



# Internal Audit Project 2010-05: Review of the Commercial Strategy

Draft to Client for Discussion v3.0

June 2010



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# Review of the Commercial Strategy

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This report is a draft and is expected to be superseded by our final report. This draft may contain a number of outstanding matters, identified by square brackets (“[ ]”) and italics, that require clarification or confirmation by management. We reserve the right to add, delete and/or amend the report as we consider appropriate. No party may place any reliance whatsoever upon this draft of the report.

This report and the work connected therewith are subject to the Terms and Conditions of the Contract between tie Limited and Deloitte LLP dated 18 October 2008. The report is produced solely for the use of tie Limited. Its contents should not be quoted or referred to in whole or in part without our prior written consent. Deloitte LLP will accept no duty or responsibility to any third party, as the report has not been prepared, and is not intended for any other purpose.

This report has been prepared on the basis of the limitations on page 38 and 41.

# Review of the Commercial Strategy

## Contents



<b>Report Section</b>	<b>Page</b>
• Contents	3
• Executive Summary	4
• Glossary of Terms	8
• Commentary on Key Events	9
<b>Appendices</b>	
• Appendix 1 – Detailed Scope and Objectives	36
• Appendix 2 – Approach and Limitations	38
• Appendix 3 – List of Documentation	39
• Appendix 4 - Statement of Responsibility	41

# Review of the Commercial Strategy

## Executive Summary



### Introduction

- As part of the 2010-11 internal audit plan we have undertaken a high level review of the commercial strategy adopted by **tie** since contract signature in May 2008. Our fieldwork was completed between 17 May and 11 June 2010.
- This report is a high level review of the decision making processes adopted by **tie** from contract signature to the issue of the Project Pitchfork report. The observations and commentary provided in this report are based on discussions with **tie** management and selected external **tie** advisers as set out in Appendix 2 as well as selected documents detailed in Appendix 3. Our report is not a forensic review of the commercial decisions taken during the period of the project under review and our work did not include analysis of all correspondence between the contracting parties and internally within **tie**. This report is not a validation of the procurement strategy adopted by **tie**.

### Overall Conclusion

- From the discussions undertaken as part of this work and our review of the documents provided by management, it appears that **tie** has adopted a robust decision making process since the nature of the disagreements with BSC became clearer following contract signature.

### Overall Summary

- Given the complexity and scale of the commercial matters on the project, at the outset of our engagement **tie** management identified a number of key events between contract signature and the issue of the Project Pitchfork report to guide our review. These events are summarised on slide 10. Our summary statement of each of these events is contained below:
  - 1. May 2008 - Contract Signed** - Although our scope does not involve a review of the pre-contract documents, the documentation indicates that a robust decision making process was undertaken by **tie** immediately prior to contract signature. The contract was signed on the basis of a detailed Close Report, independent legal advice, and a Quality Assurance sign-off process conducted by the **tie** management team.
  - 2. Post May 2008 - Initial Signs of a dispute** - The documentation suggests that **tie** recognised and attempted to address the emerging issues in line with the partnering obligations contained in the contract through engagement with BSC, but were unable to reach agreement.

# Review of the Commercial Strategy

## Executive Summary (Contd.)



### Overall Summary (Contd.)

- 3. February 2009 - Princes St. Dispute** – tie recognised the need to adopt an alternative mechanism to reach a resolution on the Princes Street dispute and took advice from DLA when negotiating the PSSA with BSC. The PSSA was limited in scope and was used by tie in part, as a pilot to determine if this form of mechanism could be adopted, with amendment, elsewhere on the project. However, since completion of the works, BSC has applied for c.£13m under the PSSA which has been valued by tie at circa £8.3m, as an on account payment and subject to substantiation of the costs. At the date of our fieldwork the disagreement between the parties had not been resolved.
- 4. April 2009 - Commercial workstreams** – It is of positive note that at this stage tie management had identified the key eight workstreams, allocated workstream owners, confirmed the matters to be resolved, the timescale to resolution, the critical success factors and had taken specific legal advice in the form of Counsel Opinion.
- 5. June 2009 - Mediation week** – tie recognised that the mediation process had to be concluded by the parties in advance of entering into the formal DRP process in an attempt to further engage with BSC and reach agreement without the need for a formal DRP. However, the process was ultimately unsuccessful and did not achieve the outcome desired by tie, to reach a resolution on the outstanding issues.
- 6. August/September 2009 - Use of formal dispute resolution/ Increase of assertive approach** – tie recognised that the position with BSC needed to be crystallised which ultimately led to Project Pitchfork. tie continued to seek a resolution in discussion with BSC but increased the commercial pressure on BSC. A clear decision making process has been maintained along with regular reporting to the Board. tie also introduced a challenge process, which included attendees from an additional legal firm appointed by tie, in advance of implementing specific DRP's to test the strengths and weaknesses of tie's argument.
- 7. March 2010 - Project Pitchfork** – A long list of options was identified in the report and a review of the Project Pitchfork report suggests a robust decision making process was applied to this element of work.

### Additional Summary Comments

- tie's approach to date in relation to change estimates, and their administering of public funding, can be viewed in the context that the approach adopted by tie has led to tie agreeing to additional value of £17.9m against the amount claimed by BSC of £31.9m, as at the end of May 2010. This saving is in respect of the value of items settled only and represents settlement at 56% of the amount claimed by BSC, or, considered another way is an overestimate of entitlement/unsubstantiated claim by BSC of 78%.

# Review of the Commercial Strategy

## Executive Summary (Contd.)



### Additional Summary Comments (Contd.)

- As of 14 June 2010, 15 matters had been placed in formal DRP, eleven by **tie** and four by BSC. Three have been resolved by negotiation, three have been resolved at external mediation, seven have been referred to external adjudication (six have been concluded) and two are at an early stage in the process. Overall, the DRP's have led to BSC claims for additional payment being reduced from circa £18m to circa £7.5m for the nine out of 15 DRP's that have reached financial settlement. This excludes the costs incurred by **tie** in progressing matters through DRP. Although the outcome of the DRP's in terms of legal principles is finely balanced and subject to further discussion, **tie** is satisfied that the overall balance of adjudication outcomes has justified their interrogation of the initial claims made by BSC.
- Our discussions with management, and our review of the documentation, indicates that communication with key project stakeholders, namely CEC and Transport Scotland, were conducted regularly and governance matters have been clearly recorded in documents including the Tram Project Board and FCL meeting minutes.
- **tie** has also made use of external advisers at key points in the process and the challenge process implemented by **tie** prior to launching formal DRP's has supported **tie** by providing a significant level of analysis and a high degree of rigour.
- The documentation indicates that the design had not been finalised by the date of contract signature. This risk was considered by **tie** and the novation of the management of the design process was concluded at the time of contract signature.
- **tie** has taken external legal and specialist advice to maintain their contractual position, but accepts that BSC does have entitlement in some areas for example where **tie** has instructed a change, or as a result of the delay to the utilities diversion works. The acceptance of the entitlement has been communicated to BSC on a number of occasions.
- One of the key areas of dispute relates to performance on design which **tie** believes has not been properly managed by BSC. At the date of our fieldwork, **tie** was assessing the respective design inputs required of **tie** and BSC in line with the contract to make an assessment if both **tie** and BSC had managed their design management inputs and responsibilities in line with the contract. This work was in progress at the date of our fieldwork and we have not undertaken a review of the design management process for this report.

