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and to

Willie Gallagher  
Executive Chairman  
**tie** Limited ("**tie**")  
Citypoint  
65 Haymarket Terrace  
Edinburgh, EH12 5HD

12 May 2008

23004433

Dear Sirs,

**EDINBURGH TRAM NETWORK ("ETN")  
DRAFT CONTRACT SUITE AS AT 12 MAY 2008**

We are instructed to report to **tie** and to CEC in relation to the status of the ETN Suite of documentation as at 12 May 2008. You of course have our letters of 12 and 18 March, copies of which are appended for ease of reference.

Since we last wrote on 18 March, **tie** has been engaged largely on negotiations to close the SDS novation and to complete programme and final pricing and commercial discussions with Parsons Brinckerhoff ("**PB**") and Bilfinger Berger and Siemens ("**BBS**") respectively. Close discussions have also been held in Spain with Construcciones Y Auxiliar de Ferrocarriles S.A. ("**CAF**"). There have also been initial proposals from BBS regarding CAF joining the Consortium and the events of 29 April to date regarding Bilfinger Berger's position on price.

Taking our letter of 12 March as the base line from which **tie** was able to issue its notifications of intent to award the ETN Contracts, we are in a position to update as follows (using the sections and numbering in that earlier letter):

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**1. CORE INFRACO CONTRACT TERMS SETTLED AND ALIGNED WITH TRAMCO CONTRACT**

**1.1 Core Infraco Contract Terms**

The Core Infraco terms are closed as to all matters of contractual, technical and commercial principle. BBS legal teams were instructed on 24 April to respond during the final quality assurance period of 7 days in order to remove or refine any omissions or errors co-operatively. No issues have arisen since we last reported which have resulted in any adverse alteration (of consequence) to risk balance. As they stand, the terms and conditions represent a clear reflection of the positions which have been negotiated by **tie** and are competent to protect and enforce those positions.

**1.2 Employer's Requirements ("ERs")**

**tie** report that BBS and SDS are satisfied (and have agreed to its inclusion as a Contract Schedule) that the ERs document (at version 4.0) has now been signed off by the relevant technical teams. Limited legal reviews on the ERs were carried out to remove inconsistencies and repetition where obligations were already captured in the core terms and conditions. The evolution of the ERs as a contractual (as opposed to technical) document has taken some time and our own involvement in quality assurance has been limited. Nevertheless, the core Infraco terms contain a clear mechanism to address any mismatch between the ERs, the Infraco Proposals and the terms and conditions - giving the core terms and conditions precedence. We are instructed by **tie** that the SDS Provider has been given a change order to align its design completed to date with the Employer's Requirements and the Infraco Proposals and will warrant to Infraco that (once this exercise is complete) the SDS design produced to date will comply with the Employer's Requirements and the Infraco Proposals.

**2. RISK ALLOCATION MATRIX**

We have revised the Infraco Contract matrix to reflect in particular the recent discussions with SDS and with BBS on liability caps and on BBS responsibility for SDS design and performance post novation.

**3. PERFORMANCE SECURITY PACKAGE**

We have nothing further to report here, save that the PCGs now contain a progressive cover step-down during the Term of the Infraco Contract which extends 9 years (with an option for a further 5 years) beyond the issue of the Reliability Certificate (approximately one year from commencement of operations). **tie** has the right to call for a cash retention or a bond should a survey reveal that deficient routine maintenance has caused the need for more than £50,000 refurbishment works.

#### **4. CONFIRMATION OF NOVATION STRATEGY**

CAF remains committed to novation. SDS has now committed to novation and the terms of their novation agreements are settled, bar final discussion with SDS which **tie** are closing out at present. Our comments in the letter of 12 March remain valid. We are content that the two novation agreements are competent to achieve the transfer of the Tram Supply and Tram Maintenance Contracts to the Infraco under the commercial principles that **tie** has agreed with each party (under tripartite negotiations) since preferred bidder appointments. The SDS Novation Agreement is under final discussion with BBS and SDS regarding details of design review process and design release. There is some risk that the close of this novation will take up further time until commercial issues are settled between **tie** and SDS.

#### **5. RISK**

Following on from our letter of 12 March, we would observe that delay caused by SDS design production and CEC consenting process has resulted in BBS requiring contractual protection and a set of assumptions surrounding programme and pricing.

**tie** are prepared for the BBS request for an immediate contractual variation to accommodate a new construction programme needed as a consequence of the SDS Consents Programme which will eventuate, as well as for the management of contractual Notified Departures when (and if) any of the programme related pricing assumptions fall.

#### **6. THIRD PARTY AGREEMENTS**

6.1 The contractual position remains as we explained in our letter of 12 March. We were instructed by **tie** to carry out an analysis of all third party agreements entered into by **tie** to identify unusual provisions or constraints. That has been done across the spectrum of commitments and undertakings (which **tie** has provided us with) and we have made recommendations to **tie** regarding how these agreements require to be managed and monitored during works execution and beyond. We are advised by **tie** (through Dundas & Wilson) that all parliamentary undertakings during committee stage were taken into account in the amendments to the Bills.

