

## Edinburgh Tram Network

### Factual background in relation to Pricing Assumption 1<sup>1</sup>

- 1 The agreement between tie and the SDS Provider was entered into on 19 September 2005. The SDS Provider developed the Employer's Requirements from a high level as part of their scope of work under the SDS agreement.
- 2 From the issue of the invitation to negotiate on 3 October 2006 until the end of October 2007, there were two bidders in live competition: Infraco (Bilfinger Berger and Siemens) and Tramlines (Laing O'Rourke, Grant Rail and Bombardier). During this period, tie sought to evaluate the bids in order to arrive at a preferred bidder and a reserve bidder. The bidders had full access to the design as it had evolved, and to the SDS Provider.
- 3 On 22 October 2007, tie and the Infraco entered into an agreement in relation to selection for appointment as preferred bidder<sup>2</sup>. tie and Tramlines entered into an equivalent agreement. The preferred bidder agreement was based upon "the Draft Deal". Part of that Draft Deal was a schedule in relation to price. The price schedule at that time consisted of a contract price analysis (which still required further development). It was also a term of the preferred bidder agreement that the preferred bidder would have the SDS Provider (and the tram supplier, CAF) novated to them, contemporaneously with execution of the construction contract. It was subsequently agreed that CAF would instead join the BBS consortium.
- 4 In the run up to the selection of the preferred bidder, both bidders made their Best and Final Offer. BBS' BAFO was £208,700,342.
- 5 On 5 November 2007, the BBS consortium was appointed preferred bidder. That appointment almost immediately triggered a series of negotiations in relation to contractual, commercial and technical issues, which went far beyond the scope of the Draft Deal. Bilfinger Berger were represented by Pinsent Masons, and Siemens by Biggart Baillie. The aim was to achieve financial close during the week commencing 11 January 2008.
- 6 To this aim, the final business case was issued by tie on 7 December 2007<sup>3</sup>. One of the key drivers was that there would be a single point of responsibility for design, construction, integration, commissioning and maintenance. In relation to design, this would be achieved by novating the SDS Provider to the Infraco. The business case was to be presented to City of Edinburgh Council on 20 December 2007 for acceptance by formal full council resolution whereby specific delegated authority to execute the contracts would be granted to tie.
- 7 On 11 December 2007, tie wrote to BB<sup>4</sup> to ask them to, amongst other things, fix their price save in relation to a few specified exceptions where the design was not available.
- 8 BB's response was sent on 12 December 2007<sup>5</sup>. In relation to price confidence, they stated that "*we have considered fixing our price on the information provided and believe that we are able to do this in all areas where the design is available.*" They then made reference to a schedule of items which had previously been described as "provisional", but in relation to which a fixed price would be agreed essentially upon payment of an additional premium, which totalled £8.12m. The letter also contained a list of assumptions on which their price and programme were based. Those assumptions appear to be the genesis of what eventually became the pricing assumptions in Schedule Part 4.

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<sup>1</sup> Taken from discussions on 17 February 2010 with Steven Bell and Dennis Murray of tie and Andrew Fitchie of DLA Piper

<sup>2</sup> Document B

<sup>3</sup> Document C

<sup>4</sup> Document D

<sup>5</sup> Document E

9 Following this exchange of correspondence, there was a meeting between senior representatives of tie and BB, which took place in Wiesbaden. The discussions at that meeting generated what is known by the parties as the Wiesbaden agreement, executed on 20 December 2007<sup>6</sup>. tie had no external legal input into the drafting or execution of the Wiesbaden agreement. This agreement forms the basis of the pricing assumption wording which eventually found its way into Schedule Part 4, and in particular contains the exclusionary wording in relation to design development.

10 There was a series of e-mails leading up to the execution of the Wiesbaden agreement<sup>7</sup>.

10.1 In an e-mail sent at 8.37am on 19 December 2007, BB stated that their "*firm price including the additional £8m<sup>8</sup> to fix the 'variable' sums noted in our tender is based on all the additional information which we received from SDS via the 4 No. CDs. The last of which was delivered to us on 25th. November 2007. We therefore insist that our contract be related to this.*" The design information delivered up to 25 November 2007 was what eventually became defined in the contract as the Base Date Design Information. In other words, BB's e-mail links their price with the BDDI.

10.2 tie's response was sent at 11.43am on the same date, and in relation to BB's point notes "*Scott [of BB] has had a discussion with Matthew [of tie]. Based on that discussion there would be no reason to change the current wording on design – which was acceptable to you yesterday*".

