

tie	24/08/10	£267.3m	06/06/12	Airport to St Andrews Square plus Enabling Works at Newhaven	INF CORR 5858 Part A - excludes SDS/ PSSA costs
BSC	11/09/10	£405.5m 7 Euro 5.8m	18/12/12	Airport to Haymarket plus Newhaven Enabling Works	25.1.201/EKI/6682
tie	24/09/10	£282.3m	06/06/12	Airport to St Andrews Square plus Enabling Works at Newhaven	INF CORR 6275 (Appendix 11, p 10) + £8m for contamination

(Table 8)

It should be noted that **tie**’s proposal excluded payments to SDS and for Princes Street Supplemental Agreement and assumed purchase of a reduced number of trams. Taken together these items account for £43.8 million of the Infraco’s price. In addition **tie** has offered to include a provisional sum of £8 million for the removal of contaminated material.

The fundamental differences between **tie** and Infraco can be summarised and explained as:

**tie Proposal**

**Price** – **tie**’s offer is based on a fair valuation a fair valuation putting the parties back where they would have been in May 2008 if they had known the full extent of the difference between BBD and IFC. Whereas the Infraco are claiming full recompense for their additional costs calculated by reference to a schedule of fixed rates given in Schedule Part 4 with fixed percentages for preliminaries and profit. They also seek to retain the “mobilisation payment of £45.2 million. Whereas **tie**’s fair valuation absorbs this payment because it was de facto a payment in advance. In addition they are looking to recover their prolongation costs from **tie** whoever is responsible for the

**Negotiating Position**

**tie** has conceded from the start that the revised price was open to negotiation upwards. Moreover, various Infraco executives have suggested that they will reduce their aspirations.

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prolongation.

**Payment for Princes Street – tie’s offer**  
excluded payment for Princes Street, making  
it subject to further negotiation.

**tie** always saw this as a negotiating point.

**Payment to SDS – tie’s offer** made this  
subject to separate agreement.

**tie** always saw this as a negotiating point.

**Completion Date – tie’s offer** sets these at  
those determined at adjudication.

**tie** always saw this as a negotiating point.

**Scope – tie’s offer** unambiguously makes the  
Infraco responsible for all additional costs  
however so arising except for unforeseen  
utilities costing more than £50,000 and  
Contaminated Land up to £8 million.  
Whereas the Infraco are attempting to keep  
Schedule Part 4 extant.

Agreeing to the Infraco’s proposal would  
reduce the risk to the price but **tie** would not  
have price certainty and the Infraco could  
still act in a delinquent manner.

The benefits of Project Carlisle in the form desired by **tie** are described in the essential  
principles described above. In addition to that any agreement based on the concept  
of Project Carlisle, even one which retains Schedule Part 4 in part but reaches a full  
and final settlement on a defined scope, would reduce the burden of forensically  
investigating and formulating its case as described above.

The subsequent correspondence on this matter also clearly shows that as far as BSC  
were concerned they were not willing to compromise on any of the core deliverables  
and effectively withdrew from the Carlisle process from mid October and started to  
explore alternatives around “divorce” where Siemens indicated they would be happy  
to remain as a supplier but did not want to continue through the Infraco Contract.

Separate discussions with CAF reveal that they are keen to be novated back to **tie**,  
even if the Infraco Contract is not terminated and they also indicated a willingness to  
become more involved as a management contractor for systems using Siemens as a  
supplier.

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4.4. Notice

On 10<sup>th</sup> March 2010, the TPB endorsed a recommendation that we retain termination of the Infraco Contract as an option, not to be pursued at that stage but kept under review for serious consideration if evidence emerged which merited action.

In June 2010 we embarked on an enhanced process of exercising the contractual provisions to notify BSC of alleged breaches and underperformance which require that they provide details of how they would make good. The contractual mechanisms to be used were continued DRP’s, the Remediable Termination Notices (RTNs) and Underperformance Warning Notices (UWN) which were contained within Clauses 90 and 56 of the Infraco Contract. This became known as Project Notice. This strategy was to continue to administer the Infraco Contract robustly and in so lead to 3 potential outcomes to the dispute:

- Reach agreement on the Carlisle option
- Termination under Clause 90 of the Infraco contract through an Infraco default. This was likely to be a contested termination and lead to litigation, or alternatively,
- Make the current situation and potential consequences so undesirable to BSC and potentially painful contractually that it may lead, not necessarily to a litigious Termination through the Infraco Contract, but may lead to a mediated settlement in respect of Termination of the Infraco Contract.

The objectives of the strategy were to:

- Draw from BSC their reaction/response to allegations of breach of contract
- Present BSC with a clearer view of our position and the possible consequences of their conduct and delivery deficiencies if improved performance and/or Carlisle did not bear fruit
- Bring matters to a head – in a way which DRPs of their own were not delivering certainty or resulting in progress on the ground
- Shift the focus strict from legal interpretation of design development and the change mechanism to wider failures of BSC to perform – this is important as it is a core reason why we do not believe the project can be completed with BSC as currently constitute and managed - it is not just commercial as there are also many examples of it lacking core competencies and behaviours
- Provide a clear platform on which to collate evidence of InfraCo default (including how they respond to RTNs) and get it assessed by legal and QC as a basis for termination if it came to that.
- Use the tools of DRP, RTN’s and UWN’s as negotiating tools to strengthen **tie’s** position for a Carlisle settlement, force discussion on a mediated settlement and exit of BB or, ultimately for use in a contractual Termination, albeit this was likely to lead to litigation if contested by BSC.

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4.4.1. Notice Preparation

In **tie**’s opinion there was evidence of breach of contract in a number of areas, but since March 2010, the team had been continuing to assemble, structure and refine the detailed evidence for use in any Remedial Termination Notice or Notices. Whilst there were no guarantees that this strategy would lead to a clear cut case for termination it could also be used for the purposes of applying pressure to a dysfunctional Consortium. Subsequent audits, the continued commercially assertive strategy and the lack of shift in behaviour, particularly of BB, had all provided additional evidence of breach in a number of areas as identified in the list of RTN’s in Table 9.

Additionally, the behaviours being demonstrated in respect of the negotiations on Project Carlisle indicated that Infraco might be seeing this as an opportunity to re-price the project, to complete only the off-street sections and to move risk back to **tie**.

At the meeting on 16<sup>th</sup> June 2010 which was attended by Mackay and Jeffrey from **tie** and Wakeford and Darcy from BSC, **tie** advised BSC that the alternative to Carlisle was for **tie** was to initiate Clause 90.1.2 letters of breach in accordance with the Infraco Contract.

In parallel with the Project Carlisle negotiations, **tie** was receiving detailed legal advice on the basis on which the Contract could be terminated in view of BSC’s failure to fulfil its obligations. It was necessary to run both the Carlisle and Notice processes simultaneously as an illustration of a contingency plan if an acceptable result did not emerge from the Carlisle negotiations.

In response to these concerns **tie** and its advisors had been preparing Remediable Termination Notices (RTN) in accordance with Clause 90.1.2 of the Infraco Contract specifying Infraco Defaults (a) and (j). These defaults are:

- (a) 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 Works;
- (j) the Infraco has suspended the progress of the Infraco Works without due cause for 15 Business Days after receiving from **tie**’s Representative a written notice to proceed.

Senior Queens Counsel was instructed on 22 June 2010 and a consultation arranged for 8<sup>th</sup> July to discuss the strength of the case for Termination and the format for RTN’s. This consultation session was useful in that Senior Counsel advised that there were a number of strong areas which support the issue of a Clause 90.1.2 letter leading to potential Termination if BSC did not remediate the breaches. QC advised

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that a number of RTN’s should be issued rather than one covering a number of breaches and so this advice was taken and a number of RTN’s identified and the drafting commenced.

Counsel did also confirm that it would be necessary for **tie** to provide evidence of adverse breach of contract to substantiate termination. However, it was not necessary to compile and test the body of evidence prior to the issue of RTN’s. We took a conscious decision in light of time pressures from CEC to issue RTN’s without having complied this evidence but recognising that such evidence would need to be completed prior to any termination. An exercise to collate this evidence had now started and continues and this “Body of Evidence” is being stored electronically in a “virtual” data room accessible to **tie**’s advisors and replicated in hard copy.

