be entitled to insist on being allowed to complete the Infraco Works in accordance with the Infraco Contract¹⁷;
 - (b) tie would remain liable to Infraco for the value of work done before the purported termination;

¹⁷ See, for example, paragraph 14 of Richard Keen's Opinion.

- (c) There would be an intervening period of litigation during which tie would not be entitled to require Infraco to proceed with the Infraco Works;
- (d) During that intervening period, it would be unlikely that tie would be entitled to instruct others to proceed with the Infraco Works;
- (e) At the end of litigation, the Infraco Contract would remain in place – in other words, tie would be locked in to the Infraco Contract with Infraco;
- (f) The underlying disputes between the parties in relation to contractual interpretation and the operation of the Infraco Contract would remain in existence – for example, the issues around Pricing Assumption No.1, or the progressing of work which is the subject matter of a disputed Notified Departure;
- (g) The delay and cost of the intervening period of delay where no work progressed would be the responsibility of tie, with no recovery from Infraco;
- (h) tie would require to resolve the question of consents and approvals that might have expired during the intervening period.

10.12 Dealing with point (f) in the foregoing paragraph in more detail, it is evident that the consequences of delay would be borne by tie. This would either be as a function of the underlying provisions of the Infraco Contract, which would treat the intervening period as one for which Infraco were entitled to an extension of time and the payment of loss and expense, or as damages for breach of contract. This last point is addressed at paragraph 14 of Richard Keen's Opinion:

"...Infraco would have a claim for damages measured by reference to the direct loss and expense which Infraco suffered by reason of tie's wrongful termination notice. In this context it should be noted that while the claim for common law damages is excluded upon termination of the contract such a claim is not excluded where there is a breach of contract which does not result in termination of the contract. In view of the fact that the common law claim for damages could reflect the increased cost of completing the works after the delay for litigation (potentially a number of years) the measure of the damages could be considerable. It follows that unless tie is absolutely certain of being able to serve a valid termination notice such a course of action would carry considerable risk... I would observe that a purported termination by tie on grounds which are ultimately not upheld would amount to a repudiatory breach for which Infraco would be entitled to recover damages at common law."