IN THE MATTER OF THE EDINBURGH TRAMS STATUTORY INQUIRY

SUPPLEMENTARY WITNESS STATEMENT OF DAVID GOUGH

PROVIDED ON BEHALF OF BILFINGER CONSTRUCTION (UK) LIMITED

1. My name is David Gough. I have previously given a written Witness Statement to the Edinburgh Trams Inquiry **(TRI00000040)**.

2. I have been asked by Bilfinger Construction UK Limited ('BCUK') to provide this additional Witness Statement as a result of the publication of Bilfinger's Internal Monthly Reports which have now been made available to the Inquiry.

3. I was employed by BCUK on the Edinburgh Tram Project initially as Project Quantity Surveyor from October 2007 until July 2010 and thereafter as Commercial Manager until May 2012. I reported to the Project Director who from March 2009, was Martin Foerder.

4. The result for BCUK on the ETN Project was ultimately a positive one. To understand how this came about, it is first of all necessary to understand how the Infraco Contract came to be re-negotiated following the mediation which took place at Mar Hall in March 2011.

Project Phoenix

5. I was involved in pricing the Project Phoenix Proposal, which was submitted to tie on 24 February 2011 **(BFB00056549)** and which subsequently formed the basis for discussions at Mar Hall.

6. I was involved in working with the BCUK management team in preparation for the mediation and the negotiations post mediation leading up to the agreement of MoV 5, which included the re-negotiated Target Price for the On-Street Works and the Fixed Price for the Off-Street Works.

7. As the Inquiry has already heard, Schedule Part 4 contained many pricing exclusions and pricing assumptions, which had to the time of mediation, resulted in a great many Notified Departures entitling Infraco to additional time and money.

8. In preparing the Project Phoenix Price, we were offering to 'buy out' a lot of these pricing assumptions and exclusions, with only a small number remaining (as set out in Appendix 4 of the Project Phoenix Proposal (page 140 of the document)).

9. The Proposal was for a fixed price, subject to certain assumptions and remaining exclusions, to take the tram from the airport to Haymarket Viaduct, the Enabling Works in Section 1A and work already executed in Sections 1B, 1C and 1D.

10. At that time, the scope of works east of Haymarket Viaduct (On-Street Works) were undefined and consequently were not included at all in the Project Phoenix Proposal.

11. In providing this Witness Statement, I have been given access by BCUK, to the Project Phoenix Proposal and have spent some time reminding myself of the numbers included in there.

12. Referring to Page 11 of the Project Phoenix Proposal, BCUK's price for the Project Phoenix Proposal was £231,837,822 however BCUK, through the Consortium Agreement, was responsible for the administration of SDS's account, therefore the total for BCUK including SDS was £246,978,617.

13. BCUK added 10% for overheads and profit equating to £22,452,601 as shown on page 11 of the Phoenix Proposal.

14. The Project Phoenix Proposal also contained three elements of 'further risk' in respect of providing a fixed price for the Works (when the Infraco Contract to that point in time had not been fixed price as a result of all of the exclusions and pricing assumptions in Schedule Part 4). These three elements were:

    14.1.1 A risk/opportunity allowance of £2,629,383 (1.1%) against the Direct Costs of the Job for items such as design changes, programme and general risk identified by our supply chain partners.

    14.1.2 A risk/opportunity allowance of £5,040,000 (2.0%) against 'Indirect Costs' which had been derived from a Monte-Carlo calculation of the probability of certain risks being realised.

    14.1.3 A sum of £8,058,450 (3.3%) which was our price for reducing the number of exclusions which had been included in earlier versions of Project Phoenix (Project Carlisle). The evaluation of these exclusions was predominantly based on rates agreed in earlier tie Change Orders or Infraco Notices of tie Changes for work of a similar nature and largely related to dealing with contaminated ground.

15. We required these further risk elements because BCUK would now be taking responsibility for further items which had previously been excluded by way of Schedule Part 4 and Project Carlisle. For example, we were assuming the risk for the following matters:

15.1.1 design changes up to the issue of the drawings included at Appendix Part 4 of the Project Phoenix Proposal;

15.1.2 known utilities on the Off Street Works;

15.1.3 known quantities of contaminated ground;

15.1.4 third party approvals; and

15.1.5 programme and general risk.

These further risk items were clarified on Pages 5-7 of the Project Phoenix Proposal.

16. The residual exclusions from our Project Phoenix Proposal Price were set out on page 141 and included the following:

16.1 Any works associated with the Gogar Interchange / Edinburgh Gateway;

16.2 The construction of any Floating Slab within Section 2A;

16.2.1 Utilities which had not already been implemented through a tie Change Order;

16.3 Dealing with the occurrence of Fossils and Antiquities; and

16.4 The Airport Kiosk and Canopy Design.

17. Overheads, profit and the contingencies outlined at paragraph 15 above, expressed as a percentage of the overall total, before entering into mediation was therefore 15.5%.