**4.4.2. Notice Initiation**

As part of the Project Carlisle negotiations, the GMP was due to be delivered by Infraco by end July.

The TEL/**tie** Chairman, David Mackay was to meet with senior members of the Infraco on 16<sup>th</sup> June 2010. It was anticipated that any RTN would not be sent to Infraco until at least after this meeting and then based on the attitude being demonstrated by Infraco and the expectation of a successful/or otherwise negotiation on Carlisle. The discussions on Carlisle were continuing positively and the issue of the Clause 90.1.2 letter would be based upon output from the following events and TPB buy-in:

- Advice from Senior counsel in respect of the strength of the termination case;
- Delivery of fully assured integrated design from BSC in mid July, and
- Delivery of the GMP by end July

TPB on 28<sup>th</sup> July endorsed the strategy presented which outlined that a commercial decision needed to be made in respect of the issue of RTN’s. On 9<sup>th</sup> August, **tie** issued the first 3 RTN’s and the 1<sup>st</sup> UWN. As at 13/12 the status of these is as follows:

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RTNs issued						
	RTN	Date issued	Response due	Plan received	tie response to rectification plan	Approved or rejected
RTN 1	Princes Street (Defects). Relates to the defects which emerged on Princes St following the track and road construction during 2009.	09.08.10	21.09.10	17.09.10	29.09.10	Rejected
RTN 2	Princes Street (Superintendence). Relates to the level of superintendence provided by BSC during the construction works on Princes Street during 2009.	09.08.10	21.09.10	None received	-	-
RTN 3	Clause 10.4/10.16 – relates to BSC’s failure to provide access to information and an extranet facility as required under the Infraco Contract.	09.08.10	21.09.10	17.09.10	1.10.10	Rejected
RTN 4	Clause 60 – relates to BSC’s failure to progress the works and manage the programme.	16.08.10	28.09.10	24.09.10	7.09.10	Rejected
RTN 5	SDS Agreement – relates to an agreement between BSC and SDS in relation to development of the design and payment thereof.	1.09.10	14.10.10	None received	-	-
RTN 6	On-street trackform design – relates to the management of the design for trackform throughout the route and the lack of an approved integrated trackform design some 30 months after contract award.	8.09.10	26.10.10 *tie agreed 5 BD extension	26.10.10	9.11.10 (due)	Rejected
RTN 7	Category 4 - Russell Road. Relates to the management of demolition works in relation to construction works.	21.09.10	2.11.10	None received		
RTN 8	Clause 80 - tie Change - relates to BSC’s management of Clause 80.	30.09.10	11.11.10	None received		

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RTN 9	Course of conduct – relates to some 99 breaches of contract.	30.09.10	11.11.10	None received		
RTN 10	Design (Gogarburn Retaining Wall) – relates to management of the design of the above structure and the failure to get approval of a key stakeholder – BAA.	12.10.10	23.11.10	None received		

(Table 9)

RTN 9 is an all encompassing RTN covering overall conduct and covers 99 breaches of contract including:

- Failure to comply with instructions – Clause 80.13/34;
- Failure to complete an assured and integrated design – Clauses 7.3 10 and 19;
- Failure to procure the delivery of the SDS services and to manage the SDS provider - Clause 11;
- Breach of obligation to comply with the Change procedure – Clause 80;
- Breach of obligations in respect of Compensation events – Clause 65;
- Breach of general obligations – Clause 6;
- Breach of core obligations – Clause 7;
- Breach of obligations in respect of sub-contractors – Clause 28;
- Breach of best value obligations – Clause 73, and
- Breach of confidentiality – Clauses 7.3.16 & 101.14.

In **tie**’s opinion, there are many other examples of breach throughout the contract which albeit smaller in materiality all add to the overwhelming view that Infracore have consistently breached the obligations of the Infracore Contract, but the examples above are the areas of breach which are deemed to be most material to **tie**.

QC also confirmed that the process of issuing Underperformance Warning Notices (UWN’s) as per Clause 56 of the Infracore Contract could be used, although some questions were raised as to the validity of these notices.

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This advice has been acted upon as follows:

UWN  (material breach)					
	Topic	Date of issue	Issued	Response from BSC	tie response
UWN 1	Princes Street (Defects)	09.08.10	✓	Yes – stated that this was a non valid use of UWN	Noted BSC response
UWN 2	Programme	08.09.10	✓	Yes – stated that this was a non valid use of UWN	Noted BSC response
UWN 3	Design (trackform)	12.10.10	✓	Yes – stated that this was a non valid use of UWN	Noted BSC response
UWN 4	Non compliance with instructions/misconduct/design integration	Not yet sent			

(Table 10)

tie has now issues 10 RTN’s but has only received 4 rectification plans from BSC. Of these and after due consideration, tie has rejected these plans. Having rejected these plans, coupled with BSC not supplying plans for the remaining 6, tie is now in a position where it could proceed to terminate the Infraco Contract.

Section 6 of this report deals with the legal advice around termination at this point in time.

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4.5 Incremental Delivery Strategy / Updated Business Case

Following the Pitchfork report in March ~~the~~ prepared an analysis of the options available to deliver the project in an incremental basis to manage affordability and financial risk in light of the impact of the contractual difficulties on the forecast outturn costs for the delivery of Phase 1a in a single phase of construction. A detailed presentation of the findings of the Updated Business Case is not the subject of this report but the principal findings are presented here as they informed both the negotiations under Carlisle and are a key influence on the development of a reprocurement strategy to continue delivery of the project beyond a termination of the Infraco Contract.

The review of options for incremental delivery addressed the need to manage the project affordability (in the context of the current commercial disputes with BSC) by means of flexible delivery of the on street sections over a longer period of time and in a way which provides the Council with greater control over the precise timing of the remaining on-street works.

The approach will ensure the considerable investment already made in the project is realised through the delivery of a viable tram service, integrated with bus services, whilst preserving for delivery the entirety of the scope of Phase 1a, as detailed in the Final Business Case of December 2007.

The scope of the exercise focussed on the following key considerations:

Financial and operational viability

The base revenue and operating costs projections for tram and bus operating as integrated services were reviewed, both for the entirety of Phase 1a and for a number of incremental delivery options, most significantly for a first phase of operating tram from the Airport to Haymarket and from the Airport to St Andrew Square.

The base patronage projections were remodelled by Steer Davies Gleave taking cognisance of an updated view of future economic growth in Edinburgh, a longer profile for the completion of ‘committed’ developments e.g. Edinburgh Park in the West and the Forth Ports estate in the North, experienced growth in passenger numbers at Edinburgh Airport and a rebasing against current actual patronage experience of Lothian Buses. For the first time the projections incorporated the positive impact on patronage of the Edinburgh International Gateway interchange between main line trains and trams to be delivered by Transport Scotland.

The development of these financial projections was carried out with the full oversight of the management of Lothian Buses.

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The overall conclusions reached were:

- The financial and operating viability of Airport to Newhaven was reconfirmed
- A tram service from Airport to Haymarket is marginal in terms of operational and financial performance in the years following commencement of service
- A first phase of tram service from Airport to St Andrew Sq provides the best prospect of delivering a meaningful transport connection, integrated with buses and capable of operating without the need for subsidy to the combined operations of tram and bus and the prospect of a positive contribution from trams following patronage build up in the initial years of operation.

Consequently, the negotiations under Carlisle and the initial development of our reprocurement strategy have focussed on delivering a first phase of tram operations from Airport to St Andrew Square in addition to completing the whole of the route to Newhaven in due course.

**Economic viability**

The Updated Business Case reconfirmed the Economic Benefits from the introduction of tram as detailed in the Final Business Case of 2007. It also gives additional perspective on the importance of the tram as part of the wider aspirations for a transport solution and economic growth in Edinburgh in the period up to 2030 including the new development envisaged to the West of Edinburgh in the area of the airport which has not been reflected in our patronage projections.

