

Gill Lindsay
Council Solicitor
City Chambers (Legal Services)
Anchor Close
30 Cockburn Street
EDINBURGH
EH1 1YJ

Your reference

Our reference

AF/NH/310299/15/
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10 March 2008

Dear Ms Lindsay,

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

This letter is our report to update you on the matters which we addressed in our letter of 16 December and to report further on the evolution of the contract documentation to close. We are instructed that **tie's** intention is to issue a notification of intent to award the Infraco Contract and the Tramco Contracts on 13 March 2008. This letter therefore provides our view on the status of the contracts and their readiness for this final stage of the procurement commenced in October 2006.

PROGRAMME

The following is foreseen by **tie** as enabling Council officers to recommend Full Council authorisation for **tie** to enter into the ETN contract suite as anticipated in the full Council Resolution of 20 December 2007:

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

We are able to report the draft ETN contract suite has been advanced to a point where there are no significant legal issues outstanding on the Infraco and Tramco core terms and conditions which would prevent the documentation being ready for signature by end of March. This will rely also on the cooperation focus of, and interaction with, the Consortium. Detailed drafting remains necessary to ensure accurate and fully agreed reflection of all commercial aspects which have come together in the last 10 days.

Infraco/Tramco Contract alignment has been completed to a painstakingly detailed level on all issues which were outstanding when we last reported. CAF has agreed to the terms of the TSA and TMA (as obliged) and BBS and CAF have agreed to the terms of the two related Novation Agreements, subject to final review.

2. UPDATED RISK ALLOCATION MATRICES

Regulated by the Law Society of Scotland.

A limited liability partnership registered in Scotland (number 300365) which is a law firm and part of DLA Piper, a global organisation.

A list of members is open for inspection at its registered office and principal place of business, Collins House, Rutland Square, Edinburgh, EH1 2AA and at the address at the top of this letter. Partner denotes member of a limited liability partnership.

UK switchboard
+44 (0)8700 111 111



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The Infraco Contract Risk Matrix is appended to this letter. It is updated to show change since our previous report. **Highlight main changes**.

3. PERFORMANCE SECURITY PACKAGE

3.1 There is no change to the structure of the main performance security package. The BBS Consortium will provide:

- (a) bonds/financial guarantees to be issued by ANZ Bank and/or Deutsche Bank (to cover the construction and commissioning of the ETN) ; and
- (b) parent company guarantees to underwrite contractual performance and financial liability of the two UK contracting subsidiaries.

3.2 On Demand Bonds

Two "On Demand" Bonds offered by the BBS Consortium have been negotiated to a level (on proposed amounts and detailed acceptable terms and conditions), enabling the BBS Consortium to select their proposed sureties for confirmation of pricing. No issues (aside from a possible adjustment to the value of the main performance bond to reflect final contract price) of significance are outstanding and we are awaiting final confirmation on agreed terms accepted by the sureties.

3.3 Parent Company Guarantees

As you know, we have advanced these negotiations in parallel with the negotiation of the terms of the Council's formal Guarantee of **tie**'s payment obligations under the ETN suite of contracts. The key terms are now agreed. What remains is the liability cap for each Parent Company Guarantee, following final agreement reached on the liability cap duration and scope for the Infraco Contract, which will be settled by Wednesday 13th March. Following this, the Parent Company Guarantees will finalise quickly.

3.4 Confirmation of Novation Strategy

Contrary to the expectation we had in December 2007, the process of engagement on SDS Provider novation has proved arduous with both BBS and SDS taking positions at opposing ends of the negotiating spectrum. BBS have taken a most risk averse stance, due to their views on SDS performance to date, in particular in relation to design Consent achievement, but also in relation to design quality.

BBS have insisted on reinforced contractual protection (in our view unnecessary) and commercial support in the form of **tie** accepting compensation entitlement for BBS in the event of SDS default. This position is predominately a function of SDS underperformance

throughout its mandate and also at a time when this has been under close bidder scrutiny.

Nevertheless an advanced draft Novation Agreement is in play in negotiation to close. The terms of the Novation, as mentioned, result in retained SDS performance risk for **tie**.

4. RISK

- 4.1 Our view on the contractual allocation of risk and responsibility between **tie** Limited and the competitively selected private sector providers remains that the Infraco Contract and the Tram Supply and Maintenance Agreements broadly aligned with the market norm for UK urban light rail projects, taking into account: the distinct characteristics of the Edinburgh Tram Network. The project's state of technical and commercial readiness has matured since Christmas. However, the fact that work still continues on the Employer's Requirements - the project scope - at this very late stage (resulting in SDS insisting on an instruction to align their designs with **tie**'s Employer's Requirements and the Infraco Proposals) means that technical ambiguity (and therefore delay/cost risk) is likely to exist in the interplay between design, scope and method of execution.

