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Your reference

Our reference

SLF/JM/310299/15/
16755155.1

17 December 2007

Dear Ms Lindsay

**EDINBURGH TRAM NETWORK ("ETN")
DRAFT CONTRACT SUITE AS AT 16th DECEMBER 2007**

As you know, since the announcement of Preferred Bidder on 23 October 2007, we have been working intensively under **tie's** instruction with the Bilfinger Berger Siemens Consortium legal and commercial team. The objective has been to reach a position on the post Preferred Bidder refined contract documentation suite to support **tie's** programme for financial close by 28th January 2008.

PROGRAMME

The following was foreseen by **tie** as enabling Council officers to recommend Full Council authorisation for **tie** to enter into the ETN contract suite. :

- **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 core terms and conditions which could currently be seen as an obstacle reaching a contract close and signature as programmed by **tie**. Work remains to translate commercial and technical positions being settled into agreed detailed drafting and these tasks are being managed and closed out methodically.

After a slower than ideal start, Infraco/Tramco Contract alignment has accelerated to detailed exchanges and prioritisation on all issues outstanding. Since reporting to you on 30th November, we have made good headway in understanding all of the BBS Consortium's potential concerns. Full re-engagement with CAF, the tram vehicle supplier and maintainer, in order to close out the exercise, is scheduled for this week and there has already been positive initial dialogue and acceptance on a number of important issues.

Updated Risk Allocation Matrices

We are instructed by **tie** that a full presentation has been made by **tie** to Council Finance officers based on **tie's** Master Project Risk Matrix and that no issues of concern arose. Detailed contractual risk allocation matrices for

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the Infraco and Tramco Contracts are up to date and accurately reflect the status of each draft agreement.

- **Performance Security Package**

There are two components to the performance securities being provided by the BBS Consortium: (i) bonds/financial guarantees to be issued by acceptable sureties (to cover the construction, commissioning, maintenance and asset hand back (at end of contract term) responsibilities and (ii) parent company guarantees to underwrite the two UK contracting subsidiaries.

The "On Demand" Bonds being 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 approach their proposed sureties for confirmation of pricing. No issues of significance are outstanding and these instruments will be in full agreed form satisfactory to **tie** well before programmed financial close.

Parent Company Guarantees: draft instruments are with both Consortium member German parent companies and 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. Council legal and finance officers are closely involved in this process and we would expect to be able to close this set of instruments to fully agreed form quickly, again presenting no risk to **tie's** contract close programme.

Confirmation of Novation Strategy

There remains the process through which CAF and Parsons Brinkerhoff are committed to novation of their agreements to the BBS Consortium. This is being managed closely by **tie**, in conjunction with an agreed approach with the BBS Consortium. Papers have now been exchanged on how the SDS novation process will reach close on a practical and commercial level. Full draft novation agreements have been reviewed by all parties involved (indeed have been in play since the issue of the tender documentation in October 2006), comments are now being received and evaluated so that when technical/commercial discussion finishes, the documentation can be rapidly tailored to reflect the arrangements reached. The production of these contracts is a function of the pace and complexity/clarity of discussion outcome, not contractual negotiation. We have no indication that any party involved (BBS, CAF or Parsons Brinkerhoff) has placed or is intending to place a block on the formal novation moving to close on agreed terms.

RISK

We remain of the view (as in both our earlier written reports to you) that the contractual allocation of risk and responsibility between **tie** Limited and the competitively selected private sector providers remains broadly aligned with the market norm for UK urban light rail projects, taking into account: the distinct characteristics of the Edinburgh Tram Network, its technical and commercial state of readiness at ITN issue in October 2006 coupled with the development of scheme

engineering and data design since that date. Refinement will be needed within the draft ETN contract suite between now and programmed close to take account of the actual final state of the Employer's Requirements, the matching Consortium's proposals and project specific and Background Information. This exercise is mapped and at present is not expected to either materially alter risk allocation or adjust the core contractual rights and responsibilities.