**Affordability**

In June 2010 we formally reported to the Council that the full extent of Airport to Newhaven was not unlikely to be delivered within the approved funding envelope of £545m (£500m from Central Government and £45m from CEC). In June 2010 CEC officers reported a number of possible additional sources of funding for the project (including Prudential Borrowing) which might be used to provide contingency funding up to a level of £600m, assuming a continued cap on Scottish Government funding of £500m.

The examination of options to deliver the project on an incremental basis takes cognisance of the funding restriction and is meant to manage financial risk by continuing delivery of the project but only committing to the delivery of new infrastructure as and when the funding to do so is identified.

The negotiations under Carlisle and the planning we have undertaken for reprocurement following a termination have been undertaken with a view to

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delivering the identified viable first phase of operations from Airport to St Andrew Square within the currently available funding of £545m. However, as long as there remains significant commercial uncertainty with BSC, it is not possible to provide a robust estimate for either the full cost of Phase 1a or for Airport to St Andrew Square.

In all cases the affordability analysis has been prepared on the basis that the terms of the Government grant will be amended such that the entire funding of £500m will remain available for the reduced first phase of delivery to St Andrew Sq. This remains to be formally agreed.

**Other key advantages from incremental delivery**

Learning from our experiences from utility diversions and the construction on Princes Street, the other desirable characteristics which can be secured as part of an incremental delivery approach are:

- **Greater control over impact upon the City** – the Council will be in a better position to mitigate the impacts of temporary traffic diversions, avoid the critical embargoed periods, execute the works in a way which respond better to the concerns of stakeholders and provide greater certainty as to start and completion dates.
- **Control over scope change on-street** – building upon the experience on Princes Street, the Council should be in a better position to exercise due diligence on the extent and specification of road and pavement reconstruction and respond to obstructions and unforeseen utilities with fewer concurrent work areas to manage.

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5. Process & Governance - Mar 2010 to Present

5.1. Governance

Since March 2010, it has been a requirement to keep all key Stakeholders informed as to the ongoing status of the Infraco Contract. In doing so, the following has been undertaken:

- TPB – has continued to meet every 4 weeks
- TEL Board continued to meet and be updated
- Strategic Options Group – this meeting between **tie** and CEC has been formed and latterly has met almost every week
- Group Leaders – **tie**’s CEO has met with all Group Leaders on an ongoing basis
- Transport Scotland – as well as the 4 weekly report, **tie**’s CEO has met with TS Officers on an ongoing basis
- Scottish Government – **tie**’s CEO has met with Ministers on an ongoing basis
- Events log – this has been kept up to date to record all key meetings including those involving Stakeholders
- TEL also wrote to CEC in accordance with its operating agreement to advise them of the likelihood of the project exceeding £545m. This has been reported in the CEC report dated 24 June 2010.

5.2. Audit

As part of the internal audit programme, Deloitte carried out a high level review of the commercial strategy adopted by **tie** since contract signature in May 2008 (Appendix 19). the key items identified in the Executive Summary are:

- That **tie** had adopted a robust decision making process since the nature of the disagreements with BSC became clearer following contract signature.
- **tie**’s approach to change estimates and their administering public funding could be viewed in the context of driving down amounts claimed by BSC.
- It identified ongoing liaison with CEC and Transport Scotland and that governance matters were clearly recorded in a number of documents.
- **tie** had made use of external advisors at key point in the process and had implemented a challenge process prior to launching DRP’s.

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- Disputes appear to originate from negotiations concluded prior to contract signature.
- Risks associated with elements of the contract not complete prior to signature, such as design, had had risk items identified.
- Performance of design had been identified as a key issue in the overall management of the Infraco contract.

In October 2010, **tie** requested that Deloittes reviewed the processes adopted since March in progressing the options outlined in the Pitchfork Report (Appendix 20). There were no significant issued identified as a result of this review.

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6. Termination of Infraco Contract

6.1. Legal Risks & Consequences of a contested Termination

The Infraco Contract stipulates what should happen in the event that **tie** issues a RTN which is as follows:

- 1) Infraco may submit a comprehensive rectification plan setting out how it intends to remedy the Infraco Default. This must be within 30 Business Days of the date of the RTN (or longer if **tie** agrees).
- 2) **tie** has 10 days to consider this plan and determine if it is acceptable or not.
- 3) If **tie** does not accept the rectification plan, or Infraco does not submit a rectification plan, **tie** may after giving 5 Business Days notice in writing to the Infraco terminate the agreement.
- 4) Following termination under the agreement, **tie** may enter upon the Infraco Works and any part of the site and expel Infraco.
- 5) Where **tie** has entered upon the Infraco Works, **tie** may complete or carry out the Infraco Works itself or employ any other contractor to complete the Infraco Works.
- 6) Where **tie** has entered upon the Infraco Works, the Infraco shall, if instructed by **tie**, use reasonable endeavours to assign to **tie** any agreement as soon as practicable which the Infraco may have entered into and which are, in the reasonable opinion of **tie**, material to the completion of the Infraco Works.

Having rejected a number of BSC’s rectification plans associated with Remediable Termination Notices, **tie** is now in a position where technically we could issue a Termination Notice. However, BSC have maintained throughout, in each response to a Remediable Termination Notice, that there is no Infraco Default and that **tie** are not therefore able to Terminate the Infraco Contract on the basis of these. In some cases they have not provided any rectification plans and relied on the basis that they believe there is no default.

Senior Counsel opinion (dated 22/11/10) has been received on the mechanics of the clauses in the Infraco Contract in respect of Termination of the contract. Whilst BSC may accept Termination of the contract, there is a risk that they may decide to challenge such a Notice. The response to the Remediable Termination Notices indicates that they do not agree with **tie**’s claim of an Infraco default. Such a challenge would proceed by way of adjudication and then litigation. The time involved in such a process could 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

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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 in it is possible that interim interdict would be pronounced against **tie** preventing us from entering up on the works. BSC would be able to seek unlimited damages against **tie** is they were able to prove wrongful repudiation of the contract. Senior Counsel's advice dated 22/11/10 and 1/12/10 concludes that in the event of **tie** giving notice of termination of the Agreement in reliance upon the 3 of the specified RTN's he reviewed, there would be a material risk of their acting being found to be a wrongful repudiation of contract.

6.2. Legal opinion on grounds for termination

McGrigors were appointed to lead the workstream on any potential termination of the Infraco Contract. McGrigors have produced a full report and this is included as Appendix 21 to this report. The summary of this follows.

Additionally Senior Counsel opinion has been sought and a series of consultations were held. Senior Counsel opinions are contained in Appendix 21 to this report.

In summary, legal opinion on termination of the Infraco Contract at this moment in time raises a number of issues as outlined below:

- To constitute a valid RTN, the document must specify the nature of the Infraco Default which has occurred – there are at least some respects in which the RTN's issued can be criticised for lack of specification. This means that there is a material risk of BSC claiming wrongful repudiation of the Infraco Contract if **tie** were to use these as the basis of the Termination.
- Rectification plans – **tie** cannot decide to reject such a plan in bad faith. If **tie** rejects the rectification plan but does not terminate the Infraco contract, BSC are required to proceed with the contract.
- On Termination, **tie** is entitled to enter upon the InfraCo Works and expel Infraco. This is likely to provoke a legal challenge – interim interdict or DRP. During the period of litigation **tie** would not be entitled to require Infraco to proceed with the InfraCo works, nor would it be entitled to get others to carry out and complete the works. This process could last a year or a number of years to resolve.
- An alternative approach could be that **tie** could raise proceedings to test entitlement to terminate or refer such breaches to DRP.
- **tie** should continue to undertake the forensic analysis to identify the areas which have greatest prospect of establishing that an Infraco Default has occurred.
- **tie** can only recover the costs of completing the project from BSC if **tie** win any litigation and the full project is completed. This recovery is capped at 20% of the Construction Works Price.

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- If BSC is successful in challenging a termination by **tie**, then **tie's** exposure is likely to be significantly greater than if it had made out a case to be entitled for Infraco Default.

