

## Executive Summary

MOV 4 reached agreed form (but has yet to be executed) following extensive engagement between the CEC negotiating team and Infraco negotiating team on Saturday 16 April 2011. This was revisited on 10 / 11 May to address matters which had not been completely accepted by CAF.

This updated agreed document was provided to **tie** on 11 May and has been reviewed. The previous version had also been subject to a detailed discussion with **tie**, CEC legal and McGrigors on 19 April 2011.

This report highlights advice from **tie** to the CEC negotiating team over the last six weeks and includes detailed mark up comments to fully inform CEC decision makers in the attached Appendices.

For ease of reference, **tie** considers that the principal issues that CEC should consider when deciding on executing this Variation to the Infraco Contract are as follows:

1. **Valuation of Entitlement under this MOV.** The value of the payment schedule included in the MOV (particularly the £49m payments scheduled over certificates 1, 2 and 3) cannot be supported by our analysis. It is noted this is a commercial decision for the funders and that Hg Consulting fully support the valuation. A detailed report was provided to Hg Consulting on 2 May and is included at Appendix 4.
2. **Certifier Agreement.** This needs to be prepared and in agreed form, including mechanics of operation, and compatible with responsibilities and accountabilities (and necessary Insurances). A draft agreement has been circulated and needs some amplification in relation to the practical valuation process intended. As at 11 May, this has still to be executed but it is understood that the Certifier and CEC have reached agreed terms, subject to Infraco review. The valuation process flowchart etc. is understood not to be included.
3. **Payment.** The payment mechanics in Clause 6 prescribe payment by 22 April 2011 based on an Hg Consulting Certificate 1 which was received by **tie** on 25 April and discussed with Hg and CEC on 26 April ; with no vesting of materials until cash has been received by Infraco; with no executed version of the MOV4; with a Certifier Agreement which has yet to be agreed and executed by the Certifier, **tie**, CEC or Infraco); An instruction was received on 3 May 2011 from CEC to **tie** to pay on the basis of the MOV4 terms, noting the risks and assumptions raised in **tie**'s letter of 3 May and noting that CEC accepted it would take **tie**/TEL outside the current Operating Agreement terms with no revised delegated authority from CEC (**tie** considers that these payments include entitlement beyond the £545m and that they become commitments once MOV4 is signed). In addition, all payments are now classified as final and binding, allowing no changes to these amounts at a final account stage. Payment was made on the basis of the above on 3 May 2011.
4. **Removal of Design approval rights and Infraco Obligations / ROGS duty holder risks.** The proposed changes to utilising only the Infraco IDC procedure, deleting obligations under Clause 10 and removing **tie** rights of approval under Schedule Part 14. If the transparency of the "self certification" being undertaken by Infraco is not suitable and timely, it is very likely to increase the risk of **tie** (and potentially the ICP) being unable to discharge their duties under ROGS. This could result in the city being unable to open the tram system for revenue services. Recent correspondence has demonstrated an uncooperative approach from

Infraco. A detailed review on these specific issues has been reprogrammed for w/c 16 May with **tie**, McGrigors and CEC. If any changes are required, CEC advise this will be addressed with Infraco before final execution of the document.

