From: Stewart McGarrity
Sent: 17 February 2008 20:21
To: Graeme Bissett
Subject: RE: Additional capex and grant availability
Attachments: Grant Offer Draft Schedule -FINAL Clean Copy.DOC

Graeme,

I've given some responses to each of your very valid points below.

The Grant offer (schedule thereto attached) lacks detail on how each of these situations would be treated in which case the default should be what is fair and reasonable. TS might point to their own interpretation of reasonableness or previous custom and practice of which I have no experience.

Some broad assertions to discuss:

- The lack of clarity can work for us and against us. Keeping TS well informed through the right channels will keep the dogs off and demonstrate our competence.
- We need to recalibrate the project end date in the grant letter with TS sooner or later.
- If we build Ph1b then the sharing of costs between TS/CEC becomes less relevant.
- The public sector exposure to SDS lateness beyond close should be explained in terms of quantum and mitigation to TS as well as CEC.

Stewart

From: Graeme Bissett [mailto:graeme.bissett@[redacted]]
Sent: 13 February 2008 08:45
To: Stewart McGarrity
Subject: Additional capex and grant availability

Stewart, a dimension we haven't explored fully to my knowledge within the area of protections is the balance between TS and CEC funding. In simple terms, any cost which attaches to the construction of a system which enables revenue service to commence would be within the grant scope. Any cost which relates to operation would be for TEL's account. There are some grey areas – eg mobilisation, pre commencement training – which have been agreed as within grant scope. However :

- What is the last point in time for claiming a capital cost (assuming the nature of the cost was not contentious) under the grant ?

The grant is for the purpose of meeting "Eligible Capital Costs incurred until 31/3/11" but the terms also state the Council is not prevented from making applications for instalments after 31/3/11. I take that as meaning that if the project is completed and operations commenced by 31/3/11 then the Council can make further claims as the contractor's accounts for the construction phase are finalised - which might considerable time if we had significant claims to resolve. We'd make accruals of our best estimates at completion but it would be unreasonable to hold the Council to the accuracy of accounting estimates.

The date of 31/3/11 is inconsistent with our current programme which sees Phase1a operations commencing June 2011. If the grant were to be used for Phase 1b then 31/3/11 is too early – the terms don't deal with how the 31/3/11 date would be extended to cover Phase 1b construction. In the event we went ahead with Phase 1b next year and therefore (in all likelihood) had spent the £500m by 31/3/11 the end date would be less of an issue.

The end date of the grant is clearly something we need to bottom out with TS/Ministers. We'll start reporting a project end date for Phase 1a of post March 2011 soon enough and that will bring the issue (if there is one from their perspective) onto the table soon enough. This is worth pointing out to Donald McGougan in the meantime though.

- Are we comfortable that additional costs arising out of compensation events, scope changes and all other mechanisms of this type are within the scope of the grant and can be accrued and dealt with before any guillotine descends ?

The grant is for the purposes of "Eligible Capital Costs" which is defined as no more than in terms of a list of summary cost classifications in the annex to the conditions. This can work both for us and against us. Earlier in 2007 TS were seeking to manage this by sign-off of the contractual Employers Requirements. Now I guess they would revert to the "Project Scope" section of the Final Business Case which is general enough that a few more pavements, rebuilt roads and the like would be unlikely to considered scope changes not covered by the grant – especially if they are requirements of the relevant statutory authority.

Stakeholder initiated changes to requirements or to the programme beyond financial close would be more open to question by TS should they want to play tough and examine our records as they are entitled to do under the grant. In fact I think we should consider a detailed audit or two from TS or other Ministerial representatives as an inevitability.

I would be comfortable that other compensation events arising out of commercial hand to hand combat are covered by the grant – including BBS claims for SDS being late. I do however believe that the exposure of the Public Sector to the BBS/SDS situation is a change to the risk allocation in the FBC. The question is the extent to which we need to inform TS that the risk is properly contained and managed at this stage.

One cannot discount a situation where there is a sense that compensation events arose from tie's incompetence and TS feel they want to demonstrate that we and/or CEC have failed to comply with the grant conditions wit respect to proper control and reporting. The project risk register and QRA is important in this regard.

- Do we have a view on how long after revenue service commences there could still be scope for additional payments surfacing and becoming due to BBS / CAF and how does this fit with a grant guillotine date ?

See above – the grant offer as it stands specifically allows for additional payments after the "guillotine date". The trick is to get the end of construction / operational commencement date understood.

- How would our claims against BBS / CAF work against grant funding – would any such claim naturally go back to offset grant claimed or is there any manner in which LDs or other contractual compensation claims by tie / CEC could be to tie / CEC account fully ?

The reasonable approach is of course to match the amounts claimed against the party funding the underlying costs. If for example we are claiming LDs on Infraco – these are calculated to recover standing tie PM and Transdev/TEL costs in the event of late completion. If TS picked up 91% of the underlying cost – we credit them with 91% of the LDs. Would need to be assessed on a case by case basis.

- What happens if claims are made by us against BBS during operations because there is a latent defect or other basis for claim – does CEC / TEL bear the full cost and keep any compensation or is there any mechanism to share the pain with any unused grant ?

Latent defect reparation is more likely to be in the nature of BBS putting it right at their cost. Any cash claim against them beyond commencement of operations will be likely to be against costs or profits lost by CEC and TEL and not therefore shared with TS. Again would need to be assessed based on specific circumstances.

There are no doubt other angles on this, but you get my drift. I'm focussing on the SDS / BBS dimension particularly.

Regards
Graeme

Graeme Bissett

m : [redacted]