**6.3. Notice – Mitigation Plan**

Legal advice has outlined the consequences should BSC successfully challenge an attempt by **tie** to terminate the Infraco Contract through Infraco Default. As a result of this advice, it is recommended that **tie** undertake some further testing of the robustness for the **tie** RTN's and defaults to which they refer.

This will be done by submitting to DRP examples of the contract areas which **tie** believe BSC have breached and where BSC claim in response to the RTN's issued that there is no breach. Should the adjudicator find in **tie's** favour then this is strong evidence of provendefault which can be used should **tie** proceed to terminate the Infraco Contract on this basis and then BSC proceed to challenge this in court. If the adjudicator disagrees with **tie**, then further examples of breach will be tested through the DRP process and eventual adjudication.

Additionally, **tie** will continue to gather the forensic evidence relating to all identified breaches, populating the data room for potential termination and subsequent litigation. This evidence will be useful for any further RTN's or DRP's.

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7. Mediation

Mediation is a key feature of the Infraco Contract Dispute Resolution Procedure and mediation has been carried out on a number of the issues submitted by both parties to the DRP process. There has been mixed results from mediation. To date, mediation of the entire contract and relationship has not been attempted since the parties were attempting to find a solution through the Project Carlisle negotiations. Whilst neither party had agreed that those negotiations had irrevocably broken down, it was clear from correspondence and discussions with BSC, that they did not see a successful outcome on Carlisle being possible. Furthermore, they had actively sought discussions with **tie** relating to an agreed exit for BB and Siemens from the Infraco Contract.

This coupled with events during the week of 15<sup>th</sup> November 2010 have led to a widely held view that the time is now right to enter into a mediation with BSC on the Infraco contract. The events during wc 15/11/10 were:

- 1) Discussion at TPB on 17<sup>th</sup> November 2010 - See Appendices 23 & 24
- 2) Emergency motion approved at Full Council meeting on 18<sup>th</sup> November 2010 which endorsed an approach being made to BSC with a view to mediation. See Appendix 25.
- 3) Open letter to the Scotsman from a leading Senior QC offering to mediate between the parties – See Appendix 22.

BSC were approached in writing - see Appendix 26 and responded (Appendix 27) to say that they would engage in mediation. Subsequent to this CEC met with BSC on 3<sup>rd</sup> December 2010 to discuss this option.

Richard Jeffrey has written to CEC (Appendix 28) to outline views on the scope of the mediation.

Assuming that the scope of mediation is to find an acceptable end to the relationship/contract between **tie**/BSC the benefits and dis-benefits to this option are:

Benefits

- Removes uncertainty around Termination due to Infraco Default being challenged through litigation
- Removes risk of injunction being taken out against **tie** preventing them from carrying on with works until the termination litigation complete
- May allow Siemens to carry on with systems work which, in many cases are proprietary and would require re-design if another supplier was procured
- May allow an easier novation of the SDS contractor back to **tie**

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- Still allows for CAF to be novated back to tie and potential options for surplus trams to be investigated
- Allows **tie** to carry on with re-procurement of the remainder of the project
- Takes away litigation costs for the duration of court action – these costs would include legal and claims consultant costs
- Removes an element of cost uncertainty by entering into litigation as if litigation lost then CEC exposure is effectively not capped
- Removes uncertainty for project team and helps to provide a platform for key team member retention
- Allows a new programme for completion of the project to be produced providing certainty for the city, limiting business impacts caused by the past few months uncertainty
- Stakeholder support through having reached a conclusion
- PR benefits as project now has a defined path going forward

Dis-Benefits

- Costs of mediated settlement may be higher than winning any Infracore Default termination
- May lose ability to “claim” costs of completion from BSC
- May lose ability to call bonds

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8. Appraisal of Options available now

Section 4 of this report outlines the workstreams that have been active since March 2010. These are:

- Contract administration/Review on progress and behaviours;
- DRP’s;
- Carlisle, and
- Notice

These workstreams have been undertaken in order to lead us to a range of outcomes or options for the Edinburgh Tram Project and the Infraco Contract. The following summarise the resultant options that are, at December 2010, available for the project:

- 1) Enforced Adherence;
- 2) Carlisle;
- 3) Termination – which has the sub-options of being followed by re-procurement, postponement or cancellation of the project, and
- 4) Mediation - mediated settlement resulting in mutually agreed termination or other solution to complete the project. This option has the same Termination sub –options as outlined above.

Each of these options is outlined in more detail below and a full summary of costs of each option will be produced prior to any final decision being endorsed by TPB.

8.1. Enforced Adherence

The “as is” option i.e. continued application of the Infraco Contract in its present form with present players was effectively eliminated in March 2010 whilst retaining an approach of “enforced adherence” of the existing contract with a view to settling disputes in the short term and negotiating a new way of working. The enforced adherence approach in itself was seen as running in parallel with an exploration of the possibilities of achieving a partial or whole exit of BB from the consortium.

The behaviours and actions of the consortium since March, as evidenced by the matters which have been the subject of RTNs and UWNs, lead us to the conclusion that we have not resolved our principal commercial differences to any material extent:

- The issue regarding design change (BDDI-IFC) remains, albeit there are interim adjudication decisions to act on;

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- Programme dispute and cost of time – despite the MUDFA rev 8 DRP the issue of delay due to utilities remains unresolved and we have no meaningful or compliant programme for the completion of either the off-street or on-street works;
- Clause 80 – failure to commence the works until estimate agreed continues and **tie** is now analysing individual INTC’s in light of adjudication decisions and QC advice;
- Failure to deliver best value;
- Notified departures continue because the design is not complete;
- Continued failure to mitigate delays;
- Continued failure to manage design including non delivery of an integrated design for on-street works or value engineering opportunities;
- Supply-chain mismanagement including failure to deliver Collateral Warranties and contracting as individual Infraco members;
- Failure to integrate design leading to rework and delays;
- Lack of control over sequencing on-street works, and
- Issues with defective works on Princes St and the rejection of BSC’s rectification plan associated with these works.

What Project Notice has demonstrated more conclusively than ever is that we are not simply grappling with a series of disputes over the legal interpretation of individual contract terms. The consortium (with the notable exception of CAF) is not delivering across the most basic of responsibilities we would reasonably expect from a competent contractor.

In addition, the engagement with the consortium continues to be characterised by a lack of trust and respect. Our concern that the frustration of **tie** employees leads to exodus of project management resources remains. Our legal and commercial costs associated with attempts to resolve the disputes now run to several million pounds.

There is no evidence that Siemens are willing take a more active role in resolving matters with their joint and several liability for performance under the contract. They did not work with Bilfinger to find a way forward with the “Siemens 25” to enable work to progress from the depot to the airport and the failures to manage and deliver on design are as much their responsibility as Bilfinger. It’s also true that Siemens approach to pricing their element of the BSC Carlisle proposal reflects no more respect for the original contract price than Bilfinger.

There is no evidence that the consortium would be willing to undertake any of the remaining on street works in an expedient manner other than on a basis similar to the Princes Street Supplementary Agreement, the outcome of which has proven to be unacceptable to **tie** in terms of either cost or quality of the work done.

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There is no evidence that there would be any change in the behaviours of the consortium even if an acceptable commercial resolution could be delivered. We have now been striving for a way forward with the consortium since March 2009 and have exhausted all the courses of action open to us to make progress.

Most recently the demobilisation of contactors on site in October 2010 is a cause of significant and irrecoverable delay to the delivery of the Infraco Works.

The totality of the above matters lead us to conclude that it is simply not possible to provide a reliable estimate of outturn costs and completion time for any element of the project under the enforced adherence option. In this respect it fails completely to deliver on the requirement to deliver cost and programme certainty.

**8.2. Carlisle**

As more fully described at section 4.3 above, the Carlisle negotiations have not yet delivered a complete deal which is capable of being negotiated to a conclusion. This is due to the absence of a significant movement in position by the consortium both on price, programme and commercial terms. As such this section serves to describe and compare the respective position of the parties at the latest point of the negotiations.