You have requested a further interim view on risk generally and on significant movement since Preferred Bidder appointment:

1. During the Preferred Bidder stage, there has been a predictable hardening of stance by the BBS Consortium on matters where their position had been expressly reserved or outlined only (either due to extreme time pressures of the programme on contract negotiation to Preferred Bidder appointment or due to paucity of technical information/incomplete due diligence). Two areas where, in our view, the desired CEC public-private risk allocation may not be achieved are Consents and Third Party Agreements. The primary reason for this is the BBS Consortium's view that **tie**/CEC are best placed to manage risk associated with certain consents and full compliance with permissions or constraints under third party undertakings. **tie**/CEC's role here is also a reason why an adjustment to responsibility retention by **tie**/CEC for some, but not all, of these matters (which are essentially a project management and stakeholder interface function) may not be unpalatable. Parsons Brinckerhoff's function and performance in relation to planning consents is also central here. The Consortium does accept risks associated with the performance of works to meet the requirements of third party agreements and undertakings (entered into by CEC and /or **tie** to preclude or remove objection at parliamentary stage) which we were instructed to include in the ITN draft Contract Suite. There were approximately 40 of these as at October 2006.

These represented in fact the main commercial third parties; we have recently been instructed by **tie** to release all parliamentary undertakings and third party commitments which **tie** had collated into two CDS. This documentation has now been given to the BBS Consortium for their due diligence and we understand several sessions have been held to explain the context, genesis and management of these commitments to date by **tie**.

2. Network Rail Asset Protection Agreement: there are a number of Network Rail agreements under negotiation involving land and property rights (for access and occupation of site) and operational railway interface and protection. **tie** is separately advised on the property aspects of ETN and we are aware that **tie** is now nearing conclusion on these licence and lease arrangements. Our instructions relate to the draft Asset Protection Agreement. The proposed risk allocation under this document is onerous, but it is a regulatory template and the ability to negotiate (indeed on any major project interfacing with Network Rail assets) on it is always relatively small. The extent of commitments offered by Network Rail is limited (e.g. the level of liquidated damages they are prepared to offer should their actions delay ETN works) but indemnity required from **tie**/CEC is out of proportion to the actual extent of works and operational interface between tram and railway. Though

our engagement has achieved improvements on the terms and conditions, **tie's** leverage to obtain more balanced commercial arrangements has been not been great. **tie** is seeking to re-involve Transport Scotland in order explore how the wider "future impacts" indemnity (as opposed to the indemnity in relation any physical loss/damage or costs caused directly by the ETN works themselves) Network Rail is requiring can be underwritten by Transport Scotland, given their special funding relationship with Network Rail and their overall responsibility for the Scottish Railway. This possibility of this support had been intimated to **tie** but, after preliminary discussions and a request for a decision, no commitment was forthcoming.

We are aware that **tie** has been making strenuous efforts to obtain commitment from Network Rail to conclude these agreements prior to programmed close and that the statutory process related to depot change and station change for Haymarket are about to be put in train. We are aware that you have received up to date reports from **tie** on these matters.

3. ETN Third Party Agreements: much work has been done and time invested in securing agreements with commercial organisations and private individuals in order for their legitimate commercial and private interests to be protected in suitable contractual fashion. Current negotiation centres around the extent to which the BBS Consortium is prepared to indemnify CEC and/or **tie** against claims from third parties (benefiting from **tie**/CEC undertakings) resulting from ETN construction and maintenance activities.

These agreements contain safeguards (to extent **tie's** team were able to negotiate these either at the parliamentary stage or later) but the project programme and budget will nevertheless remain to some degree vulnerable to any of these stakeholders seeking redress within the limits of their commitments/rights. In short: the actuality of even permissible and expected disruption and inconvenience may result in these stakeholders using their entitlements aggressively. **tie** is alive to this risk and proper execution of **tie's** planned management and mitigation strategy should reduce these risks significantly. In negotiations to close we will continue to explore rigorously with the BBS Consortium how they are prepared to absorb as much responsibility for third party risk as is technically achievable, fair and cost effective.

We will continue to provide every support necessary to **tie** Limited and CEC to achieve the successful outcome the project deserves.

Yours faithfully



DLA PIPER SCOTLAND LLP

c.c Matthew Crosse, Project Director for Edinburgh Trams, **tie** Limited