5. **Design obligations.** The MOV does not require Infraco to achieve any completed design for the payments made under this variation and the Certifier appears to have considered other than a progress statement for design from Infraco within Hg Certificate 1. Supplementary information has been requested by the Certifier and Infraco have promised to provide this. It is understood that this was provided by 11 May 2011 but has yet to be reviewed.
6. **Outstanding Consents.** The MOV transfers the risk of all Outstanding Consents to **tie**, irrespective of whose obligation they currently are. The risk exists that **tie** will not be able to procure these outstanding consents in time, or indeed at all. This requires particular scrutiny of the items included in Schedule Part 3. Currently there is no known valid reason for accepting most of the items included in this current listing.
7. **HSQE rights regarding subcontractors.** The MOV removes all rights of **tie** to impose any restrictions on Key Sub-Contractors including Health and Safety performance measures. Given experience to date of Infraco's underwhelming attention to this matter, **tie** will have no rights to address this for the Prioritised Works.
8. **Programme amends Section A completion irrevocably.** By agreeing to MOV4 it is accepted that Infraco are entitled to EOT to December 2011 to complete a reduced scope of works and that no LDs will be levied before then. If MOV5 is never signed this cannot be taken back.
9. **MOV4 sets a number of precedents.** MOV 4 contains a number of issues, which we understand CEC consider to be acceptable given the limited duration and scope of works to be carried out under MoV4, but which would not be acceptable for MoV5. **tie** is concerned that precedents agreed to under MOV 4 will be very difficult to water down for MOV5, and it is best to resolve these before signing MoV4.
10. **Review and incorporation of Schedules** The MOV refers to a number of schedules and other documents. They have not been reviewed in detail until now. Schedule Parts 1, 2, 3, 5 and 9 are all subject to specific concerns / recommendations for correction / amendment before the final document is executed. Details are provided in the body of the report.
11. **Formal Advice Note from McGrigors.** The **tie** advice incorporated in this report should be read in conjunction with the legal advice note prepared by McGrigors on the impact of MOV4. **tie** has commented to McGrigors on their advice note.

## Introduction

The Minute of Variation 4 (MOV4) agreed between CEC negotiating team (supported by McGrigors) and Bilfinger Berger and Siemens representatives, and subsequently CAF (all supported by their legal advisors) representing Infraco was prepared to amend the Infraco Contract in line with the Heads of Terms agreed at Mar Hall Mediation in March 2011.

It is intended to be a "stepping stone" to MOV5 but also needs to cater for the circumstances if MOV5 is never signed.

The scope is restricted to defined Prioritised Works, associated preliminaries plus payments for the vesting of materials and equipment and payment for Infraco remobilising to undertake works after their cessation of work in October 2010.

**tie** has provided detailed separate commentary on the above valuation issues to CEC and their lead negotiator (C Smith) during 12 March to date. This includes a summary on Hg Certificate 1.

The risk exists that the Infraco will see the “precedents” set by MOV4 as the building blocks to start negotiations from on MOV5. **tie**’s experience to date has been that once an approach has been “agreed” Infraco will resist any dilution of such a “precedent”.

#### **Commentary on proposed Minute on Variation 4**

##### Overview

Design is not explicitly within scope of works although it is included in the justification for elements of the Certifier’s Certificate 1.

The parties have agreed to a joint risk register approach but that has made little headway so far. This MOV is silent on it.

A formal legal advice note has been requested from McGrigors to advise CEC and **tie** on the significance of the amendments to the Infraco Contract enacted by this MOV and the consequent changes to the client rights, obligations and remedies available once this MOV has been executed. This was provided on 23 April 2011 and discussed by **tie** and McGrigors in a telephone conversation on 26 April 2011. We understand that McGrigors are currently reflecting on the points raised by **tie**.

##### Clause 1: Definitions

Generally, not all Schedules appear to be in the correct final form and specific comments on increased risks or corrections requiring consideration are highlighted in this report for CEC review and consideration before sign off.

Certifier Agreement needs to be in available in final form and mechanics agreed before MOV is signed. Current drafting does not fit with processes described by C Smith. It has been proposed that a flowchart is incorporated to enable improved clarity. As at 11 May, this has still to be executed but it is understood that the Certifier and CEC have reached agreed terms, subject to Infraco review. The valuation process flowchart etc. is understood not to be included.

Fixed Sum Prioritised Works Price appears to have mismatch between Programme, Scope and Cost schedule.

IDC definition is ok in its own right but operative clauses are a major concern and addressed separately in comments relating to Clause 3.7 etc.

Materials and Equipment definition allows for other than items originally listed to be vested.

Prioritised Works definition east of Depot is now tidied up with diagram reference.

Outstanding Consents obligation now all moved to **tie**. Major Concern.

Prioritised Works Programme is not yet agreed (e.g. Princes Street Remedial Works still under discussion and will not start as shown in Programme). If this is left as currently drafted in Schedule Part 1 it will generate immediate change.

Vesting Certificate was reviewed by McGrigors but **tie** have not seen any comments on this. **tie** considers that an on demand bond associated with this should be provided or, if not, the bond arrangements must be increased for MOV5 to avoid dilution of client security arrangements.