# Review of the Commercial Strategy

## Executive Summary (Contd.)



### Additional Summary Comments (Contd.)

- There is a question over whether the commercially assertive approach and use of the formal DRP procedures adopted by **tie** could have been implemented earlier in the process. **tie's** response to this is that they were required to follow due process to demonstrate attempts had been made to resolve the disagreements using a partnering approach in line with the contract. There was a change of senior personnel in both **tie** and BB during mid 2009 and it was recognised at the time that the incoming project leads should be given an opportunity to resolve matters.
- **tie** has used the time from September/October 2009 until the issue of the Project Pitchfork report, to build a case against BSC and has been collating evidence of potential BSC breaches of contract in relation to BSC failures. **tie** did not have this evidence available at the outset of the Project Pitchfork process and has gathered the evidence through clause 104 audits, internal discussions and the use of the formal DRP process. This evidence was required to progress the post Project Pitchfork options.
- A large number of detailed meetings have taken place throughout the process although in certain instances only high level, limited minutes, or no formal records of the discussions exist. For example, the detailed challenge sessions have not been minuted in detail and whilst we recognise this was a lengthy discussion which was followed up with e-mails, a short summary of the key points and actions may have been helpful. However, this does not appear to have had a significant effect on **tie's** decision making process and **tie** has confirmed that the elements of key meetings are recorded. We have seen examples of this in the Tram Project Board minutes. **tie** could consider further enhancing the recording of key meetings and we understand that **tie** has implemented additional recording of key meetings for the post Project Pitchfork process. The recording includes the use of an Events Log which records meetings and conference calls, attendees and key decisions. We also recognise the need to address recording of meetings that will be subject to Freedom of Information requests.
- The Project Pitchfork report indicates that the increase in disagreements between the parties appears to have coincided with a BB Corporate decision to reduce their risk exposure in the Civil Engineering market. This would have been extremely difficult to forecast at, or prior, to contract signature.

# Review of the Commercial Strategy

## Glossary of terms



- **BB** Bilfinger Berger UK Limited
- **BDDI** Base Date Design Information
- **BSC** Bilfinger Berger UK Limited, Siemens plc and Construcciones y Auxiliar de Ferrocarriles SA "the Consortium"
- **CEC** City of Edinburgh Council
- **DRP** Dispute Resolution Procedure
- **IFC** Issued For Construction
- **Infraco** Bilfinger Berger UK Limited, Siemens plc and Construcciones y Auxiliar de Ferrocarriles SA "the Consortium"
- **OSSA** On Street Supplemental Agreement
- **PMP** Project Management Panel
- **PSSA** Princes Street Supplemental Agreement
- **QRA** Quantitative Risk Analysis
- **TS** Transport Scotland



# Supplemental Information – Review of the Commercial Strategy

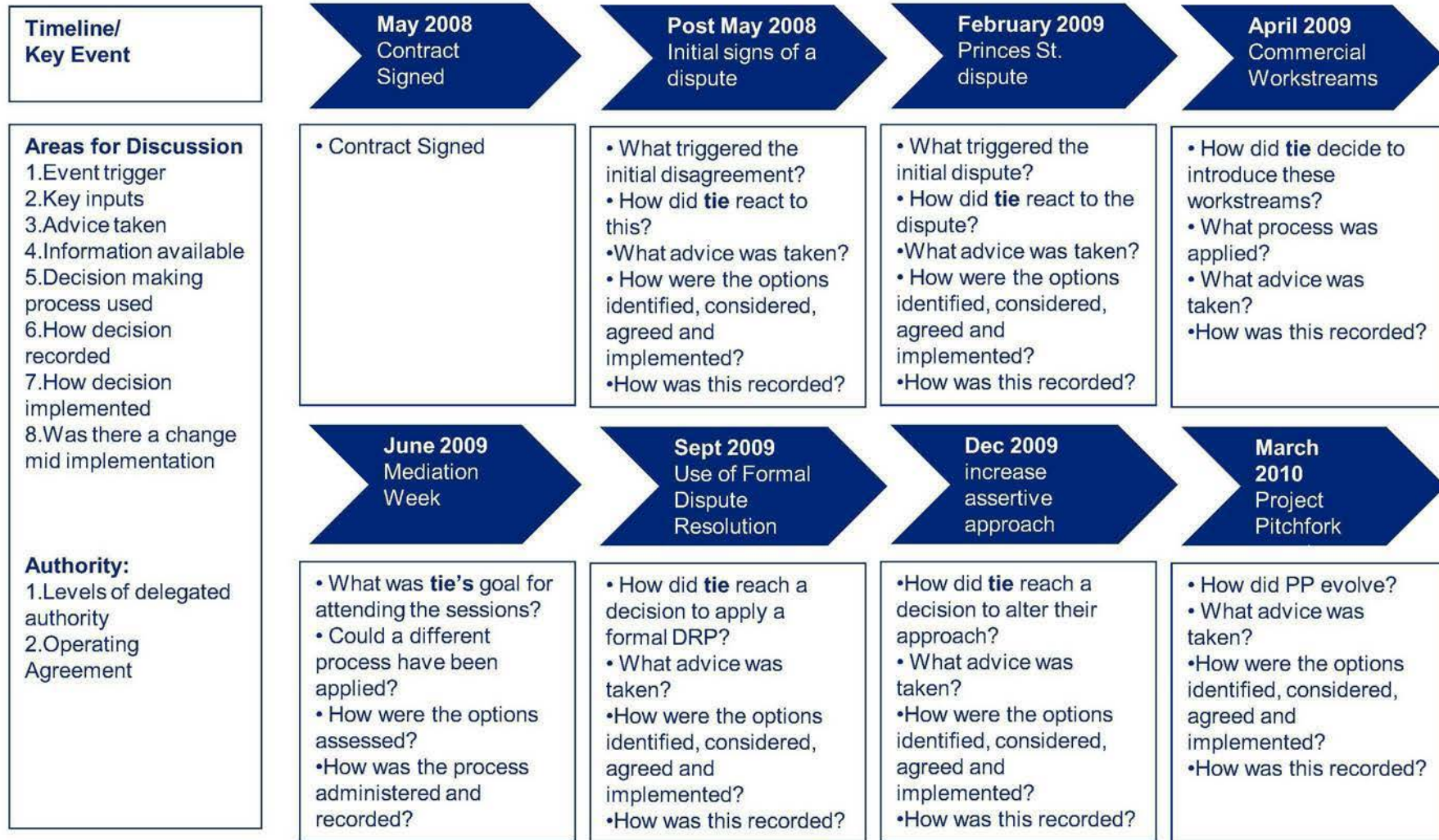


# Review of the Commercial Strategy

## Summary of key events – as discussed with **tie** on 7 May 2010



In addition to our scope document and in discussion with management, we produced the following schematic to aid discussions on the Commercial Strategy. We have also been requested to include comments in relation to Governance and Delegated Authority. Our report is structured to provide comments in relation to the events listed below.



# Review of the Commercial Strategy

## Pre Contract Negotiations



### Pre Contract Negotiations

- A review of the pre contract phase of the project, including project prequalification, is excluded from our scope for this piece of work.
- To provide context to our work, we were provided with the following documents in relation to the conclusion of negotiations between **tie** and BSC:
  - Edinburgh Tram Project – Report on Terms of Financial Close (Close Report) undated
  - Edinburgh Tram Project – Assessment of Risk of Successful Procurement Challenge dated 12.05.08
  - Edinburgh Tram Project – Financial Close Process and Record of Recent Events dated 12.05.08
  - DLA letter to **tie** dated 12 May 2008
  - Report on Infraco Contract Suite dated 12.05.08
- The above documents also make reference to the Wiesbaden and Rutland Square Agreements which were key pre contract agreements.

### Summary

- Our discussions with management have indicated that a number of the disputes between the parties appear to originate from negotiations concluded prior to contract signature. For example, management has commented that some issues on the project have been encountered as a result of BB not accepting the level of risk transfer **tie** believed had been achieved at contract signature. In addition, management has also advised that the scope of works defined in the Employers Requirements, which in cases were modified by Infraco Proposals, created a scope that was deemed acceptable to both parties but, since contract signature Schedule Part 4 [Pricing] was interpreted very differently by the contracting parties.
- We have also been provided with a report prepared by **tie** indicating that in light of the negotiations with BB, other options were considered and rejected prior to contract signature (Financial Close Process and Record of Recent Events dated 12.05.08).
- The Project Pitchfork report also suggests that BB's corporate approach to managing risk in the civil contracting element of their business has changed since contract signature.

# Review of the Commercial Strategy

## Event 1 – Contract Signed



### Background

- As noted previously, the purpose of this internal audit report is to review decision making since contract signature and as a result a review of the pre-contract period, including negotiations between the parties, does not form part of this work. For completeness, we have included selected elements of this period below.

