From: Stewart McGarrity
Sent: 17 March 2009 08:30
To: Gregor Roberts
Subject: FW: Q&A - PRIVATE & CONFIDENTIAL
Attachments: Q&AforDM170309.doc

Gregor – FYI David is meeting the Minsters (Stevenson and Swinney) today and I produced the attached Q&As for him.

Stewart

From: Stewart McGarrity
Sent: 17 March 2009 08:29
To: David Mackay; Steven Bell
Subject: RE: Q&A - PRIVATE & CONFIDENTIAL

David/Steven – complete document attached subject to anything you want added.

Stewart

From: Stewart McGarrity
Sent: 16 March 2009 21:01
To: David Mackay; Steven Bell
Subject: Q&A - PRIVATE & CONFIDENTIAL

Q&A - PRIVATE & CONFIDENTIAL

David / Steven,

See cut and paste from the word document I've drafted below. Sorry if it's too long – I get carried away. I'll finish the last three items first thing in the in the morning.

Stewart

Q1 What's the broad analysis of the £512m approved estimate and what do we think it will cost now?

The following summarises expenditure to date and approved estimate for the project:

£m	Spent	AFC
Infrastructure and vehicles	76.8	308.1
Utilities diversions	51.7	51.7
Design	26.0	27.0
Land and compensation	18.1	20.6
Resources and insurance	58.4	80.4
Base costs	**231.0**	**487.8**
Risk Allowance	0.0	24.2
Total Phase 1a	**231.0**	**512.0**

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The Infraco price including provisional sums is £239m of which c£145m relates to Civils (Bilfinger) works and the balance to Siemens. The tram vehicles contract with CAF is for £58m and there is a balance of non-BSC construction items on the Infrastructure and vehicles line.

There is an unutilised balance of the risk allowance of £24.2m plus the £33m headroom between the cost estimate of £512m and the approved funding available of £545m (a total of **£54m**) most of which is available to deal with current and future Infraco changes.

In January we briefed TS on an outturn range of between £522m and £540m (excluding costs of postponing Phase 1b for now of £6m). If we achieve reengagement on delivery and programme in the very near future the outturn costs can still be delivered towards the top end of this range ie within the £545m available funding.

Additional costs above £545m could arise where we have one or more of:

- Significant further delays to construction
- If we did not prevail in our contractual position with regard to Infraco responsibility for design evolution or the consortium's historical failure to commence work
- We entered in any material arrangements to work outside the existing contractual provisions and risk allocations

Q2 What's been spent and what are the further commitments?

To date (end of Feb 09) we have spent £231m (Minsters' share £212m) on the project including the land which was acquired directly by CEC. On a "going concern" basis the full funding package of £545m must be considered committed (in the absence of grounds for termination of the Grant).

Q3 How delayed are we and what is the current expected operational date?

We have reported an unmitigated potential slippage of revenue service into Q2 2012 and that **tie** considers recovery can be achieved to deliver a date in the summer of 2011 – with an outcome within this range. The most important determining factors are that there is no further significant slippage in programme (eg work in Princes St and in other places must progress immediately) and the consortium must engage proactively in implementing recovery solutions a number of which have been identified and put forward to BSC (and reported to Transport Scotland).

Q4 Is there any exposure to Ministers beyond our £500m contribution?

Current position of Ministers is that their contribution is capped at £500m with all liabilities falling to CEC who have guaranteed the payment obligations of tie under the Infraco contract. There are no provisions in the Infraco contract give rise to liabilities for the Government

Q5 Is the Infraco contract not "fixed price"?

It's a fixed price for delivery of a defined scope in accordance with a defined programme. However like all such contracts there is a change mechanism to deal with changes to the scope or to the programme or arising at the request of the client or arising as a result of events which remained to the risk of the client. We provided for the estimated future level of these changes in our risk allowance at the point of contract signature.

When we represented our range of £522m and £540m in January, these estimates included an assessment of the risk allowance required for Infraco to completion of the project to be between £25m and £31m.

Q6 Why have commercial relationships with consortium broken down?

Until the end of October we believed we were dealing with a contractor who was late in mobilising (BB principal sub-contracts are not yet signed), delivery and can-do service was very poor (or was being hamstrung by commercial positions) , had taken some very aggressive commercial positions on individual changes and were very late in producing estimates for some of the changes.

Since then their positions as communicated to **tie** have become broader and entrenched:

- No Infraco responsibility for costs of design evolution BDDI to IFC
- Pervasive obstacles to working anywhere on route (related to design, utilities diversions, access etc)
- Estimates of the time and cost impact of changes are too complex to produce since their programme is so disrupted
- There is no requirement to work on any section of the route until all changes have been agreed in value and time consequences
- The change provisions under the contract are not workable in the context of the volume of changes and the need to agree them before work starts - they want an amended change mechanism which allows them to be paid on a cost plus basis

This culminated in the £50-80m prospective additional costs (BB only) disclosure and the suggestion to stop the job for six months and re-price/programme and/or work on a "cost plus" basis outside the contract – neither of which is acceptable to **tie** and its stakeholders. There was an attempt to hold us to ransom on Princes St although this was cleverly played contractually so they are not in any significant breach of contract.

In all disputed matters Bilfinger are the major players (rather than Siemens) and the senior management in Germany are driving matters rather than the delivery people on the ground.

Q7 How many changes are in existence and why can't they be agreed?