#### Clause 2: Amendment of the Infraco Contract

No comments.

#### Clause 3: Application of the Infraco Contract to the Prioritised Works.

Clause 3.2 removes the requirement for Infraco to progress any other Infraco Works with due expedition whilst MOV4 is in effect. This will increase the likelihood of an unsuccessful claim regarding failure to progress the works if "hostilities" resume. Tram Maintenance Services (or mobilisation for same) are now addressed where applicable.

Clauses 3.3 and 3.4 seek to cater for circumstances where MOV5 is not signed and the parties are restored to the positions they would have been in save for the agreement that there shall be a termination.

The drafting of 3.3 may need to be tweaked as the section "on or before..." could fit better after "entered..."

In any circumstance, this still obliges **tie** to pay the materials identified and certified in 8.2 and 8.3 even if agreement is not reached on MOV5. This has the potential to increase the cash paid versus value earned discrepancy.

Clause 3.5 merely states what **tie** believes is Infraco's obligation under the existing contract anyway.

Clause 3.6 should also list **tie** as well as CEC.

Clause 3.7 is a major concern. Removal of the review and approval rights under Schedule Part 14 increases the risk of **tie** as duty holder under ROGS being unable to verify and sign off for Open for Revenue Service. This may also impact the ICP's ability to give a "no objection" and hence prevent a legal opening. In addition, it waives all of Infraco's obligations under Clause 10 which is very broad ranging. McGrigors have provided a commentary on this on 28 April regarding the obligations and potential impacts which are being excused /amended and a detailed review on these specific issues has been reprogrammed for w/c 16 May with **tie**, McGrigors and CEC. If any changes are required, CEC advise this will be addressed with Infraco before final execution of the document. **tie**'s comments on McGrigor's report are included at Appendix 5.

Clause 3.8 needs to be workable to avoid breach if **tie**/CEC third party obligations and licences etc. particularly if used for future MOV. In addition, legal review is still required if deleting the Permit to Work obligation is compatible with the Tram Acts as they rely upon the Code Of Construction Practice.

Clause 4: Sole Entitlement etc.

Following discussion on 19 April 2011, we have no further comment. It is noted that design is not mentioned although it is used as substantiation for Hg 1 Certificate etc. This may create a loophole for further entitlement to be argued for design via the Infraco Contract.

4.2 operates as a “carve out” for CAF from this MOV and protects their entitlements. No further comments.

Clause 5: Amendment to Programme

In Clause 5.1 by amending the Planned Section A completion date and the Section A definition means that an irrevocable Extension of Time has been granted to Infraco until 16 December 2011. This will allow no return to previous positions if MOV5 is never signed. In addition, the carve out needs to check and ensure that the items omitted re then included in Section B completion and that interface with Tram Supply Agreement obligations and Depot Licence agreements will work.

Clause 5.2 is understood to be on the basis that CEC have agreed to lift such embargos. It is assumed that all other obligations within the C.o.C.P. such as notifications for out of hours working are unchanged. Extensive discussion has previously taken place regarding Princes Street embargo options and is recorded elsewhere.

Clause 5.3 repeats the Outstanding Consents major issue raised under Clause 1. This appears to enact a significant risk transfer. In addition, the method related access requirements to address the access items are not included in the scope diagrams as far as we can determine.

Clause 5.4 negates any need to mitigate, demonstrate critical path impact, address concurrency but it does limit EOT to an equivalent time rather than what can be proven. This risks both parties. Discussion on 19 April suggested the negotiating team considered this a “give” by Infraco.

Clause 6: Certificate 1- First Materials and Equipment and First Mobilisation

Clause 6.1 contains items of major concern.

The valuation stated here cannot be supported by the analysis **tie** has undertaken and shared with CEC and their advisor team including Hg Consulting. **tie** understands this valuation and the respective timing of payments have resulted from a commercial decision by CEC and other funders.

The payment mechanics in Clause 6 prescribe payment by 22 April 2011 based on a Certificate 1 (dated 15 April 2011) which was received by **tie** on 25 April and discussed with Hg Consulting on 26 April. A detailed commentary on that valuation was provided on 2 May 2011 and is shown at Appendix 4.

