

**EDINBURGH TRAM - INITIAL MILESTONE PAYMENTS**

(Update 20 Feb 08)

**BACKGROUND**

The programmes for construction of the tram infrastructure and the supply of the tram vehicles are based on finely grained milestones which form the basis for payments to the contractors. Final details of this programme are currently being confirmed. However, it is clearly understood that a significant ramp-up in activities is required by both, the Infraco and Tramco contractors, following Contract Award in order to:

- a) meet the overall construction completion date; and
- b) achieve affordable risk transfer for inflation risk consistent with the approved Procurement Strategy.

Both preferred bidders (Infraco and Tramco) have detailed the scope and programme of activities proposed to be undertaken immediately following Contract Award.

The milestones for these activities, insofar as not previously certified under the existing mobilisation agreements with the Infraco and Tramco preferred bidders, will become certifiable immediately following contract award and will be payable in accordance with the contractual terms (5 working days for certification plus 15 working days for payment). The proposals indicate activities and commitments to the value of **£10.9m** (Tramco) and **£36.2m (Infraco)**.

Included in the total above are initial milestones in respect of material purchases/supply chain mobilisation totalling **£15.5m** under Infraco and **£8.7m** under Tramco which are being treated as prepayments for funding purposes and will be reclassified as Cost of Work Done in the period in which the related materials are delivered to site and incorporated into the works.

**INFRACO**

The initial milestones for Infraco cover 5 key areas:

- a) Contract Award Milestone
- b) Procurement of Materials
- c) Procurement of Plant & equipment
- d) Mobilisation of staff, supply chain and planning and logistical activities

Following the initial proposals from Jan 07, BBS submitted their bid in May 07. At the end of July following initial evaluation of prices, **tie** met with BBS to set further expectations for reduced prices in the bid update due for August 7<sup>th</sup>.

### *FOISA Exempt – Qualified Exemption*

One of the negotiation points related to BBS undertaking early mobilisation and early supply chain commitments to secure fixed prices for key price sensitive materials. Following this, BBS returned a bid on 7<sup>th</sup> August 07 with a reduction of **£6.9m**. One significant factor in obtaining this reduction was the introduction of initial milestone payment in respect of early mobilisation and supply chain commitments.

This was further developed in negotiation with BBS following return of their August 7<sup>th</sup> bid. This involved firming up their provisional allowance of £11.933m in respect of inflation. At the negotiation meeting on 24<sup>th</sup> August it was agreed that:-

- a) the commitments for price sensitive materials would be made under the mobilisation and advance works agreement or as initial milestones; and
- b) the associated payment would be made for price sensitive materials as part of the initial milestone payments

For this **tie** received a further reduction in the tender of **£5.5m**.

This combined reduction of **£12.4m** resulted in substantial part from the proposals for initial milestone payment shortly after contract award for early mobilisation and allowing for the forward purchase of materials to minimise inflation risks in key materials, including price sensitive metals. The scale of the price reductions obtained and transfers of risk in return for this initial milestone and forward purchase of materials represents good value for the public sector.

Since then further details of the proposed first milestone have been provided. These consist of:-

- a) *Contract Award Milestone*  
Deliverables under this milestone are the signed Infraco contract, the SDS, Tramco and Tram Maintenance novation agreements, placement of insurance, retention bonds and collateral warranties. Infraco costs associated with these and other activities to achieve Financial Close are **£10.8m**.
- b) *Procurement of materials*  
The procurement of items with long-lead times and / or high price volatility is essential to allow the Infraco to meet the overall construction programme and to meet the agreed risk transfer on inflation risks. These items include materials for surfacing, street lighting and reinforcement for structures, tram shelters, structural steelwork for the depot, rail, switches and crossings, transformers, and copper cabling. The value of these items totals **£15.5m**.

## *FOISA Exempt – Qualified Exemption*

- c) *Procurement of large plant and equipment*  
As for materials, early order of certain plant and equipment will be required to ensure their availability in compliance with the overall construction programme. Key items are equipment for the depot, traffic signalling, comms systems and tram controls, totalling **£2.5m**.
  
- d) *Mobilisation of staff, supply chain and planning and logistical activities*  
The initial milestones will include setting up site offices, office running costs, staff costs, mobilisation of the supply chain resulting in the delivery of relevant contracts with contractors and sub-contractors, associated collateral warranties and bonds, provision of programmes, method statements, project quality plans and Health & Safety work. The milestones total to **£7.4m**.