10.3 It is not clear what the "*current wording*" was at that stage, but at 1.29pm on the same date tie sent BB a draft version of the Wiesbaden agreement which was "*amended...in red italics...for the wording we agreed.*" The draft appended to that e-mail stated:

"2.1 *The negotiated price for Phase 1a is £218,262,426...*

2.2 *[Value engineering]*

2.3 *[Provisional sums]*

2.4 *All other prices are fixed and firm, based on the Basis of the Price as set out below.*

**3.0 *Basis of the Price***

3.1 *The price is based on the following:*

3.2 *Employers Requirements Version 3...*

3.3 *Detailed designs – BBS included in their price for the construction cost risk in the development and completion of detailed designs being prepared by SDS, save for:-*

(a) *Any future changes to elements of the design intent for civils works that are substantially different compared to those forming the current scheme being designed by SDS, as typically represented by the drawings issued to BBS with the design information drop on 25<sup>th</sup> November 2007.*

(b) *Items designated as provisional in the Appendix A4.*

(c) *Excluded items, to the extent described in 3.4 below.*

*In respect of pavements, full reuse of existing curbs and flags and minimal reinstatement behind curb lines is assumed. i.e. not wall to wall.*

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<sup>6</sup> Document G

<sup>7</sup> Document F

<sup>8</sup> i.e. the £8.12m referred to in the schedule to BB's letter of 12 December 2007

*Design must be delivered by the SDS in line with our construction delivery programme previously submitted.*<sup>9</sup>

- 3.4 *Excluded items are:- [list of specific items of work]*
- 10.4 BB responded to this draft in terms of their e-mail of 2.45pm on 19 December 2007, at which point there appeared to be broad agreement, subject to confirmation from Siemens.
- 10.5 At 7.43pm on 19 December 2007, tie circulated a further version of the draft which contained some minor changes following discussion at tie board level.
- 10.6 In their e-mail sent at 6.07am on 20 December 2008, BB appeared to have undergone a significant shift in approach, stating "*we still have issues with accepting design risk. We have not priced this contract on a design and build basis always believing until very recently that design would be complete upon novation. With the exception of the items marked provisional which we have now fixed by way of the 8 million we cannot accept more drain development other than minor tweaking around detail. Your current wording is too onerous. Trust we can find a solution.*"
- 10.7 In a further draft sent by tie to BB at 2.07pm on 20 December 2007, there had been a substantial re-working of clauses 3.3 and 3.4 as follows:

"3.3 The BBS price for civils works includes for any impact on construction cost arising from the normal development and completion of designs based on the design intent for the scheme as represented by the design information drawings issued to BBS up to and including the design information drop on 25<sup>th</sup> November 2007. The price excludes:-

~~*Detailed designs – BBS included in their price for the construction cost risk in the development and completion of detailed designs being prepared by SDS, save for:-*~~

- ~~a) Any future changes to elements of the design intent for civils works that are substantially different compared to those forming the current scheme being designed by SDS, as typically represented by the drawings issued to BBS with the design information drop on 25<sup>th</sup> November 2007.~~
- b) a) Items designated as provisional in the Appendix A4.
- b) Any material changes to the design resulting from the impact of the kinematic envelope of the CAF tram vehicle on the civils design.
- c) Excluded items, to the extent described in 3.4 below.

In respect of pavements footways, full reuse of existing kerbs and flags and minimal reinstatement behind curb kerb lines is assumed. i.e. not wall to wall. Design must be delivered by the SDS in line with our construction delivery programme previously submitted.

For the avoidance of doubt normal development and completion of designs means the evolution of design through the stages of preliminary to construction stage and excludes changes of design principle, shape and form and outline specification.

3.4 The BBS price for systems works is fixed save for:-

- a) Items designated as provisional in the Appendix A4.

<sup>9</sup> Presumably the blue italics are earlier BB changes

- b) Any agreed material impact of the CAF tram vehicle specification on the traction power supply system as demonstrated by power simulation modelling.

3.5 In all other respects the BBS price is fixed"

- 10.8 The agreement was executed later that same day, in the form of the draft referred to above, save that additional words were added in manuscript as a new 3.4(c):

*"In the event of any conflict between the obligations in the Employer's Requirements and the SDS design the obligations in the Employer's Requirements shall prevail."*

