Analysis re DRP – 7 April 2009

DRP

This report follows a meeting held at Citypoint on 3 April attended by Nick Smith and Colin MacKenzie (CEC Legal), Andrew Fitchie (DLA Piper), Stewart McGarrity and Dennis Murray (tie).

There were initially two matters referred to the formal Dispute Resolution Procedure:

1. Cost/calculation of Preliminaries re Princes Street works
2. Question as to whether BSC were entitled to refuse to start work on Princes Street

DRP 1 As at Thursday last week, tie had already or certainly will very shortly seek appointment of a mediator in order to move this dispute to a resolution. ~~is presently in the mediation period as BSC have refused to go direct to arbitration. However, no mediation is actually taking place at present.~~

DRP 2 is on hold as a result of the Princes Street agreement.

Engagement

One of the decisive factors with regard to progression of the project will be the willingness of the contractor to engage with tie in moving forward on a constructive basis. tie are hopeful that the new management team within BB will lead to a new more positive relationship, with BB on board for the duration of the contract. This will be key in relation to "dispute avoidance" as this largely relies upon a good working relationship, seeking to solve problems rather than argue about them. tie have indicated that it is too early in the new process to assess how things are going, but they remain hopeful. This does of course give the Council very little comfort that further disputes will not occur. tie do not anticipate any softening of the commercial approach taken by BB thus far. tie advise that one of the main issues will be whether the new BB team are given a free hand or whether matters will be dictated from Germany, which is likely to lead to a more adversarial approach.

However, from CEC's perspective the fact remains that at this time there is little evidence to the effect that the relationship is getting better, especially with the refusal of BSC to agree to move directly to ~~arbitration~~ adjudication and dispense with the mediation period. Whilst the Project Management Panel (PMP) has been set up to steady matters and cement relationships, it is too early to say whether this will actually assist in sorting out the disputed issues.

There are presently 350 "notified departures" (ie changes as per the agreement) in process. tie acknowledge that around 30 of these are for their account and that 175 of these have little financial value but may be of strategic importance. The remainder still require to be agreed. Broadly speaking, the "big picture" disputes can be grouped into a number of different categories:

1. *Who has responsibility for design management and evolution?* tie is of the view that they are not responsible for certain of the changes which are deemed to be

"normal design development". BSC are taking the view that all changes to design are tie's responsibility. The main problem here stems from the fact that design was not complete at Contract signature~~Financial Close~~. We understand from tie that the design part of the contract therefore had to be based on a number of agreed assumptions, and accordingly, we have assumed that where BSC can argue that the design differs from the agreed assumptions (however small the change), it is possible that any such changes will be for tie's account. The reality appears to be that such assumptions were based on the hope that the parties would agree matters commercially. However, it further appears if BSC seeks to stick to the contract terms absolutely, this will likely not favour tie. In short, we understand that the contract does not define "normal design development" (which tie advise BBS are responsible for) on the basis that it is a term understood in the market. It now appears that it is more a "term of art" capable of different interpretations. What is normal for one project may not be normal for another. tie argue that the onus lies with BSC to prove why completion, however minor a task, lies outwith "normal design development." The difficulty here is that it is a very bespoke contract. tie are considering seeking a QC opinion to provide it and CEC with confidence re this issue. One of the difficulties with this is that argument may be more of commercial rather than legal one. The issue on normal design development is that (i) the agreed language of the contract does limit, by description, the detail of normal design development but (ii) it is a matter of technical opinion and engineering practice what is 'normal' as opposed to unanticipated or unforeseeable (iii) however the design has evolved, BSC is responsible for managing that process and passing all revisions through the proper contractual design review process.

2. *Who is liable for delays to date?* tie state that BSC has a general obligation to mitigate. BSC are of the view that until they have full and unfettered access to the various work sites they are not obliged to start work and should be given extensions of time to deliver. Any examination of the respective positions will require a factual basis detailing what sites were available and when. It is possible that DLA or a QC could provide a view to give confidence (or not) here. The exercise of analysing delay responsibility will have to be painstakingly completed in order for there to be a rational basis for settling allocation of costs. It has always been in BSC's interests to approach this on a "global" basis, since this offers the most effective means of obscuring their own defaults and failings behind assertions about client- side failings
3. *Preliminary costs methodology.* This is as per DRP 1 and relates to largely commercial methodologies used to calculate additional costs. tie's view is that BBS's method is too simplistic and unjustified in the circumstances. BSC's methodology is also, on any objective view, wholly inconsistent with what is in the contract and it changed in late '08 to a more opportunistic and incorrect approach. Tie have already granted an extension of time amounting to 7 weeks (overhead and profit based).
4. *Unforeseen ground conditions.* These are to tie's account. However, there is a dispute as to what constitutes "unforeseen". tie anticipate that they will be in a better position to assess likely liability for this by mid-May.
5. *Failure to agree estimates.* This relates to the operation of the change mechanic in the contract and BSC's approach that indifferent quality/ non provision of competent estimates is excused by the number of changes which has occurred. ~~operation of clause 80 and sequential.~~

tie have also indicated that they anticipate that there will be a "tipping point" beyond which it will not be advantageous for BBS to seek to frustrate matters as there will be little for them to argue about. ie the design will be complete to IFC status, the revised