Further details of the Infraco Initial Milestones are provided in Appendix A.

## **TRAMCO**

Similarly, the Project negotiated a reduction in price of £500,000 with CAF the vehicle supplier in return for initial milestone payments representing early mobilisation including design and supply chain commitments. This represents a discount of 1% on the price. The discount and the deliverables obtained represent good value to the Public Sector given that it also enables risks to programme to be reduced.

- a) *Mobilisation of staff and planning & logistical activities*  
The initial milestone includes development and delivery of agreements between Tramco and Infraco, Programmes, Resourcing commitments, Quality and Management Plans. The milestones associated with these activities total **£0.6m**.
  
- b) *Design works*  
This element of the initial milestones relates to the Tram mock-up, progression of the Tram preliminary design and industrial design works valued at **£0.4m**.
  
- c) Hedging of the exchange rate to fix the tram vehicle contract for delivery in sterling avoiding further adverse changes in the sterling euro exchange rate.
  
- d) Mobilisation of the supply chain includes placing procurement commitments for traction packages, braking systems, depot equipment and other key items totalling **£9.9m**.

Further details of the Infraco Initial Milestones are provided in Appendix B.

## **KEY RISKS**

The two key risks arising from the certification and payment of the initial Milestones and the way and to be mitigated are as follows:-

- a) Supplier insolvency resulting in loss of advance payments. Two aspects are to be considered insolvency of the Infraco Contractor and insolvency of the primary supplier
- b) CEC exposure in the event that a contract is not awarded

## **PROTECTIONS AGAINST IMPACT OF INSOLVENCY**

Protections against such failure are included within the Infraco contract terms. This is particularly important in respect of materials and equipment committed and paid for but not yet delivered. Dealing first with Infraco insolvency: The Infraco, BBS, consists of two major international contractors, Siemens and Bilfinger Berger with joint and several liability in all respects under the contract. Both groups currently have strong investment grade credit ratings reflecting the strength of their balance sheets.

In the circumstances of the insolvency of one of the Infraco consortium members (both UK registered companies, wholly owned by their German parents) the contract terms will provide for:-

- a) The remaining Infraco consortium member proposes a plan to deliver the contract using an alternative consortium partner/supplier.
- b) The remaining Infraco will be liable for providing the deliverables for which any payments have already been made.
- c) The requirement that sub-contracts require automatic vesting of title in CEC in any materials and supplies for which advance payments have been made by **tie**
- d) Recourse to the parent companies under Parent Company Guarantees which reflect the joint and several liabilities of the subsidiaries
- e) Recovery of any resulting losses by calling in the performance bond (£20m), retention bond (initially £2m) or be recourse to the liability cap under the contract.

In the circumstances of the insolvency of both Infraco consortium members, the contract terms will provide for:-

- a) The automatic assignment of the key supply contracts for advance materials and supplies to **tie**
- b) Sub contracts vesting title in any materials and supplies to CEC for which advance payments have been made by **tie**
- c) Recourse to the parent companies under parent company guarantees
- d) Recovery of any resulting losses by calling in bond as above

### *FOISA Exempt – Qualified Exemption*

To ensure these protections are included in sub contracts for advance materials purchases, such suppliers will be designated key subcontractors. **tie** has the right of review and approval of the terms of all key sub-contracts. This enables **tie** to check that key provisions are in place and to review the creditworthiness of the supply chain.

In the circumstances where Infraco supplier becomes insolvent before the delivery of advance purchase materials, Infraco remains responsible for delivery of these items, if necessary from alternative suppliers approved by **tie**.

Similar provisions are included within the Tramco contract terms and the full amount of the initial milestones under the Tramco contract will be covered by a specific payment bond until delivery of the first tram vehicle.

### **CONSEQUENCES IF AN INFRACO CONTRACT IS NOT AWARDED**

Commitments in respect of material purchases/supply chain mobilisation items will not now be made to any material degree prior to contract award. **tie** does not consider that this dilutes the value for money of making these commitments to any material degree.

In the event that Infraco were not to proceed then Infraco will be entitled to recover any cancellation costs in respect of commitments which have been made in respect of mobilisation items but not yet certified under the existing Mobilisation Agreements – currently less than £1m in value.

The same arrangements apply within the Tramco contract where advance commitments are again estimated to be less than £1m in value.