It is proposed that there is no vesting of materials associated with Certificate 1 until cash has been received by Infraco. Currently there is no executed version of the MOV4; with a Certifier Agreement which has yet to be agreed and executed by the Certifier, **tie**, CEC or Infraco)

In addition, all payments are now classified as final and binding, allowing no changes to these amounts at a final account stage.

It is noted that Hg Consulting on behalf of CEC have requested further information to support the Certificate 1 issued and that it is reported that Infraco have committed to provide this. It is understood that this has been received by Hg Consulting (post 3 May 2011) but has yet to be reviewed.

An instruction was received on 3 May 2011 from CEC to **tie** to pay on the basis of the MOV4 terms, noting the risks and assumptions raised in **tie**'s letter of 3 May requesting instruction and noting that CEC accepted it would take **tie**/TEL outside the current Operating Agreement terms with no revised delegated authority from CEC (**tie** considers that these payments include recognition of entitlement beyond the £545m and that they become commitments once MOV4 is signed).

Clause 6.2 states that Parties acknowledge that materials may not be required as part of the Infraco Works. That should only be to the extent that the Infraco Works are curtailed by any incremental delivery.

Clause 6.3 is silent on where the materials are when vested and previous correspondence identified a significant quantity (~50% by value) located other than on site or at Infraco's warehouse in Broxburn. In addition, the MOV is silent on responsibility for security, storage and transport post vesting.

#### Clause 7: Certificate 2 - Second Mobilisation

Comment as per Clause 6 applies regarding valuation. In addition, the original drafting did require **tie** to pay a value on a date irrespective of any certification. This has been adjusted to paying the amount certified in the latest draft.

#### Clause 8: Certificate 3 (A, B and C) – Second Materials and Equipment

Comments are as per Clause 6 on valuation. In addition there appears to be no reconciliation of Vesting Certificate value to the agreed sums.

#### Clause 8A Intellectual Property Rights

This is a new clause inserted to clarify the rights for **tie** to use the Infraco IPR. Clause 8A.2 drafting may be read as preventing construction and commissioning of materials and equipment. This may need to be further clarified.

#### Clause 9: Payment for the Prioritised Works

There appears to be no mechanic to avoid double recovery. There is no express mechanism to require Infraco to apply for payment. The action / responsibility is on the Certifier, again which is inconsistent with the process described by C Smith to **tie**. Subsequent discussion has suggested a potential solution of adding an agreed process flowchart. See previous comments in this report.

Clause 9.3 brings forward payment by 7 days from the terms of the Infraco Contract, providing a cash flow benefit to Infraco.

Clause 9.4 identifies the certificates issued pursuant to this MOV4 as final and binding, which will mean that any final accounting for whatever reason cannot adjust any of these values in future, unlike the main Infraco Contract. This is a movement of risk to the client.

Clauses 9.6 to 9.8 have conceded on the principle of time related preliminaries with no further justification. In addition, we note that it is drafted with a bias to pay rather than to value according to progress. We understand that this is a commercial decision made by CEC and their advisor.

#### Clause 10: Total Price

Clause 10.3 appears to carve out TSA and TMA change issues from the MOV4 Change Clauses but the drafting also appears to delete Clause 80. This perceived conflict should be reviewed / reconciled.

#### Clause 11: Excess Trams

Generally, latest draft appears to capture the intent but may need to be checked with CAF's carve out as noted earlier with regard to Clause 4.2 etc.

#### Clause 12: Mar Hall Confidentiality

No comments

#### Clause 13: Communications Protocol

It would appear not to contemplate a circumstance where Infraco wish to release a statement.

#### Clause 14: Moratorium

Provided an MOV5 is executed then this looks ok although the following points should be noted.

Clause 14.1.1 creates the opportunity to generate an argument over whether facts and circumstances existed or were allegations.

Clause 14.1.3 still seems to waive for ever **tie**/CEC's rights to (unless overwritten in MOV5 explicitly) Liquidated and ascertained damages. This would be an enormous concession.

Clause 14.2.2 is related back to the date of exchange of mediation statements however, Infraco continued to serve notices thereafter (e.g. Depot EOT Claim on 4 March 2011).