Mar Hall Mediation

18. Project Phoenix was the basis for all of our discussions with the City of Edinburgh Council ('CEC') at mediation. Whilst I had been heavily involved in preparing the submission, and gave detailed information to our own commercial team at the mediation, the ultimate deal was reached between a small number of our senior management team along with their counterparts from CEC. I was not involved in these discussions but I was advised of the outcome.

19. The Bilfinger Price agreed at mediation for the Off Street Works was reduced by £10.4 million from the number included in the Project Phoenix Proposal. That was part of the commercial deal discussed in detail with CEC.

20. Matters such as the overheads and profit percentage which we wished to achieve and the contingencies outlined above were entirely visible to CEC and its advisers.

21. The total amount agreed in the Heads of Terms following the March 2011 mediation for the Off Street Works (including Siemens and SDS) was £362.5 million.

22. At mediation, CEC also sought a cost for taking the tram to St Andrew's Square. A target cost for this was estimated at £39 million of which £25 million was for BCUK, which included £2.3 million (10%) for overheads and profit.

23. BCUK's agreed Price coming out of the mediation was therefore £261.6 million, including SDS and the On Street target price.

24. Overheads, profit and contingencies expressed as a percentage of the overall total agreed following mediation was now 13.5%.

MOV 5 (Settlement Agreement)

25. Following the agreement at Mar Hall, BCUK and Siemens worked with CEC and its advisors to develop and agree MOV5 which was signed on the 15 September 2011 **(BFB00005464)**.

26. Whilst the price for the Off Street Works remained at £362.5 million in MOV 5 (as shown in the revised pricing schedule (Schedule Part 4)) attached thereto, of which the BCUK element was £261.6m, the On Street Works price, by this point in time, had moved from the estimated £25 million to £35 million. This was in a large part dictated by CEC's decision to extend the tram from St Andrew's Square to York Place.

27. BCUK's revised price by the time of execution of MoV5 had changed to £271.5m but essentially it still contained the overheads, profit and risk allowances as originally contained within the Project Phoenix Proposal.

28. The residual exclusions from Mar Hall were reduced and now only included those items listed at Schedule Part E of MOV5.

29. Overheads, profit and contingencies expressed as a percentage of the overall total agreed following MOV5 were therefore further reduced to 13.30%.

Final Result

30. I left the project in May 2012, and so experienced a number of months of post mediation progress prior to departing. I contributed to compiling the monthly reports which were sent to Germany. I am therefore familiar with the form of reporting used.

31. It is also fair to say that having been involved in the Project with tie for 5 years, and given the difficulties we had encountered, there was not much faith or trust that things would change after the mediation.

32. At the mediation, I understand that the Infraco made it clear that they would not continue unless tie were removed from the Project. We knew that City of Edinburgh Council would get more involved and we were pleased also at the involvement of Colin Smith and Turner & Townsend.

33. In the event, things ran much more smoothly after mediation. The planning process and third party approvals were tackled in a much more efficient way by CEC, and the process of developing a 'sweep' for utilities diversion, where the utilities were removed by the utility companies just in advance of the construction works, was far more successful.

34. We developed a good working relationship with CEC, Colin Smith and Turner and Townsend, and as a consequence of this, the outcome for BCUK was more positive than had been predicted at the time of tender, and whilst I left the Project in 2012, this was apparent even then.

35. I have now seen the Monthly Report prepared at the end of the Project (July 2014), which indicates a gross profit of 21.2% **(BFB00112249)**. This figure is higher than the planned / projected overheads and profit which was agreed at 10% with CEC. The primary reason for this was that BCUK was able to bank the contingencies included within the revised Price, and other operational and efficiency savings which were made.

36. Having now examined the final Monthly Reports from June and July 2014 and following discussions with representatives from BCUK, I believe that the savings which were made were primarily in the following areas:

36.1.1 A Value Engineering saving on the On Street Construction Works, negotiated after the Settlement Agreement was signed, which lifted traffic management arrangements and embargoes within the City Centre. The programme saving of 22wks was handed over to CEC and the financial benefit shared 50/50 with CEC. This generated a net uplift of £1.9 million (0.7%).

36.1.2 Savings on the Off Street Construction Works achieved by negotiating confirmed orders with key subcontractors and suppliers following mediation and the careful management of those subcontractors and suppliers through to completion resulting in a saving of £6.0 million (2.1%). This saving includes the benefit of mitigating the risk provision of £2.629 million on this element of work, identified in Project Phoenix.

36.1.3 BCUK achieved a saving of £5.04 million (1.8%) against the Risk and Opportunity contingency from the Monte Carlo Calculation, referenced in

Project Phoenix. Through good and proper management post the Settlement Agreement and developing a sensible way of working with CEC, we managed to avoid design, programme and commercial risks associated with the Off Street Works and this sum was added to the BCUK gross profit.