5. THIRD PARTY AGREEMENTS

The position achieved regarding Third Party commitments made by the ETN project is as follows:

- 5.1 At ITN issue in October 2006, DLA Piper had included all major third party agreements **tie** had concluded at that time (plus SRU agreement in draft) in the so-called Schedule 13. This put Infraco on notice of the requirements to carry out work and/or observe constraints in these agreements. The inclusion of these agreements in the ITN documentation was carried out by DLA Piper without details **tie** instruction and that remains the case. That is to say the obligations selected for step down are DLA Piper's judgement, but not informed by any sectional engineering view from **tie**. The third party agreements - with the exception of the utilities divisions and Network Rail APA - were all prepared by Dundas & Wilson for CEC without DLA Piper's input.

In addition to the Schedule 13 agreements (which has been updated to introduce one further agreement concluded since ITN issue date), **tie** had entered into a range of commitments with private individuals and smaller businesses during the parliamentary phase and beyond. Following preferred bidder appointment, BBS took the position that they had never been shown or given access to these papers (contained on two CDs). Whether this assertion is accurate or not, that is the qualification BBS held to with determination. This situation was negotiated strenuously by **tie**.

- 5.2 BBS have accepted the contractual outcome that:
- (a) BBS must comply with the obligations set out in Schedule 13;
 - (b) BBS must not put **tie**/CEC in breach of (or in a position where it cannot use entitlement under) the Schedule 13 Agreements (which include, in essence, Network Rail APA and EAL Agreements);
 - (c) BBS undertakes to take all reasonable steps to ensure not to cause **tie**/CEC to be in breach of the CD commitments;
 - (d) if BBS is impaired by constraints/requirements in the CD commitments which are, in essence, unusual or could not reasonably have been foreseen by an experienced contractor, BBS will be entitled to apply for relief and any demonstrable additional cost

SDS are contractually obliged to ensure that their design deliverables take account of all third party agreements and commitments and they are guaranteeing this to BBS under the Novation Agreement.

5.3 EAL

A number of issues have arisen from mismatches between the Licence agreed to permit construction activity at the airport under MUDFA and **tie** Infraco Contract and the terms of the pursuant lease negotiated with EAL. These are required to be corrected to remove risk and a Minute of Variation is under preparation.

A future risk is uncovered at present. The terms under which EAL is entitled to require the tramway to be shifted (post January 1, 2013) do not include an indemnity in relation to any defects or unforeseen interference in the ETN system which might result from this construction activity and its ultimate interface with the existing system. **tie** is assessing this.

5.4 SRU

This agreement is included in Schedule 13 in draft form but no pricing allowance is at present made for the Infraco executing the works.

6. CONSENTS

- 6.1 The terms of the novation of SDS have therefore been settled on the basis that BBS risk adversity required accommodation, otherwise no transfer of responsibility for design production and consent management could have been achieved in the timeframe. Two prime concessions have therefore been made by **tie**:

- (a) to the extent the CEC consenting process is delayed through no fault of SDS Provider, that delay will entitle BBS to claim a Compensation Event under the Infraco Contract (time relief and additional cost). Such a claim would also encompass SDS Provider delay costs. Although the SDS Contract provided that SDS would take all consent risk, without exception, BBS were not prepared to absorb this risk (through recourse to SDS Provider) having carried out post preferred bidders due diligence on SDS design and the consent process with CEC.
- (b) If through its own fault or dilatoriness SDS is late in delivering a design into the CEC Consent process and this in turn delays the issue of construction drawings to BBS (Issued for Construction), BBS will be entitled to apply liquidated damages up to an agreed level (currently proposed by tie at £1,000,000 and with approximate minimum rate of £20,000 per week).

BBS would have recovery risk on such liquidated and ascertained damages¹ but beyond the cap, tie would be required to recompense BBS.

BBS are reluctant to take any risk as regards to quality of BBS designs. The current position is that any damages or loss suffered by BBS beyond the £10,000,000 cap under SDS novated contract (in relation to deficiency in SDS design) would be a tie risk.

- 6.2 Following the novation of SDS, tie will hold a collateral warranty from SDS regarding SDS services and work product prior to novation. The terms of the Collateral Warranty will be standard for a design and engineering services consultancy and were substantially contained in one annex to the SDS Contract when it was executed in September 2005. tie will also hold the SDS Parent Company Guarantee which supported the original SDS Contract.

7. NETWORK RAIL ("NR") ASSET PROTECTION AGREEMENT

- 7.1 The Asset Protection Agreement with NR has been fully negotiated and ready to close. This has been an arduous process, however the outcome is a document which achieves significant commercial improvements for tie/CEC on what was originally offered by Network Rail. The arrangement is nevertheless heavily tilted in Network Rail's favour, as is inevitable given the starting point of the biased regulatory template agreements. The main improvements secured have been:

¹ Note that the enforceability of such LADs is open to question unless they represent a genuine pre-estimate of BBS loss from the delay.