From the outset our objectives in entering the Carlisle negotiations were to deliver a deal which:

- Delivered a high level of cost and programme certainty in respect of all of the Infraco Works from the Airport to St Andrew Sq - being the extent of tram infrastructure which would be viable as a first phase of operation;
- Was at an affordable price which could be demonstrated as being value for money;
- Substantially eliminated the commercial uncertainties and disagreements which have plagued the project – essentially a Guaranteed Maximum Price(GMP) with programme certainty, and
- Provided us with an assured integrated design for both the off street and on street works.

tie presented a fair value for the works in the negotiations on Carlisle based on actual costs of market tested sub-contractor quotations and Siemens original contract price adjusted for scope with an allowance for fair and reasonable preliminaries, overheads and profit. The offer excluded the Princes Street Supplemental Agreement (PSSA) and SDS which were to be agreed separately and a reduced number of 17 trams. It also offered a provisional sum for the removal of contaminated material. It wasn't an adjustment to the original contract price.

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Infraco’s approach was to ask for expenditure to-date: plus cost to complete: plus additional risk cost for incomplete design. It was in effect their claim for adjustment to the original contract price. The said proposal was not compliant with tie’s essential requirements of price certainty. It in effect retained the Infraco’s ability to apply Schedule 4 to an increased price for a reduced scope of work.

8.3. Terminate & Reprocure

As more fully described under section 4.4 above, and in parallel with the Project Carlisle negotiations, we have been pursuing under Project Notice the notification and remediation of Infraco breaches under the contract, individually and collectively amounting to default which by definition materially and adversely affect the carrying on and completion of the Infraco Works.

In the absence of any of: 1) An ‘as is’ option which represents a practicable way forward; 2) a Carlisle deal on acceptable terms; or 3) an acceptable rectification plan for all of the matters which are the subject of RTNs and UWNs, termination of the Infraco contract is an option available to begin creating some certainty around the delivery of the project.

The determination of the timing of any contract termination is in large part a function of the assessment of legal risks and legal opinion on the grounds we have for termination (including evidence to support an Infraco default) as further discussed at Section 6 of this report.

In addition to the legal risks associated with a termination of the Infraco Contract (and a presumption that the delivery of the remaining infrastructure will be reprocured) there are a number of other benefits as well as risks and uncertainties arising, the principal ones being:

Termination Benefits

- Ends the two year long attrition which shows no sign of delivering an acceptable way forward
- Opportunity to reduce and/or refocus our own spend away from futile disputes with BSC - and our exposure to the consortium’s recurring costs
- We get control over procurement method, timing and sequencing of further on street construction in particular – project can be delivered to minimise impact on the city and traffic and over a timescale which is responsive to the availability of funding
- We generate the time necessary to deliver clarity around the costs and programme to deliver the project from Airport to St Andrew Square including resolution of all outstanding design, consents, approvals and governance issues.

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- Value is secured from the investment in the project so far
- The first phase of the project interchanges with the Governments’ new railway station at Edinburgh Gateway
- This allows **tie**/CEC to control the respect for the city agenda by giving control for staging of the works back to **tie** and effectively brings into control and end to the reputational damage suffered.

Termination - Disbenefits/risks and uncertainties

- Absent a justifiable out of court settlement we will be entering into litigation which would take 2 years at least – the impact of the litigation outcome on outturn costs would not be known until then;
- Uncertainty surrounding potential legal action by BSC resulting in the inability to continue with the project until it is resolved. Could mean 2 years of “do nothing”
- Possible further loss of political and public support for the project
- Uncertainty re whether the Government Grant of £500m will be available for a first phase to St Andrew Square.
- In the short term the affordability of the first phase from Airport to St Andrew Sq is still an issue.
- Reprocurement strategy to be clarified developed which will deal with: Interface risks between civils and systems works
- Compatibility of newly procured systems with Siemens work already installed and the CAF vehicles
- Maintenance solution over all infrastructure delivered by both BSC and newly procured contractor
- Liability for work completed to date including design
- Assuming we novate the TSA / TMA back to **tie** we will have too many vehicles for the initial service to St Andrew Sq unless and until we secure a lease or sale of the surplus vehicles.

Section 9 outlines the current thinking on re-procurement should the Infraco Contract be terminated. some of these issues required to be considered as part of the termination process and these include:

- Are the TMA and TSA contracts with CAF novated back to **tie**?
- Is the SDS contract novated back to **tie**?
- It is assumed that 100% of the Infraco performance bonds and retention bonds are called in a forced termination event.

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**8.4. Terminate & Postpone or Cancel**

**8.4.1. Terminate and Postpone**

In addition to the terminate and reprocure option we have assessed the option of postponing the project and reprocurement after winning litigation - in a nutshell this adds 2 years to the programme.

**8.4.2. Terminate and Cancel the Project**

For this option it is assumed no decision would be taken to cancel the project until the outcome of litigation is known – if we lost the outturn costs of cancellation might be in excess of £500m with no operating tram service to show for it. Political/reputational fall out is high.

Option of cancelling the project right here and now has not formally been evaluated however, the downsides of cancellation include:

- No immediate prospect of securing value (the benefits detailed in section 3 below) for the investment made to date;
- An extended period of continued uncertainty and costs in pursuing commercial settlement with the existing infrastructure consortium;
- No possibility of recovery of costs to complete the project via Infraco;
- The costs associated with any reinstatement or safeguarding of incomplete works;
- Additional costs of reprocurement and mobilisation of a new infrastructure provider if and when the project is restarted;
- Uncertainty about market appetite and required risk premium included in the pricing of a reprocurement although the re-procurement exercise underway suggests market may work in our favour in this respect given the current fiscal environment, and
- Damage to the reputation of Edinburgh and Scotland as a place to do business with local and national Government.

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8.5. Mediated Settlement

Given the risks associated with a forced termination through the contract at this time, an alternative proposal is to mediate on the whole Infraco Contract. This has been proposed and agreed via a motion from CEC and **tie** has been instructed through the Tram Project Board to review this option.

For this option it is assumed that we enter into short form mediation with BSC. **tie** then goes on to re-procure the reminder of the project on a phased basis and without the risk of litigation. The respective risks and benefits of this option are explained in Section 7. The table below indicates the evaluation of costs associated with this option.

8.6. Summary evaluation of Options

The following table summarises the options available to us with some the key decision making criteria:

Option	Cost Certainty	Programme Certainty	Stakeholder/PR acceptability
“As is”	×	×	×
Carlisle	×	×	×
Termination	×	×	√
Mediation	√	√	√

(Table 11)

Additionally, it is worth remembering that the construction phase is the final part of the tram journey and to re-state what we have spent to date and what we have achieved for this. A large infrastructure project such as the tram project requires a substantial amount of work to be undertaken in advance of construction works.

- The budget for tram infrastructure represented 46% of the overall project budget with the most significant construction elements within this expenditure to date related to Gogar Depot (73 % complete), the structures along the off-street section and tram works along Princes Street.
- Significant progress has been made on the construction of the 27 tram vehicles with 19 complete and ready for delivery to Edinburgh. This part of the project represents 11% of the original project budget.
- The diversion of utilities has resulted in a significant enhancement of the utility assets in the City including faster broadband services and cleaner water supplies.

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- The primary reason for undertaking these diversions is to ensure that tram and other traffic are not disrupted as a result of utility companies servicing assets or reacting to emergencies in the future.
- Costs related to completed design and land account for 12% of the project budget expenditure to date.
- Design costs represent some 11% of the project budget and are estimated by TSS to be 90% complete.

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9. Resolution – Delivery of the project beyond Termination

Contingency planning work has commenced to identify the tasks required should a termination of the Infracore contract result from this work to date. The following identifies the key workstreams that the team need to focus on over the next few months.

