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- FOISA Exempt

Edinburgh Trams

EDINBURGH TRAM
Highlight Report to the Chief Executive's Internal Planning Group
21 January 2011

1 Background

This 'highlight report' is an update to the Chief Executive's Internal Planning Group (IPG) on the Edinburgh Tram Project to inform on the progress on this project and any decisions required.

The normal format for the reports has been suspended due to the ongoing contractual dispute, and this report provides an update on issues since the initial Chief Executive briefing that was issued at the start of January 2011.

2 Matters Arising

2.1 Matters to Note or for a Decision

The following issues are being brought forward to the IPG for discussion/decision:

- **Project Providence Update**
- **Governance,** with a decision to be taken about the following:
  - Is **tie ltd's** approach to the budget commitments appropriate, and the timing of the report to Council regarding funding over £546m
  - the Council representation on the interview panel for the new Chief Executive of **tie ltd**/TEL, and;
  - the method of progressing and procuring the independent review of the business case and when that should be reported to Council.
- **Mediation Update**
- **Update on Legal Issues**
- **Finance Update**
- **Communications Update**

3 Project Providence Update (Presented by Bob McCafferty)

The Council Tram coordination team has been based at the **tie ltd's** offices at Citypoint since early in the project. Their role is to provide a conduit between **tie ltd** and various Council functions which have an approval role or other interest in the project. In addition several Council employees have been seconded to **tie ltd** in recent months to work on specific key areas associated with the Tram Project – most notably in financial and communications.

A Council "*Project Providence*" team was initially established in October 2010 with a specific remit to prepare a report for submission to the Council in December 2010 mapping out the way forward for the tram project. This brought together Officers from a legal, finance and engineering background and was established on a temporary basis in addition to the coordination team.

At that time, the project had virtually come to a standstill with the infrastructure contractor withdrawing almost all resources from the various sites under construction. Several contractual disputes had been referred to the dispute resolution process with mixed success. **tie ltd** were informally indicating that the way forward lay in legal termination of the contract on the basis of failures by the contractor. The perceived follow-on was considered to be re-procurement following such formal termination.

In order to establish the status of various aspects of the project a series of meetings with **tie ltd** were established by the Project Providence team. The Project team in turn reported to the Councils IPG on a weekly basis.

Through the weekly **tie ltd** meetings the following workstreams were pursued:

- Assessment of status of the construction
- Assessment of required interim works in the event of termination
- Assessment of required remedial works in the event of termination
- Assessment of sub-contracts in place with the Infraco contractor
- Assessment of status of the design
- Analysis of costed options for various scenarios going forward
- Assessment of the status of CDM regulations in the event of termination
- Consideration of notified changes to the works with cost/time implications
- Consideration of legal advice on termination and other related issues
- Consideration of status and proposals for the delivery/storage of the trams
- Review of third party agreements which may have a legal/financial implication in the event of termination
- Review of materials currently stored on site
- Consideration of value engineering options going forward
- Review of status of Traffic Orders associated with the project
- Assessment of reasons for the failure to progress the works.

The work of the team is not yet concluded, but as the focus on mediation increases then the outcomes from these workstreams will help inform the mediation process.

A legal termination of the current contract now seems unlikely and instead a mediation process has begun involving the Council as well as **tie ltd**. In December 2010, **tie ltd** reported to the Tram Project Board on the way forward.

In the event of a negotiated termination, the information gathered above will inform the way forward and it is likely that the Project Providence Team will be required to prepare a report for a future meeting of the Council on that basis.

One of the key underlying issues of the dispute between **tie ltd** and BSC is project changes and the status of the design when they baselined their costs. As a result of the incomplete design, BSC have raised a significant number of additional changes – the majority of them not anticipated by **tie ltd**.

The table below summarises the amount of scale of the project changes being proposed by BSC. The Director of City Development has written to **tie ltd** on 20 December 2010 requesting greater visibility of the data around the proposed changes.

Change Summary

Description	Number	Cost
Total number of live changes	816	-
Total amount of estimates received	426	£93m
Total amount of incomplete estimates (BSC Action)	-48	-
Change orders issued against INTC's raised	-198	£24m
Live estimates	163	-
Estimates issued - disputed as a change by tie	52	£24.5m
Outstanding BSC action - estimates submitted	55	-
Outstanding tie action	55	-

4 Governance

Four key governance related matters need to be discussed. These are as follows:

The potential to report to Council to seek consent to incur costs over £546m (Presented by Dave Anderson/Alasdair Maclean)

The current estimated tram budget at the end of period 10 of 2010/11 is £541m, with the funding available totalling £545m. The remaining headroom of £3.8m will not allow all the sufficient project changes to be made without requiring a commitment to increase the budget above £545m. It is important to note that £541m includes all anticipated costs and that only £402.4m has actually been incurred to date.