### Pre Contract

- Following a competitive process, **tie** engaged DLA Piper to provide legal advice during the procurement process. DLA was appointed during September 2002 following a competitive procurement process.
- The pre-contract discussions are well documented in Appendix 2 of the "Report For **tie** Limited On Certain Contractual Issues Concerning Edinburgh Tram Project", prepared by McGrigors solicitors dated 23<sup>rd</sup> March 2010 and the Edinburgh Tram Project Report Financial Close Process and Record of Recent Events document dated 12<sup>th</sup> May 2008.
- A contract between **tie** and the Infraco (Bilfinger Berger UK Limited (BB) and Siemens plc) was executed on 14 May 2008. A minute of Variation dated 14 May 2008 recorded Construcciones Y Auxiliars De Ferrocarriles as a member of the Infraco.

### Documentation

- The **Edinburgh Tram Project Report on Terms of Financial Close "Close Report"** together with a letter from DLA Piper dated 12<sup>th</sup> May 2008 provided information to the Tram Project Board on the suite of contract documentation available at contract signature.
- We were also provided with a copy of the **Edinburgh Tram Project Report Financial Close Process and Record of Recent Events** document dated 12<sup>th</sup> May 2008. This document provides a summary of development of the Infraco contract suite from preferred bidder to contract signature together with an assessment of the alternatives to not proceeding with BSC.
- The documentation shows that there were a number of risks reviewed by **tie** at contract signature. The risk of concluding the contract with these risks was considered by **tie** who, having sought legal advice, viewed them to be covered by the risk allowance. **tie** Management has confirmed that the risks were understood at the time of contract signature and a £32m risk allowance was included in the Project Control Budget at Financial Close to address the identified risks. **tie** management has reiterated that the risk allowance was included for the items of risk identified in the close report and was not intended to provide an allowance for extensive delays and additional scope to the utilities work, material changes to design, or extensive delays caused by BSC. A much higher risk allowance would have been required at contract close to provide an allowance for these risks.

# Review of the Commercial Strategy

## Event 1 – Contract Signed (Contd.)



### Documentation (Contd.)

- We did not see any statements contained in the documentation reviewed which suggested the contract should not be signed. In addition, we note that Section 8.8 of the Report On Terms Of Financial Close states that “**tie** has considered the DLA report and appended risk allocation matrices and considers that the Risk Allowance of £32m contained in the projected Control Budget at Financial Close and associated QRA adequately reflects the risks identified and the change in such risks retained by the public sector since approval of the FBC in December 2007”. The risk allowance was prepared by **tie**.
- We also noted that contained in the Risk Overview section of Appendix 1 of the Report On Terms Of Financial Close is a comment that “It is not anticipated that the final Outstanding [Design] Packages will be delivered until Autumn 2008. The option of delaying Financial Close to eliminate the risk is therefore unattractive”.
- The **Edinburgh Tram Project Report Financial Close Process and Record of Recent Events** document records the process undertaken by **tie** to assess the alternative approaches to proceeding with BSC in view of the last minute negotiations. The document also identifies potential concerns with BSC but also summarises why **tie** believes these concerns to be mitigated. This document was provided to the Joint Tram Project Board on [to be confirmed.]
- We have also been provided with two examples of “**tie** Infraco Contract Suite/Close Report Quality Control Process” signed forms which record the review and comments of elements of the Infraco Contract by **tie**.

### Summary

- Although our scope does not involve a review of the pre-contract documents, the documentation indicates that a robust decision making process was undertaken by **tie** immediately prior to contract signature.
- The contract was signed on the basis of a detailed Close Report, independent legal advice, and a Quality Assurance (QA) sign-off process conducted by the **tie** management team. The QA process included the preparation of a matrix of reviewers for each section and different reviewers were allocated primary and secondary roles. The QA process is summarised and recorded in the following minutes dated 13 May 2008:
  - Meeting of **tie** Management Team to Confirm Readiness to Proceed with Completion of the Infraco Contract Suite;
  - Meeting of **tie** and TEL Approvals Committee to Confirm the Authority to Proceed with Completion of the Infraco Contract Suite; and
  - Tram Project Board minutes.

# Review of the Commercial Strategy

## Event 2 – Post May 2008 - Initial signs of a dispute



### Background

- During our discussions with management, members of the **tie** management team referenced different indicators of the first signs that a disagreement was developing with Infracore and in particular Bilfinger Berger (BB) between contract signature and November/December 2008. These indicators include:
  - Slow mobilisation by BB;
  - Programme issues - the first notified departure between v26 and v31, BSC took a period of time to define impact and associated costs with the overall programme dates slipping and little evidence of mitigation;
  - An increase in items assessed by BB to constitute a change;
  - The volume of early claims correspondence;
  - A question over responsibility for replacement of wearing course between Haymarket and St Andrew's Square;
  - A general reluctance to commence elements of the work without a change being instructed;
  - Differences in the interpretation of the contract including BDDI to IFC and provision of estimates;
  - At the very first Infracore Progress meeting, impression was that BSC were building to a client design and were not responsible for managing the design; and
  - The cessation of work on the Haymarket viaduct;
- The minutes of the initial meetings between the parties on 10 and 17 June 2008 following contract signature record **tie's** concern over little visible progress, insufficient mobilisation and no appointment of any BB subcontractors.
- As a result of these signs, management confirmed that **tie's** reaction to this was to attempt to identify the elements of work that required instructions which were critical to progress and which **tie** agreed constituted a change. Management has confirmed that during November/December 2008 there were a number of discussions with BB, recorded in e-mails and documents, which defined the level of engagement between the parties. Management has indicated that there were a number of constructive exchanges in September and October 2008.
- After two months of detailed engagement, **tie** became concerned when the Princes Street enabling works were delayed and the culmination of this period of the project was the notification by BB that they were unable to proceed with the works to Princes Street without payment of additional costs by **tie**.
- Management has also suggested that the increase in disagreements between the parties at this time appears to have coincided with a BB Corporate decision to reduce their risk exposure in the Civil Engineering market. This would have been extremely difficult to forecast at, or prior, to contract signature.
- Throughout this period, **tie** engaged with BB in an effort to understand BB's issues and reach a negotiated settlement under a partnering approach.
- DLA has suggested that in advice notes to **tie** around September/October 2008, they had proposed moving towards use of formal DRP's to resolve the issues being discussed.

# Review of the Commercial Strategy

## Event 2 – Post May 2008 - Initial signs of a dispute (Contd.)



### Background (Contd.)

- We were advised by **tie** that a high level meeting took place in November 2008 during which it became apparent that BSC's position was that the price quoted by them was not intended to be a price for the whole tram system, which was reflected in an alleged quote from senior BSC representatives that "This was only ever a price for a three wheeled car". This quote has been used by **tie** in documents provided to us as part of our engagement.

### Documentation

- As identified in our previous Internal Audit report to the Audit Committee, Review of Project and Programme Reporting/INFRACO dated August 2009, the Transport Scotland reports identified the issues being experienced on the project including slow mobilisation, a lack of engagement, an apparent lack of delegated authority of the BSC Project Director and difficulties resolving design issues and commercial matters.
- The following comments have been extracted from historic reports which support this statement. These extracts were reported as a statement of fact and progress at the time of their inclusion in the period reports:
  - **Period 8** (12/10/2008 – 8/11/2008) – the Transport Scotland (TS) report states that "*progress remains behind both the four month look ahead and the master programme*" reasons cited include design slippages, slow mobilisation and utilities delays. The report also states that planning is progressing for works to commence on Princes St "*in early 2009*".
  - **Period 9** – (9/11/2008 – 6/12/2008) – the TS report continues to state that "*progress remains behind both the four month look ahead and the master programme*" reasons cited include design slippages, slow mobilisation and incomplete utilities. The report also states that planning is progressing for works to commence on Princes St "*in early 2009*" with a work recommendation to be presented to the full Council meeting on 18 December 2008.
  - **Period 10** – (7/12/2008 – 3/01/2009) – the TS report continues to state that "*progress remains behind both the four month look ahead and the master programme*" reasons cited include design slippages, slow mobilisation and incomplete utilities. The report also states "*Works implemented to progress and plan the Princes St blockade in early 2009. This will commence on 5 January with the start of the enabling works before the full diversions are implemented in mid-end February*".
  - **Period 11** – (4/01/2009 – 31/01/2009) – the TS report states "*Planning for the full closure of Princes St, including traffic management, enabling works and construction methodology, as well as work package plans, has progressed well during the period. The Princes St diversion will be implemented from Saturday 21 February*".

### Summary

- The documentation suggests that **tie** recognised and attempted to address the emerging issues in line with the partnering obligations contained in the contract through engagement with BSC, but were unable to reach agreement.