9.1. Workstreams – to Sep 2011

Immediately following any termination of the BSC contract, either through mediation or Termination of the contract and on the assumption that the delivery of the project is to continue and that it will be under the management of **tie**, a number of interrelated workstreams will be initiated with clear timetables, deliverables, decision making criteria delegated authority / governance arrangements. These workstreams are outlined below under the following headings:

- Ongoing works
- BSC Engagement
- Reprourement
- Operational readiness planning
- Communications and stakeholder engagement

It is envisaged that these workstreams will require some amendments to the way that **tie** is resourced and advisors engaged as well as clarification of the ways in which we will engage with CEC officers. In many cases these workstreams have already commenced and the joint deliberations of **tie** and CEC are being considered through a series of working papers presented to CEC.

The totality of these workstreams is envisaged as being completed by September 2011 at which time the strategy for completion of the project would be presented for approval. In addition to the regular reporting to the Tram Project Board it is envisaged that a regime of milestones or stage gates will be defined appropriate to each activity.

These workstreams will require the commitment of additional funding for the project in advance of clarity and certainty with regard to outturn costs, phasing and funding and in advance of determination of either out of court settlement with BSC or litigation. It is not envisaged that there will be any new commencement of on-street works (East of Haymarket) until Jan 2012 [at the earliest] following the appraisal of the outputs from these workstreams.

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9.1.1. Ongoing works

**Secure sites and assets** – BSC have completed or partially completed works at a number of worksites along the route. For the most part these are off street but there are also incomplete works on the Forth Ports Estate in Leith. It is important that we secure these sites immediately following termination to ensure the safety of the public, fulfilment of our obligations to third parties (such as Network Rail, BAA and Forth Ports) and preservation of the value and integrity of the work which has been done.

**Completion of utilities** – In any event it will be necessary to complete all existing utility works underway including the recovery of betterment due from SUCs and satisfactory agreement of final accounts with contractors (the final account with Carillion having already been settled). Over the next 9 months the scope of utility works to be completed includes:

- Telecoms cabling works
- SW abandonments
- SGN abandonments
- Limited remedial works

No new commitments will be made to utility works in the on street sections, the most significantly additional diversion has been identified as being necessary at Baltic Street.

**Interim Works** – In consultation with CEC officers a series of works which it would be necessary or desirable to continue with as soon as practicable after termination have been identified. The criteria for assessment of these works have been:

- Public safety (e.g. Tower Pl Bridge where there is a highway interface)
- They are close to completion (e.g. Edinburgh Park & Carrick Knowe Bridges)
- Depot Completion including trackwork and systems (sufficient to store and test tram vehicles)
- Commercially sensible (e.g. Lindsay Rd works and Gogarburn surcharge)

The criteria above are not necessarily discreet – for instance the completion of works because it is commercially sensible to do so is closely related to the assessment of how close they are to completion. The test of commercial sensibility will in turn be dependent upon the willingness of existing sub-contractors (and perhaps Siemens) to engage in completion of the works concerned on acceptable terms (compared on a value for money and time basis to the reprocurement of the works concerned) and our compliance with public procurement law – see below.

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**Reinstatement and remedial works** – In the event of termination there are reinstatement works which CEC would require to be carried out in the on-street sections in particular in recognition that it is not intended to commence new on-street works till early 2012. It is also considered necessary to carry out the necessary remedial works on Princes St to mitigate against any further deterioration of the work completed and on safety grounds Again, a joint assessment has been carried out with CEC Officers and a schedule of the works to be carried out is in place.

**9.1.2. BSC Engagement**

Here the workstreams are predicated on settlement of all outstanding matters under the Infraco contract in the most satisfactory manner with due regard to the relative time and cost consequences of each course of action and the imperative to remove continuing uncertainty regarding the existing contract. This is shorter for a mediated solution but could take many months under a forced termination and then litigation.

**Measurement of work done by BSC** – An important ingredient of any future determination of our contract with BSC will be an accurate measurement of the value of the work completed [and on/off site materials] in accordance with the provisions of the existing Infraco contract.

**Determination of exit premium option** – Immediately as part of a mediated settlement or immediately following termination we will engage with the consortium on whether they are willing to consider settlement of all outstanding liabilities without recourse to the costs and uncertainties associated with litigation, and at what additional cost to us (if any). Each party will be heavily influenced in this regard by their respective legal advice on the strength of their case – ours is considered in detail at Section 6 above. In extremis there might be a justification for payment from the consortium back to tie but it is unlikely that will be an attractive option to them.

Our experience, most recently with Carlisle, indicates that a successful outcome to this course of action would require a clear view of the person(s) representing the consortium (rather than the individual partners) and their level of authority to conclude matters as a prerequisite. Any additional payment to the consortium is unlikely to be demonstrable value for money for what has been delivered under the contract so far – rather the relative attractiveness of such an action will be in comparison the prospect of uncertain and costly termination.

**Siemens** – It has always been a strand of our efforts to resolve matters with the consortium to have continuing arrangement with Siemens for the delivery of the systems element of the project. Much of the proposed Siemens installation and

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associated design is proprietary in nature and constitutes the more complex engineering elements of the project and the critical interface with the tram vehicles. Siemens responsibility for ensuring their installation is ready to operate, is reliable and then maintain it in the initial years of operation will be the most difficult element of the BSC contract to replace in a reprocurement – see below. Siemens behaviour has not been exemplary throughout the disputes – as Bilfinger’s joint and several partner in the consortium they have failed to take a leading role in finding an acceptable way forward. They must bear a significant part of the responsibility for the consortium’s failures including design production, management and integration. Their proposed increase in price as part of Carlisle (relative to the original contract pricing) has little justification. However we must be open to whatever might be possible on terms acceptable to us and which passes the procurement law tests.

**CAF** – This paper is prepared on the presumption that the tram supply and maintenance contracts will be novated back to **tie** in the event of termination. CAF are keen to be novated back to **tie**. The reasons for this are:

- To date we have spent £47m under the CAF supply contract out of a total contract sum of £58m. We have taken delivery of one tram vehicle and have the right to take title to the 19 vehicles which are complete and being stored in Spain.
- If on termination we do not take title to the completed trams and novate the TSA and TMA back to **tie**:
  - We will have spend £47m and have very little to show for it other than the one tram delivered to Edinburgh.
  - On the assumption we could make a competent call on the CAF performance bond (which seems unlikely as CAFs performance under the TSA has been very good) we would realise a maximum of £2.8m (5% of the contract sum).
  - We would have the prospect of seeking to recover the lions’ share of what we have paid to CAF under the TSA through litigation with the BSC consortium and undertaking an uncertain reprocurement of tram vehicles for the Edinburgh Tram Project.
- Our assessment of the current demand for tram vehicles is very strong and it is thought that new vehicles may be as much as 50% higher than the price which we secured through the CAF procurement. This is being explored with PwC who are also advising **tie** on potential leasing options for the additional trams not required to operate a service between Airport and SAS.
- To operate a tram service from airport to St Andrew Sq we have determined that we would need 17 out of the 27 tram vehicles – the best outcome in the circumstances would be one where the 10 tram vehicles which are not

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required to run the airport to St Andrew Sq can be leased to another operator until such time as they are required to operate a service to Newhaven.

- We have had encouraging discussions with TfL regarding the possibility of leasing a number of the surplus trams for use on Croydon Tramlink. In terms of capex the entire 27 trams would still be counted as sunk expenditure even if we have a cash income over the period of any lease as a return for that investment.
- A complete disposal of the 10 trams which are initially surplus to requirements would also be an attractive option from a risk management perspective.
- The timing of engagement and negotiation with CAF on the terms of the novation back and discussions with both CAF and TfL on the terms of a leasing deal will be important.

For the purposes of modelling the financial outcomes of termination and reprocurement we have assumed that we acquire all 27 vehicles but that up to 10 of the vehicles are then leased for 7 years at an annual yield of 7.5% to another party until they are required to operate the service to Newhaven at the end of 2017.