At the Tram Project Board on 12 January 2011, the board discussed the funding commitments for the project and the Council/**tie ltd** Operating Agreement requirements (that were approved by Council). **tie ltd** have reviewed the budget and are investigating freezing the budget for four provision sums (which comprises resources not currently required e.g. tram drivers, or works that will not be required for some time, or not all depending on the extent of the construction works).

This would provide £5.5m of headroom left within the funding envelope of £545m which would likely last until March 2011 based upon the current spend rate for the additional changes.

Following **tie ltd's** internal review TEL have written to the Council requesting confirmation that we are satisfied with their approach. TEL's letter is attached as Appendix 1.

The Council's legal advisors have advised that this is unlikely to be acceptable. Their legal advice is attached as Appendix 2.

The IPG will need to determine if tie ltd approach is acceptable, and when a report to Council will be required.

The appointment of the Chief Executive of TEL/tie ltd

The recruitment process for the appointment of a new chair is progressing well.

The Council will need to determine what representation will be required on the interview panel.

Audit Scotland Report (Presented by Donald McGougan)

The draft Audit Scotland report has been provided to the Council and **tie ltd**. At the Tram Project Board meeting on 12 January 2011 the board agreed to respond to Audit Scotland with their comments and raise concerns about the timing of the publication of the report given the proximity to the mediation with BSC.

A response to Audit Scotland on behalf of the Council is also being complied.

Actions following the Council meeting in December (Presented by Donald McGougan)

On 16 December the Council agreed for an independent review by a specialist public transport consultancy of the tram business case, and for further details to be provided on the incremental delivery options.

Consideration should be given on how best to progress and procure this work and when it should be reported back to Council.

5 Mediation Update (Presented by Dave Anderson)

A core team has been established with **tie ltd**, with Dave Anderson leading on behalf of the Council.

The dates for the mediation have now been confirmed as 7, 8, 9 and 10 March 2011. There was a possibility for the mediation to take place at the start of February, but **tie ltd** were of the view that this did not allow adequate time for sufficient preparation.

Initial discussions have taken place with Transport Scotland about their involvement in the mediation and this will be developed further in the coming weeks once the detailed mediation workstreams are defined and fixed. Their initial preference was to take an observer role.

As the mediation workstreams are defined it may be necessary to dedicate some internal resources to assist in the preparation works.

The table below provides a high level summary of the 'pro's and cons' of the options for mediation and do not include affordability or costs.

Issue	**Pro's**	**Con's**
Revised Carlisle deal	• Potential for visible works to progress quickly and for a programme to completion to be produced.	• Lack of trust with BSC and potential for future disputes along similar lines. • Limited price and programme certainty based on previous experience with BSC.
Mature Divorce	• Provides opportunity for a 'clean slate' with a new contractor. • Opportunity to re-tender to gain better price and programme certainty (once design and consents are in place)	• Delays the construction works. • The resultant delays would likely lead to a lack of political support.
Grind on with contract adherence	• None, but this is what will happen if the other two options do not come to fruition.	• Lack of actual progress whilst incurring overhead costs and claims will result in the funding running out.

Post Mediation Timescales

Below is an Indicative timetable for the design, procurement and construction activities for the potential scenarios which may come out of mediation. These comprise a revised Carlisle type agreement or a mediated termination.

The programme below also makes the following assumptions:

- That the on street design is completed to allow procurement packages to be issued
- That off street packages can be packaged and procured on a staged basis to allow for an earlier commencement on off street sections
- No further on street works commence until January 2012

	2011												2012
	J	F	M	A	M	J	J	A	S	O	N	D	J
All options													
TRO 1 + Off Street													
3 Prior Approvals													
Complete design													
Procure legal advice for procurement													
Agree procurement route, packaging and contracts													
Carlisle type													
Mediation finalised and Carlisle type agreement reached													
BSC re-mobilise and commence all off street works													
Design for on street Haymarket – SAS													
Prepare packages for on-street procurement Haymarket - SAS													
Procurement for section Haymarket – SAS													
Commence of on street Haymarket – SAS													
Walk Away													
Mediation finalised and agreement reached													
Prepare procurement packages for off street													
Procurement of off street works													
Commence off street works													
Design for on street Haymarket – SAS													
Prepare packages for on-street procurement Haymarket - SAS													
Procurement for section Haymarket – SAS													
Commence of on street Haymarket – SAS													

6 Update on Legal Issues (Presented by Alastair Maclean/Nick Smith)

In the autumn of 2010 **tie ltd** indicated that their Project Carlisle discussions with the Infraco (seeking to agree a rebased contract with certainty around price, scope and programme) had been unsuccessful and put the Council on notice that they may seek to terminate the contract as a result of alleged breaches by the Infraco.

