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Your reference

Our reference

SLF/JM/310299/15/
16755155.1

30 November 2007

Dear Ms Lindsay

**EDINBURGH TRAM NETWORK
DRAFT CONTRACT SUITE AS AT 3 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, with the objective of reaching a position on the post Preferred Bidder refined contract documentation suite to support clearance by the Legal Affairs Committee.

PROGRAMME

For that clearance, the following was foreseen by **tie**:

- **Core Infraco Contract terms settled and aligned with Tramco Contract**

We are able to report the draft contract suite has been advanced to a point where there are no significant legal issues outstanding on the core terms and conditions which could be an obstacle reaching a contract close and signature as programmed by **tie** in late January 2008. Work remains to translate commercial and technical positions being settled currently into agreed detailed drafting.

After a slower than ideal start, Infraco/Tramco Contract alignment has been undertaken but the level of focus behind initial legal due diligence has been influenced by the BBS management team's need to prioritise on other project issues. Consequently, though we have made good headway in understanding all of BBS potential concerns, full engagement to close out the exercise has yet to happen. Once BBS are able to support this with commercial and technical personnel, we expect the issues list to diminish quickly allowing a much more efficient route to closure.

- **Updated Risk Allocation Matrices**

Risk allocation matrices for the Infraco and Tramco Contracts are up to date and accurately reflect the status of each of the Infraco and Tramco Contracts.

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- **Performance Security Package**

The two "On Demand" Bonds offered have been negotiated to a level (on detailed acceptable terms and conditions), this has enabled the Consortium to approach their sureties for confirmation of pricing. No issues of significance are outstanding.

PCGs: draft instruments are with both consortium member parent companies and we have advanced negotiations, pending commercial agreement upon scope exact underwriting offered by the PCGs by tie. An issue has arisen surrounding Siemens ability to guarantee obligations of third parties (e.g. Bilfinger Berger) and how this is booked under US GAP rules. We would expect to be able to close these instruments to agreed form within the next ten days, on the assumption that we are instructed to progress negotiations this week.

- **Confirmation of Novation Strategy**

There remains the process through which CAF and Parsons Brinkerhoff are committed to novation. This is being managed closely by tie, in conjunction with an agreed approach with the Bilfinger Berger Siemens consortium. Papers are now exchanged on how the SDS novation process will operate and commercial/legal engagement with SDS will take place shortly. Full draft novation agreements have been reviewed by all parties involved, comments received and evaluated so that when technical 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.

RISK

As reported in our letter of 22nd October, we consider 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 and the development of scheme engineering and data design since that date. Refinement will be needed on the contract suite between now and programme close to take account of the actual state of the Employer's Requirements and Background Information finally made available. 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 an interim view on risk generally and on movement since Preferred Bidder appointment:

1. During the Preferred Bidder stage, there has been a predictable hardening of stance by the 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 risk allocation may not be achieved are Consents and Third Party Agreements. The primary reasons for this - namely the Consortium's view that **tie**/CEC are best placed to manage risk associated with certain consents and full compliance with third party undertakings - are also the primary reason why adjusted responsibility retention by **tie**/CEC for these matters (which are essentially a project management and stakeholder interface function) may not be unpalatable. The Consortium does accept risk for execution of third party agreements we were instructed to include in the ITN draft Contract Suite.

2. Network Rail Asset Protection Agreement: the risk allocation under this document is unlike any arms length commercial contract. The difficulty experienced in negotiating with NR is that the starting point is an already biased regulatory template to which (seemingly) only NR are allowed to make meaningful adjustment - to suit their objectives. The extent of indemnity required from CEC is out of proportion to the realities of works and operational interface between tram and railway. NR require CEC to indemnify them up to 10% of the value of the interface works against any adverse impact during the works and any future adverse impact which the installed tram works might have on NR or the operational railway. The former should be capable of back off to the Infraco; the latter is so wide it is not commercially transferable. The NR Corporate negotiation strategy is simple: proceed as slowly as possible until the counter-party's programme needs overwhelm desire for a balanced outcome. So it has been for **tie**. You will be aware from Colin that NR have insisted that CEC are a party to the APA.
3. Third Party Agreements: much work has been done and time invested in securing agreements with commercial organisations and private individuals. While this agreement contains safeguards (to extent **tie**'s team were able to negotiate these either at the parliamentary stage or later), the project programme and budget will nevertheless remain vulnerable to any of these parties either breaking their agreements or "gaming" within the limits of their commitments/rights to seek additional advantage or compensation. In short: protective arrangements are one thing, but the actuality of even permissible and expected disruption and inconvenience is another. **tie** is alive to this risk and proper execution of the planned management and mitigation strategy should reduce these risks significantly.

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