# Review of the Commercial Strategy

## Event 3 – February 2009 Princes St. dispute



### Background

- The first formal disagreement between the parties was the dispute on Princes Street, which is reported to have been triggered by the inability of the parties to reach agreement on the series of disagreements over what has been summarised by management as contract interpretation generally and specifically, matters relating to change estimates, change instructions, obligation to mitigate delays and the contracted scope of works.
- The overall timeline in relation to the Princes Street dispute was included in our previous Internal Audit report to the Audit Committee, Review of Project and Programme Reporting/INFRACO dated August 2009 and is included overleaf for completeness. In summary, the overview of key events is as follows:
  - The original target date for commencement of the works in Princes Street was **5 January 2009**. The roadworks commencement date was subsequently revised to **3 February 2009** as a result of traffic management enabling works.
  - A series of negotiations took place between **tie** and BSC and agreement was finally reached on **20 March 2009**. This is recorded in a Supplemental Agreement document which was signed on 29 May 2009.
  - Works to the Princes Street section of the route commenced on **23 March 2009**.
- Following a series of discussions between the parties, resolution to the Princes Street dispute was reached through the execution of the Princes Street Supplemental Agreement (PSSA). During these discussions, **tie** sought legal input from DLA. No additional external advice is reported to have been sought at his stage.
- We understand from discussions with **tie** management that since completion of the works, BSC has applied for c.£13m under the PSSA which has been valued by **tie** at circa £8.3m, as an on account payment and subject to substantiation of the costs. At the date of our fieldwork, the disagreement between the parties had not been resolved.
- The disagreement is reported to relate to the valuation of the application made by BSC although Appendix C of the PSSA sets out a clear process for the recording, collating and agreement of elements of the works. **tie's** view is that BB did not manage the process well. At the date of our fieldwork, **tie** was assessing the extent to which **tie** notified BB that it was not complying with the recording requirements of the PSSA and we have not commented on this ongoing process in our report.



# Review of the Commercial Strategy

## Event 3 – February 2009 Princes St. dispute (Contd.)



### Context (contd.) –

- The overall timeline in relation to the dispute is reported by management to be as follows:

<b>September 2008</b>	General progress issues were first identified in formal reporting.
<b>November 2008</b>	As the Princes Street mobilisation drew nearer there were weekly meetings during November 2008 between key parties involved in the Princes Street mobilisation.
<b>January 2009</b>	12 January – <b>tie</b> Notice of Change issued (INF CORR 573) We have been provided with copies of meetings notes between <b>tie</b> and BSC dated 26/1/09, 2/2/09 and 23/2/09 which suggests discussions were held at the meeting in relation to possible changes to the payment mechanism for the Princes Street works.
<b>February 2009</b>	11 February – Infraco response enclosing Estimate (INTC 274) 12 February – Letter from <b>tie</b> to BSC raising concerns regarding progress since contract was signed 13 February – <b>tie</b> issues Change Order No.21 18 February – BSC states by e-mail, they are not obliged to commence work on Princes Street 19 February – <b>tie</b> letter from Chief Executive in response to BSC's e-mail 19 February – <b>tie</b> letter faxed to BSC requesting meeting the following day 20 February – meeting held between <b>tie</b> and BSC 23 February – BSC responds to <b>tie's</b> letters of 12 and 19 February 25 February – Letter from <b>tie</b> Chief Executive to BSC responding to BSC's letter of 23 February

Source: **tie** management and Peer Review Team Memo dated 19 March 2009. Extract from Deloitte Internal Audit report to the Audit Committee, Review of Project and Programme Reporting/INFRACO dated August 2009

# Review of the Commercial Strategy

## Event 3 – February 2009 Princes St. dispute (Contd.)



### Background (Contd.)

- In addition to entering into the PSSA, the parties to the dispute also agreed a new forum for raising issues was required, which led to the creation of the **Project Management Panel (PMP)** in March 2009. The PMP was made up of senior management from **tie** and **BSC** with the remit to establish a *"framework development team as soon as possible to develop a working methodology to: expedite the work, expedite the changes and associated commercial agreements, expedite a recovery programme, expedite design and approvals, expedite access and expedite a greater focus on consortium and tie integration"*.
- During interviews, **tie** management has confirmed that there were six or seven PMP meetings between March 2009 and May 2009. Whilst the meetings were viewed positively by both parties initially (the first PMP meetings were reported to be productive), the concern was that matters of principle were not being addressed and the PMP would only reach agreement on smaller matters not affected by the high level areas of dispute.
- The Tram Project Board minutes of 6 May 2009 confirm the PMP has met three times and is "proving to be a forum for constructive engagement with BSC". The minutes also outline the next steps and outcomes for the PMP.

### Settlement Proposed by BSC

- Although not directly linked to the Princes Street works, during this time, BSC is reported to have proposed a settlement figure of £80m, although p8 of the Peer Review Memo dated 19 March 2009 notes that "BSC not seeking £80m. – Had given a range of £50m-£80m." **tie** management has added during interviews that the settlement figure proposed by BSC was entirely unsubstantiated with no supporting quantification and no guarantee of a maximum price entitlement or detailed scope. In light of this, **tie** was concerned that there was no guarantee that BSC would not return for additional monies in the future. **tie** was also concerned that there was no incentive for BSC to mitigate costs and in addition to this, it was impossible to conclude a detailed assessment of best value.

### Documentation

- The Joint Tram Project Board and **tie** Board presentation slides dated 11 March 2009 provide an update on a number of matters, including Infracore Dispute Resolution, Strategic Options and Princes Street Project Delivery – which notes that "Ongoing formal dispute limiting other physical works but not programme critical at present".
- The Joint Tram Project Board and **tie** Board presentation slides dated 15 April 2009 also provides an update on progress since March confirming that work has started under the PSSA and the establishment of the PMP.

# Review of the Commercial Strategy

## Event 3 – February 2009 Princes St. dispute (Contd.)



### Summary

- **tie** recognised the need to adopt an alternative mechanism to reach a resolution on the Princes Street dispute and took advice from DLA when negotiating the PSSA with BSC. The PSSA was limited in scope and was used by **tie** in part, as a pilot to determine if this form of mechanism could be adopted, with amendment, elsewhere on the project;
- The PSSA was also deemed by **tie** to be an appropriate method of achieving progress at the time – **tie** recognised the PSSA did not resolve the outstanding issues but it did allow progress on a key element of the project;
- The Joint Tram Project Board and **tie** Board was provided with progress updates in relation to the Princes Street dispute; and
- Resolution of the dispute using informal dispute resolution continued to support the partnering ethos of the contract.

# Review of the Commercial Strategy

## Event 4 – April 2009 Commercial Workstreams



### Background

- As a result of the ongoing commercial issues, and the process required to reach agreement in relation to the Princes Street dispute, **tie** reached a decision point that resolution of the disputes was unlikely without proactive action and commenced an internal reporting process denoted as **Strategic Options – Workstream Approach** to review the ongoing project issues.
- As identified previously, the Joint Tram Project Board and **tie** Board presentation slides dated 11 March 2009 provide an update on a number of matters, including Strategic Options. A more detailed report on the Strategic Options is provided in the Joint Tram Project Board and **tie** Board presentation slides dated 15 April 2009. The slides cover a number of elements relating to Strategic Options including:
  - Progress Since March;
  - Workstreams Approach;
  - Workstreams to End June;
  - Key commercial and legal disagreements;
  - Critical Success Factors; and
  - Timetable.
- The update to the Board is also supplemented by the “Strategic Options Update & Workstreams – 130409” memo.
- The eight workstreams were identified collectively by the **tie** management team. We have been provided with copies of e-mails dated 3 April 2009, 6 April 2009 and 13 April 2009 in relation to the development of the eight work streams which is summarised in the paper submitted to the Board “Strategic Options Update & Workstreams – 130409”.
- During this time Acutus was appointed following a tender process, whereby three organisations were contacted and asked to submit a proposal to provide assistance to **tie**, for the programming elements of the workstreams.

### Documentation

- Progress in relation to the Strategic Options workstreams was presented to the Joint Tram Project Board and **tie** Board on 6 May 2009. This presentation also confirms that QC opinion was sought on the key contractual and legal issues with an appointment to be made on 4 May 2009 and an output from the review due 7-10 days following appointment.
- Progress was reported at the 3<sup>rd</sup> June 2009 Tram Project Board meeting which records the use of advice in respect of QC input and technical programming input.