- 11 At the point at which the Wiesbaden agreement was executed, tie's commercial objective remained to achieve price certainty as far as that was possible. It was recognised by tie that, in certain specific areas, the design was not fully evolved – and in those cases, it would not be possible to achieve price certainty. There therefore required to be some form of contractual mechanism which dealt with that issue.
- 12 On 7 February 2008, the parties entered into what has become known as the Rutland Square agreement<sup>10</sup>. The rationale for this agreement, from tie's perspective, was to seek to control the continuing growth of the contract price, and to draw a line in that process.
- 13 During the period from January to April 2008, schedule Part 4 was developed. In its original form (*i.e.* when the preferred bidder agreement was entered into), this schedule took the form of a contract price analysis<sup>11</sup>. tie were seeking as detailed a breakdown as possible in order to assist them in managing change after contract formation, and during the construction phase.
- 14 BB proposed a significantly different version of schedule part 4, which was predicated on a series of base case assumptions<sup>12</sup>. There followed a series of iterations of Schedule Part 4. There was a proposal to introduce an element of materiality into the exclusionary words into what became pricing assumption 1, but that was resisted on behalf of the Infraco. Beyond that, there does not appear to have been any significant discussion in relation to the wording of pricing assumption 1. Their driver for this was interpreted by DLA, on behalf of tie, as being to reflect an agreement which had already been reached, rather than to address a specific concern. On this basis, they were not prepared to enter into negotiations in relation to the way in which Wiesbaden was imported into Schedule Part 4, other than to agree a concession in relation to the incorporation of the words *"save to the extent caused by a breach of contract by Infraco, an Infraco Change or a Change in Law"* in the definition of Notified Departure<sup>13</sup>.
- 15 During the period that led up to the execution of the contract, there does not appear to have been any specific discussion around the wording of pricing assumption No. 1 (other than in relation to *e.g.* approval bodies). There were changes in the wording of clause 3.4.1 of Schedule Part 4<sup>14</sup>, and the number of pricing assumptions grew.
- 16 tie's understanding of pricing assumption 1 is that is was intended to address the extent to which the design had developed at contract formation in a way that was fair to both parties:
- 16.1 If a design developed in such a way as to reach what might be called its "normal conclusion", then the cost implications of construction should be neutral. In other words, there might be a saving to BB - in which case BB would retain the benefit of that saving, and

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<sup>10</sup> Document H

<sup>11</sup> See for example the early version of schedule part 4 e-mailed by tie to BB on 16 January 2008 at document I

<sup>12</sup> See for example the e-mail from BB to tie dated 4 February 2008 at document I

<sup>13</sup> In addition clause 1.4 was inserted into Schedule Part 4 to address tie concerns in relation to Infraco's insistence on giving Schedule Part 4 precedence over the contract conditions, in terms of clause 4.3 of the contract conditions. There were also a few further inconsequential minor revisions

<sup>14</sup> See the iterations of this schedule at document I

tie would not seek to recover it, or there might be additional cost – in which case BB would bear that cost themselves and would not seek to recover it from tie. The consequences of normal design development would be at BB's risk, in the way in which would be expected from any design and build contractor: it ought to be for Infraco to explore more cost effective design solutions, for their own benefit. Beyond that, as part of their due diligence exercise in relation to the design<sup>15</sup>, the Infraco were aware of the extent of the development of the design, and hence ought to have been able to reflect this in their price.

- 16.2 If a design has changed from one design to another (for example, because an improved solution has been identified), then tie would expect that there would be cost consequences flowing. If the improved solution was more expensive to execute, then BB would be entitled to recover the additional cost; if the improved solution was more cost effective, tie would have the benefit of that saving. BB had not bought out all of the risk in relation to these items. The commercial driver behind this was that the premium which BB would have sought for buying out this risk would have been excessive for tie.
- 16.3 If a design was at a preliminary stage of development, then the development of that design falls within the ambit of normal design development and ought not to be treated as a Notified Departure. As an example, if the design for a particular section is at such a high level that it does not show drainage details, the Infraco ought to include for drainage in their price: any competent design and build contractor ought to make such a provision. This would be part of the design envelope. If, however, a drainage scheme changed from a simple scheme to a complex one, that takes it beyond design development.
- 16.4 To the extent that design was defective, or negligent, then tie would have expected:
- (a) That SDS would be obliged to rectify the defective design and be responsible for all design associated costs; and
  - (b) That the Infraco would have identified the defect during their design due diligence. To the extent that they had not done so, that would be a matter for them, and the associated construction cost would not be borne by tie.
- 17 tie did not consider that the Infraco's price was tied to the BDDI. If that were the case, there would have been no requirement to have included pricing assumption no. 19, which states that in respect of certain specific areas (e.g. Lindsay Road retaining wall), "*Infraco shall only be obliged to carry out works to be the extent shown in accordance with the Base Date Design Information*". Indeed, if it were to be the case that the price was tied to the BDDI, there would have been no necessity for any pricing assumptions other than no. 1.

**McGrigors LLP**  
**18 February 2010**

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<sup>15</sup> Document J

- A. Schedule of documentation relating to factual matrix
- B. Preferred bidder agreement dated 22 October 2007
- C. Final business case v.2 dated 7 December 2007
- D. Letter from tie to Bilfinger Berger dated 11 December 2007
- E. Letter from Bilfinger Berger to tie dated 12 December 2007
- F. E-mail exchanges relating to negotiation of Wiesbaden agreement
- G. Wiesbaden agreement executed on 20 December 2007
- H. Rutland Square Agreement
- I. Draft revisions of Schedule Part 4
- J. Infraco's due diligence
- K. Commentary on the close out process
- L. Report on Infraco Contract Suite
- M. Report on terms of financial close
- N. History of Infraco price increases