Comment [HW1]: AF - Not quite sure what the last sentence in this point drives at.

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Comment [HW2]: AF - "IFC"- perhaps explain that these are the drawings versions which are actually used to build from.

programme will be agreed and all the sub-contractors will be in place; MUDFA is finished. tie anticipate that this tipping point will come around the same time as the revised programme is agreed (anticipated to be summer 2009, possibly by the start of July). However, they expect negotiations re the programme to be very difficult. BBS will seek to lengthen the programme as much as possible in order that they will not be liable for liquidated damages as a result of missing the staged completion dates.

tie's likely approach is that the Council is relatively time rich but funding poor. ie, whilst delay should be avoided where possible it is more important that the Council remain within budget and have a later operational date than to pay substantial extra sums to have delivery on time. However, clearly any delay must have cost implications, even if these are smaller than the alternative. tie will therefore use additional time for BBS as the "sweetener" to avoid possibly significant cost increases.

tie have been asked to re-run the risk register with various different confidence levels to provide CEC with the fullest possible information re potential cost overruns. This is expected shortly. This cost estimate will include an estimate of costs assuming that DRP was commenced today and went the full dispute period concurrently for all disputes and tie lost all the arguments. Whilst we are advised by tie that it is unlikely that they would win none of the arguments, this figure would go some way to taking into account the fact that there are bound to be future disputes which are at present unknown, bearing in mind that the project still has a significant period to run.

tie also advise that there is strategic importance with regard to how to approach referring matters to DRP. The main matters presently requiring resolution (taken from tie Board Paper dated 11 March) are:

- Base date design information
- Hilton Hotel car park
- Edinburgh Park INTC91
- Scottish Power connections
- V26 to V31 estimate
- Sub-contractor terms
- Refusal to progress until estimates agreed
- BDDI to Issued for Construction issue
- South Gyle Access Bridge estimate
- Demolition of Leith Walk Bus Station
- Value Engineering issues
- Access versus licence to occupy issues
- Management of SDS
- Design Responsibility
- Design Review
- Gogar Depot (to be checked)

Stewart McGarrity is currently working on producing an updated strategic options paper which we understand will examine each of the main issues in dispute noted above, giving indications of tie's view on the chances of success.

Conclusion

It now appears that the contract terms which tie negotiated are capable of manipulation by commercial and technical interpretation to an extent by BSC~~manipulation to an extent by BSC~~. Whilst Andrew Fitchie of DLA pointed out that the scope for argument over individual items was kept to the absolute minimum, any commercial and legal amibiguity at all will, nevertheless, lead to the possibility of disagreement. However, given that design etc were not complete, it was perhaps inevitable that assumptions would have to be made and that there would therefore always be scope for argument around the facts and components of the set of contractualised assumptions that were negotiated and included by the parties in order to prevail upon BSC to agree to delineate a settled scope of work which corresponded to their tender price~~scope for argument~~.

tie are hopeful that the new team in place will engage more with the project and as the "tipping point" approaches be more agreeable to settling things commercially. Whether this happens remains to be seen, but it is likely to be the summer before tie and CEC can be more certain on this issue. Clearly there is a desire to progress DRP as soon as possible in order to achieve certainty for tie but this has to be balanced against taking an adversarial approach at this stage of the new relationship. It is noted that BSC are said to have assembled a team of 12 claims experts in Edinburgh, and that they may also have instructed Hill International (Claims Specialists).

The "best guess" figures from tie with regard to the possible outturn costs should give CEC an indication of the range of possible cost overruns as at April 2009. Whilst this would not include costs for any future disputed issues, it would at least give a baseline indication to CEC as to possible risks. DLAP will continue to give tie/CEC advice on DRP strategy (including the use of the contract provisions to avoid/mitigate cost) and outcomes and any other claims or claims likelihood from BSC and how BSC are or are not using the Contract~~Reassurance will be required from tie and DLA that there are no other "big ticket" issues which have the potential to delay the project, add to the cost and lead to further disputes with BSC~~.