# Review of the Commercial Strategy

## Event 4 – April 2009 Commercial Workstreams (Contd.)



### Summary

- It is of positive note that at this stage **tie** management had identified:
  - the key eight workstreams;
  - allocated workstream owners;
  - the matters to be resolved;
  - the timescale to resolution; and
  - the critical success factors.
- **tie** also took specific legal advice in the form of Counsel Opinion.
- The output of the workstreams was targeted for presentation to the Board meeting on 8<sup>th</sup> July 2009.
- We also note that **tie** reiterates on a number of occasions the ongoing requirement to enter into constructive engagement with BSC during this period.

# Review of the Commercial Strategy

## Event 5 – June 2009 Mediation week



### Background and Documentation

- In parallel with the Strategic Options Workstreams, DRP 1 - the method of calculating head office overheads and profit, and construction preliminaries in respect of **tie** Change Order 21, was planned for mediation from 27 May – 1 June 2009. The minutes of the Financial, Commercial and Legal Subcommittee dated 1 June 2009 confirms that a conclusion was reached from the DRP 1 mediation on 29 May 2009.
- The minutes of the Joint Tram Project Board and **tie** Board on 6 May 2009 records other matters identified for DRP had been delayed pending the collection of further evidence and to allow progress to be made in the PMP.
- The presentation slides to the Joint Tram Project Board and **tie** Board on 3 June 2009 identifies a further four DRP's which are being prepared in the event the PMP route proves unsuccessful and these will be informed by external QC opinion as appropriate.
- At a meeting between senior directors of the parties on 22 June 2009, both parties agreed "that core commercial disagreements remain and work will not progress in a satisfactory manner until they are", as noted in the Joint Tram Project Board and **tie** Board minutes dated 8 July 2009. The minutes also state that the PMP had not been a success in resolving the core outstanding issues of contention which led to a week of mediated engagement that commenced w/c 30<sup>th</sup> June 2009.
- The minutes also record that there was a commitment by all parties to mediation on the core commercial and delivery challenges of:
  - Programme recalibration and attribution/valuation of delays to date;
  - Design change and development (including BDDI to IFC and misalignments);
  - Possible further on-street supplemental agreements; and
  - Operation of contractual change mechanism, valuation using Schedule Part 4 and Value Engineering.
- The parties agreed the discussion topics for mediation week based on the matters in dispute between the parties. The list of matters is recorded in an internal **tie** e-mail from Richard Jeffrey dated 22 June 2009.
- **tie** management has advised that in advance of the week long series of mediations, both parties prepared a number of positioning papers and summary propositions were exchanged informally between the parties. We have been provided with an internal e-mail dated 26 June 2009 which attaches position papers for the mediation discussions.
- The Joint Tram Project Board and **tie** Board presentation dated 8 July 2009 defined the required outputs of the mediation week from a **tie** perspective and a verbal summary update on each of the eight individual areas discussed.
- **tie** has confirmed that DLA resources attended the mediation week discussions.

# Review of the Commercial Strategy

## Event 5 – June 2009 Mediation week (Contd.)



### Background and Documentation (Contd.)

- No formal notes of the mediations were issued but we have been provided with emails dated 4 July 2009, 5 July 2009 and 17 July 2009 which provide updates in relation to the various matters discussed during the mediations.
- The Mediation Week was unsuccessful in reaching a conclusion on all the matters in dispute. During our interviews with **tie** management it was reported the failure was due to a variety of reasons including:
  - Lack of authority for BSC attendees to agree settlements;
  - A replaying of the same positions with only limited movement to a middle ground;
  - The sessions were trying to resolve too many issues and it was unlikely a 'package deal' would be achievable; and
  - Scope matters could not be resolved without resolving programming issues.

### Summary

- **tie** recognised that the mediation process had to be concluded by the parties in advance of entering into the formal DRP process in an attempt to further engage with BSC and reach agreement without the need for a formal DRP. However, the process was ultimately unsuccessful and did not achieve the outcome desired by **tie**, to reach a resolution on the outstanding issues.
- The outcome of mediation week informed the decision making process and the report to the Joint Tram Project Board and **tie** Board.

# Review of the Commercial Strategy

## Event 6 - Formal use of Dispute Resolution Procedure and

## Event 7 - Increase assertive approach between Sept and Dec 2009



### July 2009

- The culmination of the outputs from the 3-month Strategic Options Workstream exercise (event 4), together with a lack of resolution through the week long series of mediations (event 5), and the ongoing issues with BSC primarily over lack of progress, were presented to the Joint Tram Project Board and **tie** Board on 8<sup>th</sup> July 2009.
- In advance of this meeting, the **tie** chief executive met with senior directors of both BB and Siemens on 6 July 2009 “informing the consortium senior representatives that the project may have little option but to pursue a formal route to reaching a resolution”, as recorded in the minutes of the Joint Tram Project Board and **tie** Board on 8<sup>th</sup> July 2009.
- The slides presentation for the Board meeting provides a recap on the Strategic Options workstreams, the week long series of mediations and outlines four possible next steps in relation to the BSC Consortium, together with summarised elements of each option and the pros and cons of each option:
  - a) Negotiated settlement on all issues with BSC;
  - b) Formal contractual approach – DRP and other contractual mechanisms;
  - c) Reduce/rephase BSC scope; and
  - d) End the BSC contract.
- The preferred approach identified in the presentation slides is option b above.
- The minutes of the Joint Tram Project Board and **tie** Board on 8<sup>th</sup> July 2009 record **“the recommendation for the Board to consider was to follow the Option (2) route and enter formal Dispute Resolution under the terms of the contract”**. The minutes also record the Board agreed in principle to Option (2) but would require more information before the formal notices were issued to BSC.
- The presentation slides for the Joint Tram Project Board and **tie** Board on 29 July 2009 provide a further recap of the four options presented to the 8 July Board and provide more detail on the Formal Contractual Approach option together with a list of proposed DRP tranches to be adopted.
- The presentation slides also identify the readiness of the “Challenge Team” which was introduced to challenge each DRP internally to test the strengths and weaknesses of the argument, anticipate the BSC strategy and check readiness for the launch of the DRP.
- The role of the challenge team was reinforced by the appointment of McGrigors solicitors, who were appointed through a competitive process. Their initial appointment is recorded in a letter of appointment dated 20 August 2009 with an extension recorded on 25 February 2010.



# Review of the Commercial Strategy

## Event 6 - Formal use of Dispute Resolution Procedure and

## Event 7 - Increase assertive approach between Sept and Dec 2009 (Contd.)



### July 2009 (Contd)

- The minutes of the Joint Tram Project Board and **tie** Board on 29 July 2009 record that a process was used internally to support selection of the DRP's which we understand were designed to gain clarity on BSC's position in relation to the matters in dispute. The minutes record a general discussion on the process. The minutes also record that " the Board was asked to approve the recommendation that RJ as CEO be given the authority to activate the items to be brought forward into the formal notice process to BSC, with the Finance, Commercial and Legal (FCL) Sub-Committee acting as steering group." The recommendation was approved by the Board.

### Challenge Sessions

- Following this delegation of authority, the challenge sessions reported to the FCL meeting which in turn agreed to commence formal DRP's at the appropriate time. The challenge meetings were separate from the FCL meetings, the FCL meetings being attended by CEC lawyers, the Tram Monitoring officer and CEC finance representatives.
- **tie** had been developing a list of potential DRP's since April 2009 and the challenge team initially reviewed the longlist to agree which DRP's were appropriate to progress. We were advised that **tie** considered the merits of a 'global claim' or selected cases and that the DRP's were selected to test key principles based on criticality to programme, the ability to provide further definition in relation to BSC's position on a matter of principle, or to test elements such as BDDI to IFC to where **tie** sought greater certainty in relation to outcome.
- A challenge meeting was held weekly and was attended by DLA, **tie** Commercial team, McGrigors, members of the **tie** Executive management team, **tie** finance team and CEC. A written document was issued in advance of the meeting which presented the case to be taken to DRP. The papers included a DLA paper, draft referral notice and a DLA expression on events and key issues.
- The case was then challenged and either approved for submission to the FCL meeting or deferred pending further review and re-challenge. If the challenge led to a concern with any element of the DRP, the case would be deferred and re-presented until the challenge team was satisfied that the case was ready for presentation to the FCL. Where different views were expressed by the separate legal advisers, any areas of disagreement were resolved through discussion although we are advised that no serious disagreements were encountered.
- Following the challenge meeting DLA and McGrigors would both issue a paper assessing the strengths and weaknesses of the case and comment on the strength of the case in terms of weak, stateable, convincing or compelling.
- We understand the challenge meetings were not formally recorded as they were lengthy internal sessions. Follow on discussions are reported to be documented in e-mail exchanges between the attendees, although we have not reviewed any e-mail exchanges between the parties.
- The FCL was then asked to support proceeding with the DRP.