- (a) Significant widening of the circumstances in which **tie** can recover money from Network Rail;
 - (b) Reasonableness in Network Rail actions and ability to refer to the Infracore ETN Suite form of Dispute Resolution Procedure;
 - (c) Dilution of indemnities given by **tie** to Network Rail to a mutually acceptable level.
- 7.2 The unreasonable position taken by Network Rail regarding the indemnities contained in the Protection Provisions Agreements (entered into to remove Network Rail's objection to the tram scheme) delayed closure for a considerable time. This has now been resolved to restrict the scope and duration of this indemnity, particularly during construction.
- 7.3 All property related aspects of the ETN-NR post construction interface have been handled by Dundas & Wilson.

7.4 [to add section on CW position and solution]

8. CEC GUARANTEE

- 8.1 The terms and conditions of the CEC Guarantee and in particular its call mechanics, liability cap and protections are in line with market practice for this type of instrument. It should be noted that the Guarantee may be called upon by the Infracore on multiple occasions if **tie** is in payment default more than once. The instrument has been drafted, negotiated and settled with direct involvement and support of CEC Legal and Finance.
- 8.2 CEC will benefit from the same contractual defences and entitlements to set off as **tie** and will have no liability greater than **tie's**. No claim can be made for an amount which is in dispute if **tie** has been referred the matter under the dispute resolution provisions of the contract.

9. PROCUREMENT RISK [This requires thorough review before committing]

[You have asked for our opinion in relation to procurement risk imported on account of adjustment of risk allocation post Preferred Bidder. Our view is as follows:

- 9.1 The time which has elapsed since preferred bidder announcement is appreciable, particularly when an outside observer may not have a detailed understanding of the procurement strategy and the difficulty caused by SDS Provider's underperformance. With that passing of time before an award, comes the risk of increased perception that the

final deal has been restructured to accommodate the winning party on different and more favourable terms.

9.2 Both bidders' final submissions were qualified as to acceptance of contractual terms. It would be difficult, in our view, for a challenge to be upheld on grounds that the position on Contractual Risk Allocation settled is a position that the losing bidder could point to and say: "that is far beyond what I would have required to maintain my price." There have been shifts in risk allocation but in all key cases, this relates to the process of the novations, which was clearly identified as a post preferred bidder process. Both bidders' positions on novation were heavily qualified.

9.3 The area where we have limited visibility is price. We played a role in bid evaluation only in relation to the bidders' response to the draft contracts. In order to advise tie has the best platform from which to resist any challenge, we would need to discuss with tie the make-up of BBS original pricing submission and the current final offer and to understand how this compares to Tramlines price.

9.4 We note below commentary from tie Limited in relation to the finalisation of commercial terms:

[In the period post the selection of preferred Infracore bidder, there has, as normal and expected, been movement in the commercial pricing of the contract based on a number of key drivers:

- Both parties in the preferred bidder review had lodged substantial and material qualifications to their bids and it was a key requirement in the ensuing months and prior to contract close that these were understood and resolved/removed, leading inevitably to change in contract terms.
- The substantial revision of the Employer's requirements, which are now at version 3.5 (Version 2.4 at conclusion of preferred bidder selection). These changes in requirements have been crystallised as both parties went through a process of harmonising and clarifying the requisite specifications. Included amongst these were the CEC's requirement for tapered poles in the heritage areas.
- Completion of further elements of the overall design which were not available at the time of the preferred bidder selection.
- Following the recognised changes to employer requirements and the completion and refinement of further aspects of the overall design a review of the programme timescale has seen the programme move from delivery at the end of March 2011 to 16th July 2011 with concomitant effect on price.

- Review of the Depot equipment base with the TRAMCO preferred bidder has seen a number of changes to said base to assure compliance.

It is not considered that this price movement from £xxxm to £xxxm represents an issue which requires review of the selected party, the volume of change as described was to be expected and would have occasioned similar price movement, ceteris paribus, with other competing suppliers.]

[tie / DLA to finalise commentary here]

We are not instructed in relation to any matter on the tram supply and maintenance procurement which would alert us to any concealed or latent risk of a challenge once CAF are formally awarded the contracts. However, BBS have discussed with tie CAF joining the Consortium. If this occurred prior to contract award, it would necessitate a re-evaluation of the bid Consortium. Present indications are that CAF may join post contract award, a matter for BBS to handle with tie's consent.

All our efforts over the next 48 hours are focussed on an efficient and optimal close of the contract documentation which will be initialled by authorised representatives to record final positions (from which the award documentation will be finalised) and on the basis of which tie can issue the notification of intent to award with confidence.

Yours faithfully

DLA PIPER SCOTLAND LLP

cc Graeme Bissett, tie Limited Strategic Planning Director