#### **6.2 EAL**

Since last reporting, we have been engaged with the BBS lawyers in order to explore how **tie** could mitigate the risks which we identified. The EAL arrangements will be stepped down into the Infraco Contract so that Infraco is on notice of their terms and is operating in cooperation with **tie** to respect EAL's requirements both during construction and operational stage phases. The shifting of the tramway at Edinburgh airport (if imposed at the option of EAL post-2013) will be implemented as a **tie** Change under the Infraco Contract.

## 7. CONSENTS

- 7.1 We need to refresh our commentary on 12 March with respect to contractual treatment of the performance of SDS. SDS are culpable contractually for delay in the consent process producing "Issued for Construction Drawings" up to a cap of £1,000,000 liquidated damages payable to BBS (payable at approximately £10,000 per deliverable). Beyond these individual and cumulative caps, any prolongation cost incurred by BBS because of consented design production delay affecting works activity would be recoverable from **tie** as a contractual compensation event. SDS are liable to BBS up to a cap of £10,000,000 (each and every event) for loss or damage caused by deficient design; beyond that amount, BBS would have recourse to **tie**.
- 7.2 In addition, SDS will be incentivised to complete their remaining deliverables (approximately £4,500,000 of remaining design tasks, we are instructed) by a £1,000,000 bonus for timely delivery which is subject to erosion by approximately £10,000 each time a consent date is missed due to SDS's fault. This bonus is payable at the end of SDS design delivery programme and is only protected against risk to the extent that SDS receives an extension of time due to a **tie** Change instructed to Infraco.
- 7.3 SDS will be taking Siemens' design through the Consents process and are expected to provide the resource to achieve this (against additional compensation) on a monthly capped call-off basis.

## 8. NETWORK RAIL ASSET PROTECTION AGREEMENT ("APA")

The situation with regard to BBS providing NR with a collateral warranty has been resolved and the APA has stepped down into the Infraco Contract. BBS are liable for claims by Network Rail up to a cap of £500,000 (£40,000 per incident) in respect of possession overruns or Train Operator Claims and up to a cap of £750,000 regarding the Network Rail Immunisation Works. Above these caps, liability to Network Rail rests with **tie**.

## 9. CEC GUARANTEE

The commitment is now settled and in agreed and satisfactory form. CEC Legal and Finance are fully informed. A simple non objection letter is required to be issued by CEC to give comfort to BBS that the CEC Guarantee will not be affected by CAF becoming a party to the Infraco Contract.

## 10. PROCUREMENT RISK

Since 18 March, **tie** has held the two most important bidder debriefs at our offices. The relevant DLA Piper partners attended both interviews to support **tie's** team. Tramlines and Alsthalm took the opportunity to ask searching questions which, in our opinion, were dealt with professionally and convincingly by **tie**. Accordingly, we had assessed residual risk of challenge

from these two parties as low provided **tie** proceeded to contract signature expeditiously. The remaining debrief is with Bombardier (scheduled at their request and convenience) for 24 May.

We have reviewed **tie's** paper entitled "Financial Close Process and Record of Recent Events" from a procurement risk perspective. **tie** has been placed in an extremely awkward position by BBS' behaviour post issue of the formal notification of intent to award. **tie** applied price as the determinant evaluation criterion when appointing Preferred Bidder, so that price adjustment can create exposure to the losing bidder challenging on the basis that their finance offering was as good or superior. This is however too simplistic an approach as we explain below.

We were not party to any of the evaluations other than the legal evaluation of tenders on which we have reported in considerable detail in previous communications to CEC. Risk of challenge to the appointment of BBS arises from three sources: the reserve bidder, any interested party who might seek to complain, either vexatiously or out of genuine sense of public responsibility and spontaneous EU Commission investigation.

#### **The reserve bidder**

We are satisfied that **tie** has prepared a methodical analysis of BBS' final financial offering (at £508 million) compared to Tramlines' pre-bidder tender price. Tramlines were debriefed satisfactorily in light of that exercise carried out by **tie**. The net effect of BBS' pricing movement is now an overall contract price of £512 million (as we understand it). We consider that were Tramlines to mount a challenge, the appreciable and key qualifications on their contract would be an impediment in them arguing that they had a firm price which would not have risen. There are a number of factors (not legal) which militate against Tramlines seeking to challenge: a relatively buoyant construction market, Grant Rail and Laing O'Rourke involvement in the Manchester Light Rail extension, the need for a determined and funded lead in any challenge (Tramlines is not a company, but rather a bidding Consortium) and the satisfactory and recent debrief. Our view is therefore that the risk of complaint by Tramlines should not be discounted, but that a legal challenge aimed to halt and disrupt the procurement is far less likely than a complaint designed to create leverage to reclaim part or all of expended bid costs. At present we are not aware of any such move.