# Review of the Commercial Strategy

## Event 6 - Formal use of Dispute Resolution Procedure and

## Event 7 - Increase assertive approach between Sept and Dec 2009 (Contd.)



### Challenges Sessions (Contd.)

- **tie** has recently received a FOISA query in relation to the costs incurred on advisers as a result of the dispute. The response to this query is recorded in an e-mail to the enquirer dated 7 May 2010.

### August 2009

- The minutes of the FCL held on 17 August 2009 record the progress with the DRPs under consideration and that DRP 5A, Gogarburn Bridge, was "ready to be put in formal dispute".
- The minutes of the FCL held on 24 August 2009 provide an update on progress and an update on the re-challenge session on Carrick Knowe bridge which had been identified as requiring further work following the initial challenge session.
- The ongoing use of challenge sessions demonstrates **tie's** approach to ensuring robust cases are being developed prior to commencement of formal proceedings.
- The minutes of the Joint Tram Project Board and **tie** Board on 26 August 2009 provides an update on the Formal Contractual Approach and an update on the DRP tranches confirming the EOT 1, Hilton Car Park, BDDI Gogarburn Bridge and BDDI Carrick Knowe had all been launched.

### September 2009

- The minutes of the FCL held on 7 September 2009 record that DRP3 would go straight to adjudication but DRP4 would go to mediation at BSC's request.
- The presentation slides and minutes of the Joint Tram Project Board and **tie** Board on 23 September 2009 record that six matters are in formal dispute, four commenced by **tie** and two by BSC. A list of future dispute matters is also included in the presentation slides.

### October 2009

- The presentation slides and minutes of the Joint Tram Project Board and **tie** Board on 21 October 2009 record that seven matters are now in formal dispute but that the Hilton Hotel Car Park has been resolved in **tie's** favour.
- The October minutes also indicate that three meetings were held between **tie's** Chief Executive and a new BB Civils Board Director, David Darcy, which were positive but that much work had yet to be done.

# Review of the Commercial Strategy

## Event 6 - Formal use of Dispute Resolution Procedure and

## Event 7 - Increase assertive approach between Sept and Dec 2009 (Contd.)



### October 2009 (Contd.)

- The minutes also identify a dispute with BSC in relation to measurement and valuation issues on the PSSA and that BSC has been refusing to work on other on-street sections unless agreement was reached on a “cost plus” agreement. **tie** notes that this approach is not acceptable but that progress in relation to a new On Street Supplemental Agreement (OSSA) may be possible if the matters in relation to the PSSA can be resolved.
- We understand that the FCL meetings ceased during October as the discussions were elevated to the Tram Project Board meetings.

### November 2009

- In a letter to BSC dated 13 November 2009 (INF CORR 2785) **tie** offers an interim extension of time award to BSC of 9 months with 6 months of prolongation costs, subject to Board approval.
- The presentation slides for the Joint Tram Project Board and **tie** Board on 18 November 2009 provide a strategic summary of the progress since the summer of 2009.
- We also note that the strategic direction of further DRP submissions being adopted by **tie** was challenged during the meeting but it was agreed it was too early in the process to establish precedence.
- **tie** management also reports that during November, the senior management team was occupied with delivery of the reopening of Princes Street.

### December 2009

- During interviews, **tie** management confirmed that the early signs of David Darcy's involvement (referred to as the Darcy effect, which planned positive action but failed to deliver) had genuinely tried to move the project forward by resolving the issues but this had not materialised.
- The minutes of the Joint Tram Project Board and **tie** Board on 16 December 2009 records a hardening of BSC's commercial position and that progress remains poor. The minutes also record that agreement on the OSSA has yet to be reached. The Board approved the necessary steps to enforce the range of commercial mechanisms available in the contract and instructed the Chief Executive to investigate withdrawal of the interim extension of time award.

# Review of the Commercial Strategy

## Event 6 - Formal use of Dispute Resolution Procedure and

## Event 7 - Increase assertive approach between Sept and Dec 2009 (Contd.)



### December 2009 (Contd.)

- The minutes also identify the appointment of Anthony Rush as a dedicated commercial resource to deploy the agreed strategy. Anthony Rush is viewed as a specialist dispute resolution resource by **tie** and his appointment was not subject to a competitive tender process. His appointment was progressed by the **tie** Chairman and Chief Executive directly to provide input to the commercial negotiations with BSC and to deliver a more commercially assertive approach. Anthony has been supported by a number of organisations.
- We are aware that **tie** had been considering the reinforcement of the commercial team for a period of time and, when this was independently proposed by McGrigors, this culminated in the identification of the specialised resource in the form of Anthony Rush.
- The minutes also record that further papers should be prepared on the longer term strategic options available to the Board.

### January 2010

- Management reports a series of internal discussions on how to address the ongoing issues with BSC.
- The minutes of the Joint Tram Project Board and **tie** Board on 13 January 2010 provided an update on the relationship with BSC and confirmed that a detailed commercial options strategy would be presented to the March Tram Project Board meeting. This is the strategy paper that was subsequently entitled Project Pitchfork.

### DRP Progress

- As of 14 June 2010, 15 matters had been placed in formal DRP, eleven by **tie** and four by BSC. Three have been resolved by negotiation, three have been resolved at external mediation, seven have been referred to external adjudication (six have been concluded) and two are at an early stage in the process. Overall, the DRP's have led to BSC claims for additional payment being reduced from circa £18m to circa £7.5m for the nine out of 15 DRP's that have reached financial settlement. This excludes the costs incurred by **tie** in progressing matters through DRP. Although the outcome of the DRP's in terms of legal principles is finely balanced and subject to further discussion, **tie** is satisfied that the overall balance of adjudication outcomes has justified their interrogation of the initial claims made by BSC.

### Summary

- **tie** recognised that the position with BSC needed to be crystallised which led to Project Pitchfork.
- **tie** continued to seek a resolution in discussion with BSC but increased the commercial pressure on BSC. A clear decision making process has been maintained along with regular reporting to the Board.

# Review of the Commercial Strategy

## Event 8 – March 2010 Project Pitchfork



### Background

- Project Pitchfork was initiated at the Joint Tram Project Board and **tie** Board on 16 December 2009. Project Pitchfork is the working name for the project with the objective of setting out reasoned conclusions and recommendations on the future direction of the Edinburgh Tram Project.
- Following the request to commence this work, **tie** set up a separate project room with restricted access.
- The Project Pitchfork team governance process was addressed through a series of different levels of meetings:
  - Level 1 Progress Updates - attended by the project team and DLA;
  - Level 2 Challenge Session - attended by the project team and invited others as required;
  - Level 3 CEC Weekly Update and FCL - attended by **tie** Chief Executive and CEC senior officials;
  - Level 4 Challenge by **tie** non-executives - attended by **tie** non-executives and invited others as required; and
  - Level 5 Meetings between the Joint Tram Project Board and **tie** Board.
- **tie** has advised that agendas were issued and minutes taken for the level 1 and level 2 meetings. A log was also retained of the **tie** Chief Executive's meetings with CEC and other relevant parties.
- Development of the report was tightly controlled with each of the key workstreams having a lead project manager appointed. The initial action of the project was to implement a series of clause 104 audits to test where BSC was not complying with the contract, and gather evidence of the non compliance. The audits focussed on key areas including design management, programme and sub contractor arrangements.
- The Joint Tram Project Board and **tie** Board on 10 February 2010 presentation provides a detailed update in relation to Project Pitchfork's progress.
- In tandem with the preparation of the Project Pitchfork report, **tie's** increase in commercial assertiveness through a series of targeted letters included, the rejection of BSC's revision 3 programme, correspondence to BSC advising that estimates which were incomplete or unsatisfactory would not be accepted and a full estimate must be provided, issuing of a warning on preliminaries, taking a robust stance on the Princes Street valuations, use of Clause 34 requiring BSC to follow **tie** instructions to commence work and undertaking clause 104 audits in key areas including design management, programme and sub contractor arrangement.
- Prior to the Joint Tram Project Board and **tie** Board in March 2010, senior level meetings between **tie** and the consortium took place during early March but these discussions did not resolve the key outstanding matters.

