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Our Ref: WG/JPT

28<sup>th</sup> May 2007

Dear Malcolm

We had a **tie** Limited Board meeting this morning, which was primarily focussed on how **tie** can most efficiently manage its projects against the current backdrop of uncertainty. Bill was able to join us for the early part of the meeting and provided the Board with some very useful context.

As a responsible public-sector body, **tie** must ensure public funds are used effectively. We have an instruction from you not to enter into new financial commitments on the Tram or EARL projects, with which we are complying. For example, we have deferred the issue of statutory notices which are required for the initial round of utility diversion work and land assembly commitments are on hold. We had a programme underway to staff the tram and EARL projects for their next phases, and this too is on hold. Meetings are planned for this week with Transport Scotland officials to seek detailed agreement on the work that should continue, that which should be placed on hold and the consequences of these decisions.

**tie's** Board and management clearly understand the need for this action as the new Government considers its position. However, there are dangers for public funding which we must all weigh carefully.

1. We cannot easily curtail short-term expenditure on key activities and simultaneously avoid the risk of higher longer term expenditure, should the projects proceed. At present we have no instruction that the projects will not proceed and accordingly have a duty to progress activities that will protect the overall programme and cost budget. The adverse effect on programme and total project cost of these delays and short-term restrictions will become increasingly marked the longer is the period of uncertainty.
2. Our project teams number more than 100 people, all committed professionals who are highly valued in a competitive market. As a Board we have a responsibility to keep our employees informed about the future of the projects and the company. We are doing so by regular briefing, but there is every likelihood that we will lose key members of the team unless the uncertainty is resolved. The overhang of uncertainty is damaging to morale which will also lead to inefficiency as time progresses. I believe it will be very difficult to replace the people we may lose with individuals of similar calibre.

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3. In the event of termination, there will be complex contractual contingencies to be negotiated. If these are to be addressed, it is better that this is done sooner rather than later while the memory of events is fresh and we have the team who have managed the contracts available. If disputes arise which take time to resolve, our legal friends will inevitably have a more prominent (and expensive) role than if matters are addressed expeditiously.
4. Both projects involve multiple stakeholders. We are working with organisations such as Network Rail, BAA plc, the City of Edinburgh Council where the resources they deploy to the projects are substantial. We also have to manage relationships with a range of other third party organisations (large and small) with whom undertakings have been entered into and which are dependent upon the projects proceeding. We have a duty to ensure that all of these organisations are treated fairly and there is a parallel risk that their level of engagement will be affected by prolonged uncertainty. A further risk factor arises in the form of possible blight claims from allegedly affected parties. It is more likely that claims will emerge the longer the period of uncertainty persists.
5. Specifically with respect to the tram project, some 200 people are actively engaged on system design, and the willingness of our design consultants to maintain the volume and quality of resources demanded by the programme will come under increasing pressure.
6. The tram procurement process is now well-advanced for the construction and tram vehicle contracts and we have four internationally renowned groups bidding for the contracts. All have expressed concern about the uncertainty over the process. Substantial time and money has been expended by these groups to date and we are likely to see a fall-off in their level of commitment to see the process through if there is an expectation of termination. A key risk is that we may be left with single or indeed no bidders for each contract. Should the project proceed, we can also expect risk premia to be less finely priced.

The Board believes these are all serious risks, but that all are capable of management. With Transport Scotland's approval, we continue to progress the procurement programme which as you know operates to a regulated timetable which we may not easily vary. We also continue with the design process, which will form the basis of secure fixed price contracts with the successful bidding consortium. Project operations are currently stable, though this may not continue. We are scheduled to spend £5m, largely on these activities in June, and a further £10m in the period July – September. Although this sum has been restricted to roundly half of the previously programmed investment, the Board's concern is that the remaining level of expenditure of public money on the tram project cannot be properly justified if the project is to be terminated. Given this, and the risks to the programme and total cost, the Board are seeking clarity as quickly as possible and preferably by end-June as to Ministers' wishes in respect of this activity in order to be able to carry out the necessary actions.

The EARL project is at an earlier stage but is planned to incur £7m over the period to end-September, having also curtailed short-term activities. The Board has similar concerns about the propriety of this expenditure against the uncertain background.

We will seek all reasonable ways to maintain the balance between the need to limit short term spending and the need to protect overall programme and total cost, with the emphasis on reducing short term spend. The Board remains of the view that the tram project can be successfully executed and will be a valuable contributor to Scotland's transport strategy and its economy in the years ahead. We also clearly recognise that the decisions on the future of the EARL and Tram projects are those of Scottish Ministers and **tie** will do all it can to implement those decisions as efficiently as possible. Our Board respectfully requests that in assessing the timing of those decisions, the risks to proper use of public funds set out in this letter are taken fully into account.

There are two further matters I would like to draw to your attention:

It is necessary that the **tie** Board has formal support for its funding arrangements, otherwise directors could be construed as acting illegally, a matter **tie's** auditors have flagged to the Board as part of their statutory audit. We have committed funding of up to £60m for the tram programme in calendar 2007, subject to the instruction as to no new commitments. I believe this is a firm basis for **tie's** current activities, and I expect the meeting planned for this week on tram expenditure to produce a detailed short term budget. The position on EARL is different, in that the current funding award expires on 31<sup>st</sup> May. As you will appreciate, we cannot continue to spend any public money without written approval. Bill has agreed to address this before Thursday and we look forward to resolving the matter urgently. The expenditure will again be governed by the agreement flowing from the review meeting this week.

Finally, there needs to be clarity as to the responsibilities of the City of Edinburgh Council and Transport Scotland in the context of potential tram project cost increases (as a result of the factors set out above) and of the costs which would crystallise in the event of project termination. Andrew Holmes requested today that a meeting be convened urgently to address this matter. A dialogue has been underway for some time on the overall project funding arrangements for tram and I understand that a slot may be available on Friday of this week. If I or my colleagues can contribute to this dialogue, we are more than willing to do so.

I have copied this to David Mackay as Chairman of the Tram Project Board who attended today's Board meeting, our colleagues at the Council, to Bill and to the Minister in relation to my previous letter to him. I would be keen to meet at a time convenient to you in order to discuss how best to deal with these difficult matters.

Yours sincerely

Willie Gallagher  
Executive Chairman

Copy to :

Stewart Stevenson MSP  
Bill Reeve, Transport Scotland  
Tom Aitchison, Chief Executive, City of Edinburgh Council  
Andrew Holmes, Director of City Development, City of Edinburgh Council  
David Mackay, Chairman Tram Project Board