The immediate engagement with CAF would focus on:

- Resolution of outstanding commercial impact of project delay on their contract(s) (in fact would we not seek a way to do that before novation back to us – to mitigate any attempt by them to lean on us commercially)
- Arrangements for storage and safekeeping of the tram vehicles
- Reassessment of the programme for completion of the depot and related track work and systems initially. This in turn will be highly dependent upon the extent to which completion of the depot and related track work and systems is part of Interim Works by existing subcontractors (and perhaps Siemens) or in the event needs to be reprocured.
- Structure of any arrangement to lease or dispose of tram vehicles (with or without related maintenance obligations) which are surplus to the number required to operate a service from airport to St Andrew Sq – the assumed first phase of operations.

**9.1.3. Reprocurement**

In parallel with the Carlisle negotiations we have been assessing the possible outcomes from a termination of the current Infracore contract and delivering the project on a phased basis beyond procurement. The workstreams we would undertake beyond termination to undertake such a reprocurement exercise are described at section 8 below. The base programme assumptions are indicative and dependent on procurement timescales and on no legal challenge being made by BSC:

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- Airport to Haymarket physically complete by Dec 2012;
- Airport to St Andrew Sq complete and open for revenue service by Dec 2013 (respecting the principle that we will not work on Haymarket to Lothian Road and Waverley Bridge to St Andrew Sq concurrently), and
- Remainder of project to Newhaven procured and constructed progressively from 2013 to 2017 contingent upon availability of finding and successful delivery and operation of airport to St Andrew Square.

**Existing subcontractor arrangements** – BSC have employed a number of sub-contractors although it would appear most of these arrangements are on the basis of letters of intent or limited orders to proceed and consequently without collateral warranties to **tie**. Following termination we will review all existing sub-contractor arrangement to assess our ability to step-in to those arrangements. This exercise will inform the extent to which existing contractors may be used to complete Interim Works and/or form part of the overall reprocurement strategy if:

- It is compliant with procurement law to do so, and
- The subcontractors are willing to do so at a price and terms acceptable to **tie**.

**Complete Design or Redesign** – we have already engaged Scott Wilson in an exercise to audit the status of the design completed by Infracore and SDS. Following termination we would immediately embark on an exercise to procure the completion of an integrated and assured design prior to the reprocurement of any new works (other than the Interim Works). We would do this by either:

- Novation of SDS back to **tie**
- Use existing TSS contract to complete design
- Re-procure a new designer

An essential element of completing design will be to ensure all practicable value engineering opportunities are secured to mitigate against the increase in costs as a result of design change and failures under the stewardship of BSC. The desirable outcome would be a significant reduction in anticipated cost before retendering the works. Our initial assessment is that this exercise has different characteristics and challenges as between the on and off street sections:

- Off-street – where substantial work has completed or is in progress and where the timescales and uncertainties associated with redesign and consent/approval thereof is likely to be unattractive in terms of impact on outturn cost. Nevertheless opportunities exist e.g. with respect to the requirement for retaining walls not yet started, drainage specification and trackform through Edinburgh Park.

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- On-street – where an assured trackform design has not been delivered by BSC and where the nature and extent of road construction will have a significant impact on outturn costs and programme. **tie** has engaged Scott Wilson already through the TSS Contract to review options for on-street trackform design.

**Development of Reprourement Strategy and Phasing** – Initial workshops have taken place on the development of a reprourement strategy and **tie** has appointed Cyril Sweett to assist with this exercise. Following a mediated settlement or termination we would embark on full development of a strategy with the assistance of Cyril Sweett and legal resources.

For planning purposes we have assumed that **tie** engages in a 9 month exercise to develop and refine a reprourement strategy which would not in any case involve any further on street works until Jan 2012 – the attendant costs including redesign where necessary are acceptable to CEC. At the end of the 9 month period a gateway review will be undertaken to determine validity of reprourement strategy and costs thereof alongside then extant funding and affordability constraints.

The essential characteristics we envisage the reprourement strategy having and the principal challenges to be overcome are as follows:  
Essential characteristics

- Packages
- Controlled phasing
- First operational system to St Andrew Sq
- Sensible risk allocation

Challenges to overcome

- Procurement law with sub-contractors / Siemens
- Design integration risk – civils v systems
- Systems using Siemens kit
- Maintenance and overall liability for making it work
- Secure outstanding consents and approvals
- Programme & phasing
- Integration

These challenges change dependent on whether we find a mediated settlement to the Infraco contract or embark on a Termination route for Infraco Default.

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**Operational readiness planning**

There are a number of operational planning activities which will continue as follows:

- Design support – the finalisation and/or taking on of the design by a new Designer will require to be checked that it delivers an operationally satisfactory system;
- Re-procurement support – the tenders for individual sections and packages of work will each require to be analysed and scored from an operations and maintenance perspective;
- Interim works support – as discussed below, the interim works offer the opportunity to achieve limited tram operations in the shortest possible time but will require operations and maintenance personnel working within a safety management system to realise;
- Management of completed assets essential to retain value – all assets whether in storage or being used to a limited extent require management in order to retain their value and minimise the degree of degradation, caretaker maintenance as a minimum will require to be performed and monitored;
- Test & commissioning management – the incremental delivery approach changes the scale of testing and commissioning. Adding on new sections to an operational system requires careful planning and management. The disaggregation of the contracts means that the responsibility for managing this effectively will sit with the Client;
- Integration management – the onus of managing the integration and configuration between systems, the trams, the track and the civil works increases under all the options under investigation. We may retain Siemens capabilities or increase the role played by CAF in this regard, however the ultimate responsibility for achieving a satisfactory outcome on this will be heavily on the Client organisation to ensure that it works;
- Tram vehicles project management – whilst the production of the tram vehicles in the factory is nearing a conclusion, the integration and configuration of them to run satisfactorily in Edinburgh has yet to be undertaken. It is imperative that they are tested and proven on the infrastructure in Edinburgh at the earliest opportunity in order not to degrade sitting in storage and to identify and rectify

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any defects that have not yet emerged, and to setup the infrastructure and location specific elements;

- Tram vehicles lease management – the tram vehicles are likely to require modification in order to make them compatible with an alternate infrastructure, they will then require to be tested, commissioned and configured for that infrastructure and thereafter the standard of maintenance and their care by the other operator will require to be audited on a regular basis in order to maintain the value of the leased asset;
- Ticket vending machine procurement – we are nearing the point of being able to award a contract for the supply of the equipment, the first phase of the supply will be to agree on the user interface and design of the equipment and thereafter to manage the manufacturing, testing and commissioning of the initial batch of equipment for the first section of tram route to enter public service.

**Communications and stakeholder engagement**

Stakeholder and City Collaboration

In the few months when redesign and / or reprocurement are taking place the scale of operations for the stakeholder team is likely to remain, like now, at a lower level of activity. Work is already underway to identify how best to deploy the team on the following core activity areas.

Branding

One of the priorities will be to maintain confidence in the trams as well as keeping high the awareness that they will be coming to the City. To this end an assessment is underway of the key infrastructure points including park and ride, overhead poles and structures which can continue to be branded in keeping with other Citywide marketing campaigns.

In addition the exhibition material from the tram vehicle is being redesigned currently as a mobile and flexible public information unit which will promote the tram in a range of venues. A leaflet will also be produced to this effect.

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Larger exhibition material and schools programme

There is still a good deal of work to be done on the larger exhibition which is due to take place in the City Museum in 2012. The collation of all the necessary material and cataloguing of this will continue.

The schools programme is being trialled with a range of schools across the route and will also be piloted and promoted through some of the City libraries.

Press and media and political activity

Day to day activity with press and media explaining the whole integrated transport story will be vital in the months following any change in working. The project continues to be one of the highest scrutinised projects nationally in construction terms and therefore gaining and maintaining confidence with a broad range of media, politicians and stakeholder groups will take the largest proportion of time amongst the team. Also the broader task of mending relationships with many stakeholder and business groups is likely to be very intensive.

**9.2. Management arrangements**

It is recognised that there is the potential for a number of workstreams to be in play post any mediated settlement or termination as described above. The impact of this is being reviewed and an organisational structure being developed. At present this is very dependent on a decision on whether a litigious Termination route is likely or whether a mediated settlement is achieved. However, it is likely that the size and shape of the will change slightly over the next few months and a more radical re-structuring developed as the future becomes clearer.