# Review of the Commercial Strategy

## Event 8 – March 2010 Project Pitchfork (Contd.)



- The Project Pitchfork report, which contains a significant amount of detail in relation to the project, and which was supported by additional reports including the "Report for **tie** Ltd on Certain Contractual Issues Concerning Edinburgh Tram Project" dated 23 March 2010 produced by McGrigors, was presented to the Joint Tram Project Board and **tie** Board on 10 March 2010. The minutes indicate a detailed discussion on the Project Pitchfork Report together with the Board's approval to implement the strategy set out in the minutes.
- The Pitchfork report uses formal weighted criteria assessment balanced with appraisal of complex legal, financial and commercial judgements. **tie** management has advised that the four options assessed in detail in the report were the only credible options available to **tie**.

### Summary

- A long list of options was identified in the report and a review of the Project Pitchfork report suggests a robust decision making process was applied to this element of work.
- The instigation of Project Pitchfork was required to crystallise and evaluate/approve the options available to progress the project given the relationship with BSC.
- The report content suggests that a rigorous process of review and evaluation of available options has been undertaken throughout the duration of the Project Pitchfork element of the project and the final report is a comprehensive summary of the project status.

# Review of the Commercial Strategy

## Post Project Pitchfork



### Background

- The Joint Tram Project Board and **tie** Board on 10 March 2010 recorded the Board's approval to the strategy set out in the minutes.
- Following the meeting, and in addition to continuing the commercial assertiveness, **tie** has implemented a further two pieces of work to progress and implement the Post Project Pitchfork strategy - Project Carlisle and Project Notice.
- In discussion with **tie** management, and as a result of this process being in progress at the time of our fieldwork for this report, we have not reviewed the processes being applied for Project Carlisle and Project Notice although we understand that the same governance is being applied as was adopted for Project Pitchfork.
- We have been advised that **tie** recognises that the use of external advisers requires additional management time to ensure that any meetings held, points discussed and actions agreed, are appropriately documented and **tie** is actively addressing this additional requirement.
- **tie** management has also advised that additional requirements in relation to meeting minutes have been implemented for this process to further enhance the recording of key discussions and decisions.
- A risk register will be used to drive a risk analysis process to address and report on unanswered questions. This is being controlled by the Deputy Project Director.
- The timescale for delivery of Project Carlisle is the end of June/early July 2010. The timescale for Project Notice will be dependant upon the outcome of the Project Carlisle negotiations.

# Review of the Commercial Strategy

## Governance and Delegated Authority



### Governance and Delegated Authority

- The key governance documents include:
  - **tie**/CEC Operating Agreement;
  - Grant offer letter from Scottish Ministers to CEC with associated Terms and Conditions;
  - Delegated Authority Rules Rev 2.0 dated 5<sup>th</sup> February 2010;
  - the Governance section of Tram Project Board minutes; and
  - Operating Agreement compliance checklist.
- In summary, the original governance and management model after financial close is set out in Appendix 2 of the Report On Terms Of Financial Close produced in May 2008.
- The detail of the governance of the project was updated in the Operating Agreement between CEC and **tie** dated 18 December 2009. Governance requirements are also detailed in the Memorandum of Understanding between CEC, **tie** and Transport Edinburgh Ltd (TEL) and the Memorandum of Understanding between CEC, Edinburgh Trams Ltd and Transport Edinburgh Ltd both dated 18 December 2009.
- The TEL board has the authority to deliver the project up to a Baseline Cost of £545m and to a Baseline Date of October 2012. Additional matters affecting programme, cost and scope are detailed in section 2.22 of the Operating Agreement. Any deviation from these key criteria requires full CEC approval.
- Where TEL becomes aware that it will be unable to deliver the project within the £545m Baseline Cost it must notify the Council. Following a paper to the TEL Board dated 2nd June 2010 the Chairman on behalf of the TEL Board wrote to the Tram Monitoring Officer on 8 June 2010 confirming that it is reasonably expected that the full scope of Phase 1a of the project cannot be delivered within the Baseline Cost.
- As identified in our previous Internal Audit Report to the Audit Committee, Review of Project and Programme Reporting/INFRACO dated August 2009, **tie** has been reluctant to report uncertain Anticipated Final Cost outturn positions to both CEC and Transport Scotland until certainty has been achieved on the matters in dispute with BSC. As a result, financial information on potential outturns has been provided directly to the Tram Monitoring Officer, CEC Legal representatives, CEC's Principal Finance Officer, who in turn briefed the Director of City Development and the Director of Finance. **tie** has also confirmed that specific information has been provided directly to the Director of City Development and the Director of Finance.



# Review of the Commercial Strategy

## Governance and Delegated Authority (Contd.)



### Governance and Delegated Authority (Contd.)

- The December 2009 and April 2010 reports from **tie** to Transport Scotland both state that “given the commercial uncertainties with BSC/Infracore and continuing delays to the project it is now considered unlikely that the full scope of Phase 1a will be completed within the available funding envelope of £545m. Until the key issues are resolved through the contractual and legal process, it will not be possible to accurately forecast a revised outturn”.
- **tie** management has advised that information provided to CEC was in e-mail format although we have not reviewed specific e-mail exchanges between the parties. With the exception of provision of the Transport Scotland reports to CEC, the only formal reporting has been a weekly update report issued by **tie** to the Tram Monitoring Officer.
- Commentary on governance requirements is also detailed in the Joint Tram Project and **tie** Board minutes provided as part of this review.
- As an additional check against compliance requirements, **tie** also issues a **Checklist of Compliance with Conditions of Operating Agreements w/CEC** and **Checklist of Compliance with Conditions of Grant of £500m from Scottish Ministers to CEC**. This exercise was concluded during May 2010 and were issued as a paper to the TEL Board on 2 June 2010. The paper states that:
  - *“The continuing uncertainty regarding outturn costs and programme require that the Board’s attention be drawn to our compliance with the requirement that TEL determines and reports to the Council on circumstances where there is an “actual or reasonably expected” (i) delay of 3 months beyond the Baseline Date (currently Oct 2012); (ii) increase in capital cost which would mean that the Baseline Cost (currently £545m) is exceeded by greater than £1,000,000; or (iii) any substantial change to the design, scope or service pattern set out in the Final Business Case.”*
- As a result of the above statement, two recommendations were made to the TEL Board on 2 June 2010:
  1. *Note the assurance with respect to Operating Agreement and Grant Conditions compliance provided by the management review undertaken as documented on the attached checklists.*
  2. *Approve the letter from the Chairman on behalf of the TEL Board to the Tram Monitoring Officer notifying a reasonable expectation the costs of delivering the whole phase 1a scope will exceed £545m.*
- We note that BSC’s March 2010 estimate of the programme completion date exceeds the Baseline Date identified above but **tie** does not agree with BSC’s assessment and views the programme date as uncertain at this time. Once certainty has been reached, **tie** will report the agreed date to the key stakeholders in line with their governance requirements.

# Review of the Commercial Strategy

## Governance and Delegated Authority (Contd.)



### Stakeholder Communications

- **tie** has confirmed that CEC Officers, the Tram Monitoring Officer, CEC Legal representatives, CEC's Principal Finance Officer, the Director of City Development and the Director of Finance are regularly updated during the contract negotiations through the use of emails, documents, briefing notes, presentations and conference calls. CEC officers are also provided with the Transport Scotland reports as noted below. We understand that not all of these updates have been formally recorded but where key decisions are made these will be recorded and where appropriate, Tram Project Board approval was sought.
- **tie** has written regular reports to Transport Scotland which are sent by **tie** to CEC for onward transmission to Transport Scotland.
- On an ad-hoc basis since January 2010, and regularly since 2 February 2010, **tie's** Chief executive has met senior CEC officials to provide a detailed update on the project. As noted above, these briefings are not formally recorded but where key decisions are made these will be recorded and where appropriate, Tram Project Board approval was sought.