#### Clause 15: Sub-contractors

It is noted that this reflects the commercial intent of items conceded in the Heads of Terms from Mar Hall.

Clause 15.2 gives a major cause for concern as it eliminates **tie**'s rights under Clause 28.6 and 38 in the Infraco Contract to require removal of sub contractors on Health and Safety grounds. Given Infraco's underwhelming performance to date, this removes some of the few teeth that the Infraco contract has left. It is important that CEC consider this point extremely carefully.

Clause 16: Preservation of rights

Subject to detailed legal comment this appears to be ok.

Clause 17: Disputes

The Forum proposal is in order (other than I presume the reference to Chief Executives should include the word meeting) but both contracting parties need to retain rights to continue DRP if the matter is not resolved at the Joint Project Forum.

Clause 18: Variations

No comments

Clause 19: Law and jurisdiction

No comments.

Noted below are comments on the schedules provided on 11 May 2011.

Schedule Part 1: Programme

Schedule Part 1 has out of date information in relation to Princes Street. It includes general assumptions which have little or no relevance to the Prioritised Works and are not necessary for inclusion (they only provide potential opportunity for claim). There is no apparent explicit linkage to the period costs in Schedule Part 2.

Schedule Part 2: Scope and Pricing of Prioritised Works

Schedule Part 2 description of scope and in particular the milestone schedule update notably includes for claim recovery. **tie** has made its position clear on this matter and does not agree that this is valid. This is not consistent with the latest words and the previous certificate issued by Hg. Hg Consulting and **tie** met to review this on Thursday 12 May. It is recommended that this section is reviewed and CEC consider significantly amending it.

The Pricing Schedules are categorised and are valued based on discussions between Hg Consulting on behalf of CEC and Infraco. **tie** had previously presented their views to CEC, Hg Consulting and Infraco on 31 March 2011. The final values (£76m in total) are in excess of that originally requested by Infraco at that time. **tie** do not support the valuations made but acknowledge it is a commercial decision for CEC in concluding this MOV and have provided separate analysis to Hg to assist in any further review of Infraco submissions.

Schedule Part 3: Materials and Equipment

The listing does not correlate listed items with particular valuation for the assets. It is assumed that this must have been provided directly to the Certifier.



Schedule Part 4

Not used.

Schedule Part 5

The current contents are a major concern. There is no apparent reason why all of the narrative and the individual items listed are included here. The schedule requires urgent review by CEC to ascertain if they wish to take these new risks. **tie** is available to advise / participate in any review required at your convenience.

Additionally, the narrative included is derogatory in content to **tie**, appears to be Infraco's opinion and is not considered appropriate for proposed inclusion in this Contract Variation.

Schedule Part 6: Vesting Certificate

No comments; subject to any legal comments / review by McGrigors.

Schedule Part 7: Change Procedure

It is noted that Certifier has role to resolve valuation of time and money if the parties do not agree. See also comments under Clause 10 and CAF carve out.

Schedule Part 8: Governance Structure

No comments.

Schedule Part 9: Interdisciplinary Check Procedure

Previous comments as Appendix 1 and Appendix 5 apply.

Schedule Part 10

Not used.

**Conclusions**

CEC decision makers should be aware that execution of this MOV4 will transfer significant financial benefit to Infraco and dilute Infraco contract terms related to design, valuation of the Prioritised Works and Programme. There are increased risks in relation to successful compliance with duty holder responsibilities under ROGS.

**tie** Ltd

Originally produced 20 April 2011, updated 12 May 2011

Appendices

- Appendix 1      Commentary provided 12/04/11  
                    Commentary provided 14/04/11  
                    Email analysis of Infraco's IDC proposal 15/04/11
- Appendix 2      Commentary provided 18/04/11 on MOV4 circulated 16/04/11
- Appendix 3      Consolidated Commentary provided 20/04/11 following review on 19/04/11 and  
                    20/04/11
- Appendix 4      Commentary provided on 02/05/11 on Hg Consulting Certificate 1 and Infraco  
                    substantiation following receipt on 25/04/11 and review with Hg on 26/04/11.
- Appendix 5      Commentary provided 03/05/11 on McGrigors' report re MOV4 and Clause 10 /  
                    Schedule Part 14 of 28/04/11.