

tie Limited

Paper to : tie Board / Tram Project Board
Subject : STRATEGIC OPTIONS – UPDATE & FORWARD PLANNING
Date : 15th April 2009

PURPOSE OF PAPER

The severe difficulties which led to the dispute around commencement of Princes St works have given way to a more constructive relationship with BSC. Our imperative going forward is to preserve and develop the positive relationships with BSC but in parallel deal with the commercial uncertainties around the completion of the project within the affordability envelope and in an acceptable timescale. The ways we will do that over the coming 3 months are described fully in this paper, which also calls on the joint boards to assess and endorse a number of recommendations which are critical to achievement of an acceptable outcome. The milestones which the joint Boards can use to assess progress are also set out.

The paper is commercially confidential and FOISA exempt in its entirety, as all elements are inter-related and could influence the outcome of negotiations with BSC.

RECAP ON COMMERCIAL STRATEGY

Our commercial strategy for Infraco engagement, selected from a number of options and approved by our joint Boards, has the following broad elements:

- Target pursuit of matters through the contractual Dispute Resolution Procedure (DRP) thereby exposing the detail of disputed matters to all members of the consortium and help minimise further delays by instructing the commencement of work whilst matters are being pursued through DRP.
- Use DRP as a means to the end of facilitating more constructive resolution of issues in accordance with the contract and delivery of cost and programme confidence.
- Leverage involvement of Siemens (and CAF) who are responsible for performance under the contract on a joint and several basis – up to and including replacement of Bilfinger as the civils partner in the consortium.

The commercial strategy recognises the absence of grounds so far to initiate termination of the Infraco contract without exposing tie/CEC to significant risk of claims from the consortium, the value of the contribution by Siemens and CAF to date and the supply chain (subcontractors) assembled for the civil works. .

PROGRESS

The change in momentum and engagement over the past month has been significant and more encouraging:

- Work has commenced on Princes Street under a Supplemental Agreement (SA) which provides an equitable and constructive way forward to facilitate the consortium working flexibly when encountering impediments or obstructions and is consistent with obligations under the Infraco Contract.
- A Project Management Panel (PMP) has been established as the forum for the more constructive engagement between **tie** and BSC which is a key element of the commercial strategy.
- Delivery impetus by BSC at other worksites has improved and work commenced by Infraco at the depot site on 6th April.

This progress represents achievement of most of the short “litmus tests” of progress we set ourselves in early March – the notable exception being the execution of all principal subcontracts and associated collateral warranties to **tie** in respect of the civils work being undertaken by Bilfinger.

We very much welcome the establishment of the PMP but must also consider the reality that the authority delegated to the Bilfinger and Siemens members of the PMP to make decisions without unnecessary referral back up their respective governance and management chains remains to be proven. This is a key ingredient to successful engagement without the risk of meeting entrenched commercial resistance on existing or new issues as we move forward. The strength in depth of the BSC resources deployed at Edinburgh Park remains a concern and will be kept under review.

NEXT STEPS

We are now implementing a number of interrelated workstreams and related milestones within which we will pursue assurance and confidence regarding programme and outturn costs for our stakeholders - CEC and Transport Scotland. That confidence will be founded on our experience of effective delivery and engagement by the BSC consortium as currently constituted in the short term. This process is now 2-3 months behind the targets we set for ourselves in early December as a result of the distractions surrounding the work on Princes St.

A characteristic of these workstreams is that the **tie**/TEL/CEC project team is delivering robust analysis and solutions in advance of commercial agreement on the subject matters with the consortium whilst carefully avoiding the danger of importing BSC’s project management responsibilities on ourselves. This requires the deployment of additional short term resources to build upon or re-validate our existing technical, commercial and legal analysis and thereby both build confidence and provide us with the necessary tools to engage with a contractor we can assume will continue to be commercially ‘assertive’.