#### **Interested Party**

This is much more difficult to evaluate objectively. The cost and engagement necessary to launch a complaint of this nature is minimal. The outcome is the same as an official spontaneous investigation dealt with below. The main mitigation against this risk is the handling of media and public relations regarding the final selection of BBS and legitimate use and control of pricing information.

## **EU Commission**

Such an investigation can be triggered by the Commission itself, in this case the Procurement Directorate. Initially representations would be made to the Scottish Executive and if a case is found to be answered, CEC would be responsible to the SE for providing an explanation and defence. Again our considered opinion is that **tie** has good material and justifiable reasons for responding to the procurement difficulties in the way it has. On balance and given the difficulty which the procurement of light rail schemes in the UK has suffered, we consider that the better view that such an investigation would not conclude that **tie** had treated Tramlines in an unfair, opaque or disproportionate manner.

We have briefly mentioned before the most relevant jurisprudence which is the London Underground project. Under a negotiated procedure such as this the law is clear that a contracting authority may make adjustments and refinements post-preferred bidder on complex projects. At what point that conduct amounts to an infraction will always depend on the facts and circumstances. At one end of the spectrum there is a straight-forward price increase and at the other is the price uplift accompanied by full blown re-negotiation of the contract. Both would expose the contracting authority to a challenge.

In our opinion **tie** has worked extremely hard to retrieve a difficult situation and to ensure that value and significant risk re-balance has been secured from BBS. Additionally, **tie** would be quite entitled to highlight the significant additional cost, delay and uncertainty which would be imported were the competition to be reopened or the existing preferred bidder demoted, to be replaced by its competitor whose commercial and contractual offering was immature in October 2006.

## **11. OUR LETTER OF 18 MARCH**

We have addressed Sections 1 and 2 in that letter comprehensively in those numbered sections above.

- 11.1 The agreed master Construction Programme (containing SDS Design Delivery Programme and Consents Programme) has been assembled by **tie** for insertion into the Infraco Contract.
- 11.2 Network Rail Immunisation has been scoped and priced by BBS with **tie's** agreement and a full set of appropriate contractual terms negotiated and included in the Infraco Contract.
- 11.3 The Pricing Schedule (Infraco Contract Schedule Part 4) has been extensively discussed over the past six weeks and is now settled as to its key assumptions, value engineering items, provisional sums and fixed prices. **tie** has assessed the likely financial impact of the assumptions not holding true and triggering changes.



#### **11.4 Indemnities (uninsured third party economic loss claims)**

These matters are now settled (as reported previously) although the sharing agreement (at Service Commencement) agreed for the £3,000,000 reserve account changed on final commercial discussion (**tie** surrendered the entitlement in exchange for meaningful risk rebalance) and the reserve account will be managed by Bilfinger Berger UK Limited. The provisions for its operation are set out in a schedule to the Contract.

#### **11.5 CAF joining the Consortium**

BBS have indicated their intention to present a plan under which CAF would formally join the BBS Consortium, as opposed to remaining as its novated Sub-contractor. This outcome was foreseen in the ETN procurement strategy; however its timing (i.e. in the last two weeks prior to Close) has had the potential to disrupt (and introduce a technical procurement hurdle of re-qualifying the BBS Consortium) the ETN Contract Award. **tie** has rejected a commercial argument mounted by Siemens for a financial mark-up on CAF's novation as a sub-contractor if CAF do not join the Consortium. BBS initially approached CAF joining on the basis that it should be a pre-condition to ETN Infracore Contract Close, but **tie** have held the position that, though welcome, the entry of CAF into the Consortium is for BBS to arrange with **tie**'s consent and the three long planned novations are complete. This sequence should minimise procurement risk for **tie**. A full legal analysis has not been possible in the time available since BBS and CAF presented a formal joint proposal but this should not hold up ETN Contract signature. We have reported separately on this matter, as has **tie**.

We attach the update Risk Matrix for your use (clean copy and mark-up against Preferred Bidder Status). This document is not a substitute for study of the ETN Contract Suite and is intended as an aide to the main components of risk allocation. It does not reproduce the commercial detail in the Contract Suite on which **tie** has reported separately.



Following all parties final due diligence on the ETN Contract Suite released by us on 22 April 2008 under **tie's** instructions (see annex A to this letter), our view is that **tie** is in a position to sign all necessary documentation to give effect to the implementation of the project. In view of extreme time pressure to adhere to **tie's** Close Date imperative coupled to lack of readiness of BBS, some ancillary elements of the contract documentation may require housekeeping post Close. We do not consider this to be a reason to defer signature of the contracts which is the best means to protect **tie/CEC** from any further attempt by the Consortium to re-open negotiations.

Yours faithfully



**DLA PIPER SCOTLAND LLP**