Up to end of February there were 284 notices of change of which 27 were initiated by tie and 257 were initiated by Infraco mostly as "Notified Departures" from the pricing assumptions they made in their bid and mostly in relation to the civils (ie Bilfinger) element of the works. Estimates of cost and time consequences have been submitted by Infraco for just 77 of the 284 notices and tie cannot consider and agree to changes until these have been provided – a large number have been outstanding for several months.

In respect of a number of the changes for which estimates have been submitted they have been excessive and/or not in accordance with the schedule of rates included in the contract. It is unclear the extent to which this is a cultural behaviour which has emerged amongst the BSC commercial people in Edinburgh or is an instructed behaviour from BB UK management or Germany.

tie believe we could clear away a large number of these changes in short order with good engagement – there are changes to our account in terms of direct cost and time. Also need to recognise there would always be some which are difficult and will require escalation (eg through DRP).

Q8 Were there any alternatives to DRP?

In the context of the reasons submitted by Infraco for not commencing on Princes St immediate referral to DRP was necessary to remove the justification for further delay to the programme and the justification for not starting work in Princes St without further delay.

tie considers further targeted referral to DRP (of the issues in dispute – see Q6 above) to be the best way to expose the detail behind the disputed principles and historic delivery failures rather than the more general positions preferred by BB. DRP is designed as an effective escalation process as well as providing the means ultimately to refer issues for adjudication if necessary.

DRP is not however seen as the way to manage the contract and is seen as a means to an end to precipitate adherence by BSC to the contract we have even if that means Siemens and CAF need to take a stronger role in consortium management or even removing BB as their partner.

Q9 What are the issues referred to DRP already?

Two issues were referred to DRP both specifically in relation to Princes Street:

1. The correct method of calculating preliminaries in relation to a change on Princes St – rather than demonstrated additional prelims BSC wants to do it on a broad and unsupportable % of direct costs basis. (Small change but big precedent)

2. The obligation of Infraco, without further instruction, to commence work on Princes St as part of their contractual responsibilities, when the only change notified to **tie** is one where the valuation requires a resolution to 1. above and **tie** has instructed implementation of the change while the dispute is resolved as it is entitled to do.

Q10 What further issues would be referred to DRP?

There is a broad range of issues which could be referred to DRP on a targeted basis with a view to achieving commercial clarity on the broad principles in dispute as at 6. above, delivering renewed certainty re outturn cost and programme and mitigating further delays to project delivery. The next tranche would see a further 5 items referred to DRP with va long stop resolution in June.

Q11 Is there a way forward without engaging in a DRP campaign?

Yes – we have identified DRP as a means to precipitate progress broader constructive engagement with Infraco and to bring about a greater and more conciliatory particiaptio0n by Siemens and CAF if necessary.

This has borne fruit with a Siemens proposal to establish a Framework Management (FM) group comprising senior reps of tie and each of the consortium members to engage in finding solutions to all significant issues and problems and ultimately agree an updated programme and the commercial implications thereof. This is no more than the way we should have been working all along anyway. Starting work on Princes St with no further delay is a stated pre-condition of implementing the FM proposals.

There is a consortium Board on Wed 18th March at which we hope the FM proposal and the individuals from the consortium management participating will be formally agreed. DRP will continue to work in parallel with this FM group as necessary.

A further very important issue requiring agreement before the work on Princes St commences is one of applying the existing contractual Compensation Event mechanism for any unforeseen obstruction or other cause of disruption to the work as it progresses. Infraco has hitherto asserted that an amendment to the contractual change mechanism is required to prevent the progression of changes themselves being a fundamental impediment to working. We now see a softening of this stance with local management subject to establishing a series of protocols for operating the contract and demonstrating mutual trust. However – this requires referral back to Germany before it could be implementation - this week is possible.

Q12 What would be acceptable near term progress?

The tie Board/Tram Project Board considered the need to see progress in the short term and the following three "litmus tests" of progress will be reviewed at the next Board meeting on 24th March:

- Start of construction on Princes Street and at the depot under the existing contract conditions
- Establishment of the Framework Management group and demonstrable progress
- Mobilisation of all BB principal sub-contractors

Q13 What is the target outcome in all of this?

The target outcome is to maintain the Infraco contract and either precipitate effective engagement and delivery by the existing Infraco consortium – we have no big issues with Siemens or CAF delivery so far, we are happy with the BB supply chain (even if not yet contracted) they are no ready to mobilise and we don't want to throw any of these babies out with the bathwater. An increased role for Siemens and CAF – up to and including the point where they replace BB as civils partner – is a plausible outcome.

Any re-procurement (either or the entire consortium or of a new civils partner) or a prolonged DRP engagement would give rise to longer delays and a significant likelihood of additional time related costs and price premia taking the outturn costs above the £545m mark.

Q14 How long will it be before cost and programme certainty is restored?

With immediate and constructive engagement we believe a revised programme and commercial settlement of all issues could be achieved during May with a gradual narrowing down of ranges between now and then. We are committed to reporting ranges of outturn costs/profiles and programme to Transport Scotland by 26th March.

Q15 Where would CEC get extra money from if it were required?

CEC would consider a range of options to finance a cost overrun (above £545m) but it's to early as yet to determine if this will prove necessary.

Q16 Can we terminate the contract?

Q17 Would an independent mediator be helpful?

Q18 What would the additional costs be to cancel the project now?

Stewart McGarrity
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tie Limited
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