The interrelated workstreams are broadly grouped as:

- A. **Rebaselined Programme** – As reported in March we have established a rebaselined programme internal with an open for revenue date of 23/02/12 (17/10/12 without mitigation). The remit of the PMP includes an objective to deliver a commercially agreed updated programme within 3 months of its establishment – ie by the end of June 09. To help with engagement with BSC on this issue, improve confidence in our risk allowances (and therefore cost outturn) and prepare for any referral to DRP on this issue, we are procuring detailed reinforcing technical analysis of responsibility for delays to date and similarly reinforcing legal opinion on BSC's obligations to mitigate those delays.
- B. **Key commercial and legal disagreements** – Despite the establishment of the PMP, it is likely that there has not been any softening on the key principles of commercial / contractual disagreement which have surfaced in the last 3 months over:
- 1) Responsibility for design management and costs of design evolution
 - 2) Liability for delays to date and in the future
 - 3) Preliminaries % to be added to value of changes
 - 4) Responsibility for unforeseen ground conditions
 - 5) BSC failure to provide estimates / abide by contractual change mechanism

In addition to the analysis of delays to date we are procuring very detailed reinforcing technical analysis of our position and potential liabilities under each of these headings and reinforcing legal opinion from Senior Counsel on our interpretation of the contract. Again this will improve confidence in our risk allowances (and therefore cost outturn) and prepare for referral to DRP on these issues if necessary.

- C. **DRP/Infraco breach** - BSC did not agree to the referral of DRP1 (which related to an unagreed estimate as a result of incorrect application of preliminaries) direct to adjudication and it is now being pursued via mediation. The next tranche of potential DRP issues has been the subject of internal review and preparatory work. They can be progressed through the DRP mechanism (internally in the first instance) if they cannot be resolved either through normal contract management channels or within the PMP.

In addition to resolving specific issues of a particular commercial, contractual or programme critical nature, **tie** continues to monitor BSC's compliance with their obligations under the Contract. Currently, evidence of failure of the "hard" obligations within the Infraco Contract is intermittent but this is being scrutinised at the weekly contract management progress and correspondence reviews.

- D. **Settlement of existing changes** - There are a number of different categories of existing "changes" which have been notified by BSC. Whilst we still await the provision of estimates for a very large proportion of "changes" notified by BSC, they have recently committed to providing these in accordance with priorities driven by the construction programme. **tie** is proposing a "without prejudice" settlement of many minor changes during April to "clear the decks" of items which are not disputed in principle.

E. **Review of risk allowance and outturn cost estimates** - We have reported an as yet unapproved outturn estimate for Phase 1a of **£527.1m** which includes a risk allowance of **£35.7m** for Infraco and is based upon the rebaselined programme with an opening date of 23/02/12. After allowing for the probable costs of Phase 1b postponement of **£6.2m** there is headroom of **£11.7m** against the total approved funding of **£545m**. As we move forward we will update the total outturn estimate by reassessing the risk allowance as the outputs from the legal and commercial activities of workstreams A to D above are delivered and we resolve other cost uncertainties as outlined at F below.

F. **Review of other cost uncertainties**

Other than the Infraco risk allowance, the most significant remaining cost uncertainties are:

- 1) Completion of the utility diversions – the outturn estimate inclusive of undrawn risk allowance and net of achievable betterment payments from SUs remains robust but will be kept under review.
- 2) Combined resource costs including tie/TEL/CEC, legal and technical resource required for the revised programme end date of Feb 2012, completion of the workstreams outlined herein and implementation of an enhanced contract and risk management regime. The review of these costs will continue during April and May.

G. **Contract and risk management regime and governance**

We are amending and supplementing our resources and contract management regime to reflect the requirements to manage the contract effectively to address the Infraco we now see generally and the progress monitoring required by the Supplemental Agreement for Princes St in particular. This includes amended processes, additional direct resources (particularly contract management and commercial) and utilisation of specific technical expertise on an issues driven basis to support the Project management team. The next planned "Peer Review" from the OGC team is due to address contract management (proposed for 21st and 22nd May 2009).

It is also essential that the proposed alignment of the project governance arrangements is implemented swiftly. At this stage, these changes are focussed on the composition, roles and responsibilities of the tie and TEL Boards and the TPB, supported by the transfer of the Council's shareholding in tie to TEL.

H. **Broader scope and funding options**

In the event costs are not contained within the available funding of £545m, CEC will want to consider "safety valves" options are available regarding scope and funding:

- 1) Scope options – Our initial analysis indicates that deferring construction from Ocean Terminal to Newhaven is a deliverable option. Termination at Foot of the Walk (or Bernard St) could work operationally economic benefits of the tram as a stimulant to regeneration would be severely diminished. Any decision to defer construction due to affordability/funding constraints must be made with the benefit of greater certainty as to outturn costs and further

examination of the incremental funding options. The utility diversions from Ocean Terminal to Newhaven can be scheduled to take place after the end of June.

- 2) Incremental Funding options - There are a number of possible additional sources of which **tie**/TEL will work with CEC colleagues to provide a view of the Council's capacity to borrow against future TEL combined bus and Tram profits (without reducing dividends or altering fares policy) by the end of June.