Since April 2010 we have had a decrease in employee numbers (including secondees). We had 97 employees in April; in December 2010 this has decreased to 74 employees and 8 secondees, a total of 82. This will decrease further in January 2011 to 71 employees and 8 secondees resulting in a new total of 79.

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9.3. Process & Governance

The Tram Project Board will continue to meet every 4 weeks to review direction and monitor costs and programme associated with the option adopted.

Additionally, following any re-procurement exercise and before any further construction contracts are awarded a stagegate process will be invoked to approve any decision of moving forward with the completion of the project.

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10. Conclusions & Recommendations

10.1. Conclusions

The foregoing has described the efforts made by **tie** to find a solution to the dilemma of having to manage a project under contract terms which have proved to be unclear and open to interpretation resulting in many being the subject of dispute between the contracting parties.

Despite our extensive efforts, and the strategy approved by TPB, since March 2010 there has been no improvement in the behaviours being demonstrated by BSC and indeed positions, whilst these might have improved over the summer with the introduction of new personnel on both sides, they now seem to have returned to the previous level if not deteriorated.

The results of DRP’s and adjudications on contract terms have not always been conclusive or favourable to **tie** and have certainly not delivered the clear interpretation of the Infraco Contract which we might have hoped for, albeit they have given guidance which is now being used in day to day contract administration. However, they have de facto saved the taxpayer tens of millions of pounds. Where associated with works which were stalled due to alleged **tie** Changes, **tie** were able to issue associated Clause 80.15 instructions to get work started, but the BSC response to this has been slow.

Generally, BSC have continued issue Notification of Change for alleged Changes and been slow to provide Estimates. They have also continued to use Clause 80 of the Infraco Contract which they allege allows them to stop work until the Estimate is agreed, as opposed to Clause 65 which requires them to continue to work.

The overall management of programme and design management by BSC have not seen any improvement since March 2010 and the Open for Revenue Service (OFRS) date has continued to slip.

A number of workstreams have continued since the TPB in March 2010 and are reported on in Section 4 of the report. Section 6 outlines the options available to the project. The options now facing us are:

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- Enforced adherence
- Revive Carlisle
- Terminate (mutual and contentious) - followed by cancel, postpone or carry on with the project
- Mediation

**10.1.1. Enforced Adherence**

In this option we continue to seek to get BSC to perform using the existing contract. This would include continuation with Clause 80, clause 34.1, revisiting other parts of the contract and abiding with DRP/Adjudication decisions.

This could end in BSC compliance or, a stronger case for termination or, continued deadlock. There are a number of factors to consider in this option which includes:

- Trust between the parties is broken
- Contract is ambiguous
- Work has almost stopped
- No certainty on cost or programme
- Do we keep going until money runs out – tie default
- Political patience
- tie and CEC team resilience

**10.1.2. Carlisle**

The latest position from BSC would mean Airport – Haymarket for £640m by end 2010 (but now out of date). A deal would contain get out clauses for BSC, not a GMP. Factors to consider include:

- Design is still not finished/approved
- Trust
- Ambiguous contract doesn't disappear
- Procurement risk

More recently, a letter from the Infraco (25.1.20/RJW/7586 dated 2 December 2010) suggests mediation on a concept of Project Carlisle.

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It may be possible to use mediation to reach a settlement on the lines of Project Carlisle, but as the signs are that there is disagreement between Infraco Members as to what may be an acceptable settlement it is likely that the settlement would be substantial less favourable than the parameters placed on Project Carlisle.

10.1.3. Terminate

**tie** has now issued 10 Remediable Termination Notices and rejected 4 of the rectification plans received back from BSC. **tie** is now in a position to proceed to issue a Notice of Termination to bring about a contractual end to the Infraco Contract. This could be done by one of two ways which both have different considerations:

1) Mutual agreement

- What payments for work done to date?
- What commercial settlement?
- Status of Deliverables (especially design)
- What will it cost us to finish (which design will we use) and how long it will take.

2) Unilateral Action(contentious)

- Consequences – how much could we lose or win
  - What are the essential elements of our case
  - What are our strengths and weaknesses
  - What are our chances
  - How long will it take and how much will it cost
  - What is the possibility of an out of court settlement
  - Resources to manage this process
- Risk of BSC seeking judicial review and interdict
- What do we do with the Trams
- What do we do with SDS
- What do we do with the works already started
- What do we do with the remedial works required

**tie** and its advisors have been, and continue, to collect the body of evidence to defend any litigation. Additionally, **tie** plan to test the breaches through DRP which will give further confidence in **tie** should a forced termination of the Infraco contract be the only option left.

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The use of issue of RTN’s, whilst seen as a mechanism to terminate the Infraco Contract, if required, was also seen as a mechanism to exert commercial pressure on BSC which could lead to a successful conclusion being reached through Project Carlisle or alternatively might lead to BSC being inclined to discuss an end to the Infraco Contract.

Following termination, there are decisions to be made on the future of the project – cancel, postpone or carry on, again each have considerations:

Cancel

- What re-instatement works
- Dismantling project management structures
- Tram Acts
- Vehicles
- Land

Postpone

- How long?
- What re-instatement works
- Dismantling project management structures
- Tram Acts
- Vehicles
- Land

Continue

- Stage 1 – until late summer 2011
  - Close out InfraCo contract
  - Plan re-procurement
  - Complete design
  - Continue with interim and remedial works
  - Take trams
  - Costs
  - Report back to CEC for go/no go
- Stage 2 – following late summer 2011

Meantime, risk of interdict by BSC remains.

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10.1.4. Mediation

Over the past few weeks, BSC has intimated that it would be willing to undergo mediation for the range of the disputes over the Infraco Contract. A proposition has been made and motion agreed at full Council in respect of mediation between the parties to see if a mediated solution can be found. **tie** formally contacted BSC on 22/11/10 who are in favour of this approach. CEC have also met with BSC to discuss this and CEC is agreed that mediation should take place (Appendix 29).

The scope of the mediation is to be agreed but currently is proposed as:

- BSC complete airport – mid point terminus, or
- BSC leave in an orderly fashion.

There are options around timing of the mediation – now or in 4-6 months and the style – fast and commercial or in a slow and detailed manner. The preparation for mediation is key and will include a) what does “good” look like, b) resources and parties involved and c) governance.

10.1.5. Re-Procurement

**tie** has commenced work on the range of options available for reprocurement and management of the project should any termination or alternative scope of the project be realised – mediated or otherwise. The range of this includes completion of design, reprocurement, any reinstatement or remedial works and organisation required to support such activities.

**tie** also continues to collect the body of evidence to support any DRP or forced termination and also to support any other legal/commercial workstreams.

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10.2. Recommendations

It is recommended that:

1. **tie** enters into mediation with BSC.
2. The scope of this mediation to cover options for an amended scope of the project along the lines of Project Carlisle or an agreed termination of the Infraco Contract.
3. The mediation to be short form with legal agreements reached at the end of the mediation. All agreements to be subject to Full Council approval.
4. The mediation result to be presented to TPB following an outcome on mediation.
5. Continue with enforced adherence of the Infraco Contract in the short term.
6. **tie** to continue to work on the scenarios for re-procurement following any mediation. Recommendations on workscope along with budget requirement for the first 9 months of 2011 to be presented to the TPB once the outcome of mediation is understood.
  - Any proposals for re-tendering should be presented to TPB before they commence and stagegate review held before any new construction contracts awarded.
  - Before any new construction contracts are awarded, all design should be complete, integrated and assured.
  - Before any new construction contracts are awarded all third party agreements should be concluded to reduce the risk to the Tram project of negotiation positions being taken by 3<sup>rd</sup> parties.
7. Work should continue, regardless of the output of mediation, on the review of SDS and potential for legal action for poor design services throughout the life of the SDS contract.
8. Work should continue with building the “body of evidence” for use in any potential litigation associated with a contentious termination of the Infraco Contract by the parties.

**tie Ltd**  
22<sup>nd</sup> December 2010

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