36.1.4 A significant reduction on the amount of contamination and other Off-Street risks identified within the Project Phoenix Submission, resulted in a saving of £8.058 million (2.9%).

36.1.5 Included within the Final Value of the project is a payment of £3.2 million made by tie/CEC which related to a contractual amount due for the cancellation of Phase1b. The costs associated with Phase 1b were incurred by BCUK Head Office in the UK and therefore should not be accounted for in the final gross profit realised by BCUK on the Edinburgh Tram Project.

36.1.6 A combination of Changes agreed after the Settlement Agreement came into effect and the smooth running of the project resulted in further savings on allowances BCUK had made for staff/consultants; legal support and office running costs generated a further increase in the profit margin of £10.7 million (3.8%).

36.1.7 After the Mediation at Mar Hall BCUK negotiated a further saving against the SDS Designer of £1.2m (0.4%) based on a number of issues including where SDS had caused BCUK to incur additional cost and early payment of their account following this agreement.

Specific Questions raised by the Inquiry Team

37. The Inquiry Team have asked BCUK to respond to the following questions in relation to the content of certain Monthly Project Reports.

38. (1) **The Monthly Project Report for January 2009 (BFB00112178) at paragraph 1.3.1 notes in the section headed "Construction" that "*Traffic Management is being installed to allow works to commence in Princes Street in February 2009 on a cost plus fee basis*". On what basis was that entry made in that report? Other evidence before the inquiry indicates that an agreement on the Princes Street dispute including, in particular, that works would be paid on a cost plus basis, was not reached until March 2009.**

39. This entry was made because tie had issued Change Order Nr 21 under cover of their letter ref INF CORR 758 dated 13 February 2009. This Change Order related to the provision of Traffic Management on Princes Street. This predated the Agreement with tie/CEC to proceed with the main construction works on Princes Street on a cost plus

basis but was known about before the Monthly Project Report for January 2009 was issued. The January 2009 report would not have been issued until late February 2009 because that was the way that the reporting periods worked.

40. **(2) The Final Monthly Project Report, dated July 2014 (BFB00112249), at paragraph 1.01 (Project Overview Charts) includes the following figures in the "Result" line: 11.07% (original contract), 7.23% (settlement agreement) and 21.21% (actual). It appears to us that these figures represent Bilfinger's projected and actual profit from the Edinburgh tram contract? Is our understanding in that regard correct and, if so, why was Bilfinger's actual profit so much greater than the profit anticipated both when the Infraco contract was signed in May 2008 and at the time of the settlement agreement in September 2011?**

In the Inquiry's question reference is made to profit percentages. This is not quite correct as this is the gross figure for overheads and profit. The numbers quoted are prior to the deduction of overheads. In this additional Witness Statement, I have provided comments on why BCUK's gross profit was greater than anticipated both in May 2008 and in September 2011. Essentially, BCUK made allowances and contingencies for areas where they assumed risk post the settlement agreement. Through the removal of tie and proper and constructive dialogue with CEC/ Colin Smith/ Turner and Townsend, and certain contingencies not coming to pass (e.g. contamination not being as bad as allowed for), together with BCUK's proper and efficient management of the contract and its subcontractors, BCUK managed to obtain a result which was better than anticipated.

41. **(3) In its internal monthly reports in 2011, Bilfinger reported a shortfall of around £9.5m between sums it had invoiced to tie, and the sums tie had paid. The reports attributed this difference to invoiced but uncertified preliminaries (see for example the report to 31 May 2011, BFB00112211 at paragraph 1.2.4). Was that shortfall cleared by the payments tie made to Bilfinger under Minute of Variation 4 (£12.5m paid in instalments on 22 April and 17 May 2011: CEC01731817, paragraphs 6 and 7)? If so, why did Bilfinger continue to report the shortfall in preliminaries of approximately £9.5m up to and including its report of 31 August 2011 (BFB00112214, paragraph 1.2.4)? What was the balance (of approximately £3m) for?**

42. The shortfall was not cleared by the payments tie made to BCUK under Minute of Variation 4 (£12.5m paid in instalments on 22 April and 17 May 2011: CEC01731817, paragraphs 6 and 7). The payments made under MOV4 related to Site Wide Remobilisation as set on Page 47 of MOV4, as well as some payment towards the unpaid preliminaries. BCUK continued to report the shortfall in preliminaries until the

September 2011 report, at which time, credit notes were issued to tie, relating to the shortfall and therefore clearing any balance due. The issue of these credit notes followed the successful conclusion of MOV5.

I believe that the facts stated in this additional witness statement are true.

Signed: ....[redacted]................

David Gough

Date: 1 October 2018.