As well as the continuation of the project with BSC, we will continue to monitor and report upon the more extreme commercial outcomes including replacement of Bilfinger as the civils partner and termination of the BSC contract with resultant re-procurement or project cancellation.

THE OUTCOME

It is self-evident that the challenges described within these workstreams that achieving an acceptable outcome will not be easy. The primary objective of the next two months is to reach a position where there is a recalibrated programme and cost estimate, accepted by all parties, which has reasonable certainty of delivery. The factors which offer some confidence that this can be achieved include:

- The programme of utility works now has a clear path to completion and the interface issues with the Infraco construction programme are clear
- The programme of completion of all design work by SDS and integration thereof into the construction programme – all of which has been an Infraco responsibility since novation
- The construction works are now underway in many of the critical areas
- The process of handling current commercial arrangements is working, including those relating to Princes Street
- New Bilfinger management in Edinburgh are demonstrating better responsiveness
- Day to day operational relationships with BSC are working well
- Tram vehicle delivery remains on track
- Despite recent problems, public support for the tram project is improving.

These are important building blocks, notwithstanding the challenges. The focus of **tie** activity since the beginning of March was focussed on progressing construction rather than on disputed matters. It may also be helpful to define at this stage what a "gold medal" outcome could credibly look like. Momentum is very important for the project and for the morale of the team (including all family members), which has had a bruising time in recent weeks. Recognising the reality of where we are, a credible gold medal outcome would be completion within the £545m affordability envelope and revenue commencement by the end of 2011.

The most critical determining factors in achieving this – which are all being tackled within the workstreams described above – are as follows:

1. Respectful relationships at senior **tie**/CEC/BSC level, which will provide ballast against future turbulence and bad behaviour. This includes the role of the new **tie** CEO.
2. Constructive engagement around the PMP process and its relationship to current and future DRP action

3. Delivery of the utility diversion programme as currently planned
4. Completion and approval of all design - bearing in mind its BSC's responsibility
5. Continued smooth progress on vehicle delivery
6. Reinforcement of the tie commercial team with experienced and savvy people
7. Project governance re-aligned, the family speak with one supportive voice, external communications treated as a critical part of the plan
8. Cost implications of recalibrated programme are established and agreed, potentially via DRP / adjudication
9. All of the legal disputes are important, but the most critical to resolve are 1) BDDI / IFC costs (to reinforce a key principle) ; and 2) dealing with backlog changes (to clear the air)
10. Establishing clarity around the tie/TEL CEC working and reporting interfaces such that CEC has full visibility of progress and issues but avoiding duplication of effort.

This outcome and the factors driving it will be informed by the outcome of the individual workstreams and cannot be guaranteed, but this is the direction of travel in the short term. The recommendations summarised below and the milestone measurements are designed to support this process.

STAKEHOLDER REVIEW OF PROGRESS AND MILESTONES

Principal review points

30th April Council Progress Report – Informed by:

- This work programme and approach to deliver certainty and provide decision points for CEC and the Board
- First version of the Programme Storyboard – by 27th April
- Updated cost estimate and risk allowance at different confidence levels – by 27th April

6th May and 3rd June Board – informed by:

- Outputs from the technical and legal reviews of liability for delays and other commercial uncertainties
- Further updated cost estimate and risk allowance to reflect these outputs
- Report of progress with BSC engagement, recalibration or contractual programme and physical progress with the works including Princes St

8th July Board

- Consolidated review of outputs from this 3mth engagement
- Formal consideration of recommendations regarding scope truncation, incremental funding sources and stop/go decision on project.

Regular stakeholder engagement rhythms

- TMO – CEC team engagement – Weekly meeting scheduled
- Alan Coyle – integral part of the monitoring of the workstreams as they progress
- Financial Commercial and Legal committee – every 4 wks (14/3, 1/6 and 6/7)
- Transport Scotland engagement – 4 weekly meeting (w/ tie as deemed appropriate)

Other key engagements

- Late April / Early May – Meeting of BSC principals and CEC Directors
- 21st and 22nd May - Peer Review Panel – Contract Management Regime

RECOMMENDATIONS

The Board are asked to:

1. Note the progress which has been made since the beginning of March by implementing our commercial strategy.
2. Approve the workstreams described above as they are being implemented by tie management
3. Approve the milestones outlined above to report back on these workstreams and to consider the strategic decisions regarding scope and funding in light of the additional certainty of outturn cost and programme which will be delivered.

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Date: 15th April 2009