

## SDS CONTRACT NOVATION OPTIONS

### Purpose

1. To confirm that the strategy remains to novate the SDS contract to Infraco.
2. To confirm that novation should take place at Financial Close.
3. To propose the extent of novation.
4. To set out the method by which retained scope will be contracted and programme to achieve this.

### Timing

5. **Urgent.** We need to keep the SDS contract moving forward to novation and set clear expectations for both SDS and Infraco. Failure to make progress will complicate the process to financial close.

### Principles

6. Relevant key principles of the agreed procurement strategy as set out in the approved FBC are:
  - transfer design, construction and maintenance performance risks to the private sector (i.e. a contractor owned design);
  - minimise the risk premium (and/or exclusions of liability) that bidders for a design, construct and maintain contract normally include. Usually at tender stage bidders would not have a design with key consents proven to meet the contract performance obligations and hence they would usually add risk premiums for this.
7. This strategy is delivered in respect of design by:
  - novation of the SDS contract to Infraco
  - novation of the SDS contract at Financial Close
8. Other considerations are:
  - minimising the potential for cost escalation resulting from design change post Infraco award
  - the transfer of risk to the party best able to manage that risk
  - that most risks are most effectively managed in the private sector
  - BBS are accepting Consent risk (except TROs) on the basis that SDS has been progressing critical approvals and if SDS has visibly not progressed any Prior Approval before the award of

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contract to BBS, then this would constitute a contractual Compensation Event (time and money) for Infraco

- ~~due to programme slippage tie~~ needs direct access to SDS to support certain non Infraco elements of the project.

### Confirmation of novation

9. There are three compelling reasons why novation is required:

- the objectives of the Procurement Strategy (contractor-owned design) are not achieved without novation i.e.
  - i. Risk transfer to the private sector
  - ii. Avoidance of risk premium in the final price from Infraco
- there is a risk of legal challenge as one potential Infraco decided not to bid and cited the novation proposals as a significant factor
- to avoid additional costs of complete (as opposed to partial) design validation by the contractor's own designers and delay to the scheme while remaining design is completed by a third party. This would be slower than completion by SDS given the learning curve that a new designer would face. There is no compensating cost benefit to offset these additional costs. The cost of complete design validation are likely to be of the order of £4m, plus approximately £7.5m for the cost of delays to the programme of around three months whilst validation is undertaken.

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### Extent of novation

10. There are two reasons to consider whether parts of the SDS contract scope should not be novated to the Infraco.

11. Firstly, tie will continue to need support on some tasks that is best provided by SDS. That list is not yet fully defined but is likely to include:

- support for core traffic regulation orders (TROs)
- wider area traffic measures design, including support in obtaining TROs for those measures
- remaining utilities design where works are to be carried out by AMIS and on-site support for these works
- Gogar Interchange *may* require design input / support.
- design for future extensions (if procurement scope so allows)
- ~~betterment – design of additional streetscape to complement the tram funded by CEC outwith the tram budget – No this would be by Infraco~~

12. Secondly, tie needs to consider whether any of the risks that currently lie within the SDS contract cannot be transferred to Infraco (eg because the Infraco refuses to accept them as part of the due diligence

process) or would only transfer at a premium that is too high to represent value for money (ground condition risk due to non-completion of GI surveys and reports may be an example). However, a strong presumption in favour of transfer should remain in each case. There are already some risks that nominally contractually lie with SDS that are being managed directly by tie – TROs is the prime example but there may be others.

#### Alignment of contracts as part of novation

13. tie has a contract with SDS, which is strong in many respects. The Infraco contract needs to be aligned with the SDS contract i.e. there need to be enhancements in Infraco to mirror the stronger elements and carve outs where tie has a stronger position generally within the Infraco contract.

14. There is some alignment of obligations required between SDS's contract scope and design performance obligations and those of the Infraco Employer's Requirements. With the significant exception of the alignment of run time obligations these are considered minimal. The run time obligation in the SDS contract is shorter than that in the FBC and Infraco Employer's Requirements. The SDS contract run time obligation will be relaxed to match that of the FBC.

#### Timing of Novation

15. tie is currently working towards novation taking place at financial close in accordance with the approved Procurement Strategy. However, at that point tie would be novating on the basis of an incomplete design that is not entirely complete, although the majority of the design will be complete, and tie needs to consider what that does for risk transfer and its impact on the project cost. The obligation to complete the design will become the responsibility of Infraco via the novated SDS contract.

16. The advantages of novating at financial close are:

- transfer of responsibility for all Infraco works design to Infraco including delivery of any remaining design i.e. the risk of design performance in meeting the Employer's Requirements and risk of delivery of remaining design to meet the Infraco programme
- minimising the risk of Infraco Award cost creep (while the design is owned and controlled by tie the risk of price change from detailed design and more importantly the risk and costs of delay to design completion remains with tie)
- it transfers the risk of Infraco rejecting an SDS design produced after financial close from tie to Infraco
- Infraco control over the integration of their design work with that of SDS and the development of system integration plans
- Infraco controlling the delivery of designs to meet their programme

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- Infraco has said that the level of design detail is sufficient for them on many scheme elements and tie may not secure any further savings by undertaking further design under tie's direction

Comment [SB1]: % / proportion?

16-17. The advantages of delaying novation are:

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- transfer of a completed design
- tie retain full control over the final detailed design completion
- possible reduction in Infraco costs due to reduction in risk carried by Infraco by resolving approvals before transfer but that reduction would be offset at least to an extent by the cost of tie retaining the risk

18. There is limited, if any, realisable cost benefit from these potential advantages and significant risk to tie through delaying novation that would outweigh any benefit. The significant risk is that Infraco would be relieved of any delay to the completion of design. The cost of such delays where they move the completion date out would be circa £2.5m per Period.

18-19. tie has established that the novation cannot be phased over different dates (eg as design was completed) as novation creates a new contract between Infraco and SDS. Any scope left behind at that point remains as a direct agreement between tie and SDS.

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#### Direct agreement between tie and SDS

19-20. A direct agreement between tie and SDS is established by not novating the full scope of the SDS contract to Infraco. However, not all of the scope of work that tie wishes SDS to undertake post novation was included in the original scope of work, eg design of wider area measures. This scope would need to be added to the direct agreement. This will be effected by adapting the collateral warranty between tie and SDS

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[Andrew – what is the most efficient legal mechanism to include the additional scope. Is it by varying the scope before novation?]

#### Conclusions

21. Novation of the SDS contract is necessary to achieve the objectives of the procurement strategy, transferring risk to Infraco and minimising any risk premium associated with under developed design.

22. There is very little benefit in delaying novation and significant risk to tie.

23. The scope of the direct agreement between SDS and tie needs to be finalised very quickly to allow SDS and tie to plan for the period post novation.

### Recommendations

- | ~~23.24.~~ Novation of the SDS contract to Infracore should take place at financial close. Formatted: Bullets and Numbering
- | ~~24.25.~~ The scope of the direct agreement between SDS and tie should be based on the list at para 11. Formatted: Bullets and Numbering
- | ~~25.26.~~ The scope of the direct agreement should be defined more precisely. Formatted: Bullets and Numbering

### Next Steps and programme to deliver the Recommendation

- | ~~26.27.~~ I suggest we need to: Formatted: Bullets and Numbering
  - check with colleagues what the complete list of retained services should be including any where tie would wish to retain risk (by 12 November)
  - define the scope of retained services more precisely (by 14 November)
  - review with the tie ~~Chief Executive~~Executive Chairman and Tram Project Director (by 15 November)

Damian Sharp  
7 November 2007