### Summary

- The Tram Project Board minutes of 8 July 2009 record a concern in relation to the time being taken to finalise the governance arrangements. Since this meeting, regular governance updates are recorded in the minutes and **tie** management has provided reports, briefings and updates to key project stakeholders regularly particularly through the Transport Scotland reports and through CEC attendance at the Tram Project Board and FCL meetings. **tie** has also implemented a review of compliance with the key legal agreements through the use of the Checklist of Compliance with Conditions of Operating Agreements w/CEC and the Checklist of Compliance with Conditions of Grant of £500m from Scottish Ministers to CEC.

# Supplemental Information – Review of the Commercial Strategy

## Appendices



# Review of the Commercial Strategy

## Appendix 1 - Detailed Scope and Objectives



### Background and Overall Objective:

- The scope of this work agreed with **tie** management at the outset of this internal audit is provided below for information.
- The commercial strategy implemented by **tie** to resolve the escalating dispute with BSC is an important aspect of the overall governance framework adopted by **tie**.
- This review will focus on the key events likely to have an impact on the wider project which were made by **tie** since contract signature in May 2008. In relation to each event, the work will consider how the decisions were identified, options analysed, agreed and implemented. **tie** has advised that the key events since contract signature are as follows:
  1. The first signs of disagreement and initial approach to resolution;
  2. The decisions made to resolve the Princes St. dispute during February 2009;
  3. The implementation of the strategic options workstreams in April 2009;
  4. The decision to enter into mediations during June 2009;
  5. The failure of the mediations to resolve the disputes and the use of formal dispute resolution procedures in August /September 2009;
  6. The decision to adopt a more commercially assertive approach in December 2009/January 2010; and
  7. The issue of the Project Pitchfork report in March 2010.
- The review will assess the following elements:
  - Has **tie** applied a robust decision making process;
  - Does suitable evidence of the decision making process exist; and
  - Were there any opportunities to enhance the process currently in place.

# Review of the Commercial Strategy

## Appendix 1 - Detailed Scope and Objectives (Contd.)



### Project coverage and testing:

- A review of the pre contract phase of the project, including project prequalification, is excluded from our scope for this piece of work. The review considered the context of the pre-contract negotiation process only.
- For each of the key events, we considered:
  - What issue(s) triggered the event;
  - What were the key client side inputs;
  - What advice did **tie** take;
  - What information was available to **tie**;
  - What decision making process was adopted;
  - How was the decision making process recorded;
  - How was the decision implemented;
  - Was there a change to the decision made during implementation;
  - The decision making in the context of levels of delegated authority and the Operating Agreement;
  - As part of the review, the process adopted for the identification and selection of external advisers and the recruitment of specialist staff may also need to be considered.

# Review of the Commercial Strategy

## Appendix 2 - Approach and Limitations



### Approach

- We adopted the following approach for this review:
  - Reviewed documentation supplied by **tie** surrounding the key events;
  - Met with **tie** senior management to discuss the context of the key events:
    - Steven Bell
    - Dennis Murray
    - Stewart McGarrity
    - Susan Clark
    - Alistair Richards
    - David Mackay
    - Richard Jeffrey
  - Met with external advisors to discuss **tie's** decision making process as follows:
    - Graeme Bissett
    - DLA
    - McGrigors
    - Anthony Rush
  - Preparation of a draft report, including recommendations for improvements in the process together with supporting documentation.

### Limitations

- Our work specifically excludes analysis and commentary on the decisions taken. Our work concentrates on the decision making process applied by **tie** post contract signature.

# Review of the Commercial Strategy

## Appendix 3 – List of Documentation



As part of our work we have undertaken a high level review of the following documents:

- Edinburgh Tram Project – Report on Terms of Financial Close (Close Report) undated
- Edinburgh Tram Project – Assessment of Risk of Successful Procurement Challenge dated 12.05.08
- Edinburgh Tram Project – Financial Close Process and Record of Recent Events dated 12.05.08
- Report on Infraco Contract Suite dated 12.05.08
- DLA letter to **tie** dated 12 May 2008
- Memorandum of understanding Between CEC, **tie** and TEL dated 18/12/2009
- Memorandum of understanding Between CEC, Edinburgh Trams Ltd and TEL dated 18/12/2009
- Operating Agreement between CEC and TEL dated 18/12/2009
- Operating Agreement between CEC and **tie** dated 15/04/2008
- Edinburgh Airport Rail Link **tie** Ltd Revised Operating Agreement dated 12 May 2005
- TEL Board Paper – Compliance with Operating Agreements and Conditions of Grant dated 2 June 2010
- Project Pitchfork Level 1 Minutes Sessions 5 and 11, undated
- FOISA query, **tie** e-mail response dated 7 May 2010
- Project Pitchfork Agenda 21 April, 5 May, 12 May 2010 – Level 1 Review
- Project Pitchfork Agenda 26 April 2010 – Level 2 Review
- **tie** Infraco Contract Suite/Close Report – Quality Control Process Docket dated 23/4/08 and 21/04/08
- The Joint Tram Project Board and **tie** Board presentation slides dated –
  - 11 March 2009, 15 April 2009, 6 May 2009, 3 June 2009, 8 July 2009 (two versions), 29 July 2009, 26 August 2009, 23 September 2009, 21 October 2009, 18 November 2009, 16 December 2009, 13 January 2010, 10 February 2010.
- The Joint Tram Project Board and **tie** Board minutes dated –
  - 6 May 2009, 3 June 2009, , 8 July 2009, 29 July 2009, 26 August 2009, 23 September 2009, 21 October 2009, 18 November 2009, 16 December 2009, 13 January 2010, 10 February 2010, 10 March 2010.
- Minutes of the Financial, Commercial and Legal Sub Committee dated –
  - 14 April 2009, 1 June 2009, 17 August 2009, 24 August 2009, 31 August 2009, 7 September 2009.

# Review of the Commercial Strategy

## Appendix 3 – List of Documentation (Contd.)



- **tie** letter to BSC, INF CORR 2773 dated 5 November 2009, INF CORR 2785 dated 13 November 2009, INF CORR 2911 dated 24 November 2009.
- Transport Scotland Reports dated 21 August 2009, 11 December 2009 and 1 April 2010.
- Internal e-mails dated:
  - 3 April 2009, 6 April 2009 and 13 April 2009 (Strategic Option work streams);
  - 22 June 2009 in relation to mediation week;
  - 26 June 2009 which attaches position papers for the mediation discussions; and
  - 4 July 2009, 5 July 2009 and 17 July 2009 which provide updates in relation to the various matters discussed during the mediations.
- Meeting of **tie** Management Team to Confirm Readiness to Proceed with Completion of the Infraco Contract Suite - minutes dated 13 May 2008.
- Meeting of **tie** and TEL Approvals Committee to Confirm the Authority to Proceed with Completion of the Infraco Contract Suite - minutes dated 13 May 2008.
- Tram Project Board minutes dated 13 May 2008.



# Review of the Commercial Strategy

## Appendix 4 – Statement of Responsibility



We take responsibility for this report which is prepared on the limitations set out below.

The matters raised in this report are only those which came to our attention during the course of our work and are not necessarily a comprehensive statement of all the weaknesses that exist or all improvements that might be made. Recommendations for improvements should be assessed by you for their full impact before they are implemented. The performance of internal controls work should not be taken as a substitute for management's responsibilities for the application of sound commercial practices. We emphasise that the responsibility for a sound system of internal controls rests with management and work performed by Deloitte should not be relied upon to identify all strengths and weaknesses in internal controls, nor relied upon to identify all circumstances of fraud or irregularity. Auditors in conducting their work are required to have regards to the possibility of fraud or irregularities. Even sound systems of internal control can only provide reasonable assurance and not absolute assurance and may not be proof against collusive fraud. Our procedures are designed to focus on areas as identified by management as being of greatest risk and significance and as such we rely on management to provide us full access to their accounting records and transactions for the purpose of our audit work and to ensure the authenticity of these documents. Effective and timely implementation of our recommendations by management is important for the maintenance of a reliable internal control system.

### **Deloitte LLP**

### **Edinburgh**

### **June 2010**

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