CEC's consent to certain material actions, including termination of the Infraco contract, is required in terms of an operating agreement between CEC and TEL (the parent company of **tie ltd**).

tie ltd, working with their solicitors DLA Piper (who also advised **tie ltd** on the contract negotiation and drafting) served various remediable termination notices ("RTNs"), alleging Infraco default, some of which Infraco have responded to and some of which they have not. Where a response has been submitted Infraco do not accept that they are in default.

tie ltd indicated that they would likely be seeking formal consent to terminate the Infraco contract at the Council meeting in December 2010, following expiry of the period specified in the RTNs for the Infraco to submit proposals to remedy the alleged breaches.

Recognising the potential for conflict and the need for independence in being one step removed from the dispute, CEC Legal engaged Shepherd & Wedderburn and instructed Nicholas Dennys QC, a pre-eminent UK senior counsel, to provide CEC with an independent legal opinion in relation to the potential approval of any request by **tie ltd** for consent to termination.

As CEC has not been involved in the detailed operation of the Infraco contract, CEC has had to rely on the quality of the factual information and analysis provided by **tie ltd** and its advisers.

It became apparent that **tie ltd** and their advisers had not carried out a comprehensive assessment of the full factual matrix and supporting evidence and the grounds for termination prior to issue of the RTNs.

tie ltd had continued to use DLA as its advisers in relation to the potential termination, but engaged McGrigors following service of the RTNs. McGrigors were instructed to work with DLA and **tie ltd** to identify, collate and analyse the relevant factual information in relation to the proposed grounds of termination. Richard Keen QC is also advising **tie ltd** (and we assume TEL).

The outcome of CEC's independent legal analysis was that termination on the basis of the RTNs issued by **tie ltd** was not advisable, on the grounds that:

- the RTNs were too vague and inspecific to enable termination (even if supported by the facts); and
- the full factual matrix supporting the allegations of default had not yet been properly investigated.

This advice was also supported by the subsequent opinion of McGrigors and **tie ltd's** QC, Richard Keen Q.C. following their own review.

CEC's Q.C. did express the view that, given progress to date by the consortium on the delivery of the works, it would appear probable that if properly investigated and formulated, valid grounds of breach could be articulated effectively in due course. That needs to be investigated further by **tie ltd** with their advisors.

tie ltd have advised that McGrigors are continuing their investigation of the factual matrix with a view to establishing whether any valid grounds of termination exist. It is not anticipated that this work will be complete until late February 2011.

The way forward

Both Nicholas Dennys Q.C and Richard Keen Q.C have advised that the best option is to seek to enforce the contract until grounds of termination can be established as a result of a failure to perform the works. This would also place **tie ltd** in the strongest position with regard to any mediation/negotiated settlement. Further detail of this advice is set out in Appendix 3.

It is presently unclear to what extent there has been a rigorous approach by **tie ltd** to enforcement of the contract pending the outcome of Carlisle negotiations and the focus on the termination option. **tie ltd** have been asked to explain the reasons underlying the failure to progress the works and what has been done to address these issues by way of enforcement of the existing contract. CEC Legal have identified a potential contractual lever which may not have been fully utilised to date, and **tie ltd** and its advisers are presently preparing to put this into effect.

There is a danger that mediation could lead the parties into a further entrenched position if it is carried out prematurely without the parties having their strategies agreed and having collated all relevant information.

tie ltd presently appear to be in a weak position legally and tactically, as a result of the successive losses in adjudications and service of remediable termination notices which do not set out valid and specific grounds of termination.

It was also clear from the documentation produced at the meeting by Bilfinger Berger that the Infraco was extremely well prepared. That may well place them at a tactical advantage.

However, there was a desire commercially and politically to move towards mediation notwithstanding **tie ltd's** (apparently) relatively weak tactical and legal position.

That is likely to have a financial implication with the Infraco as the party in the stronger position faring rather better out of it than might otherwise have been the case. Against that there are financial and other costs involved in allowing matters to continue.

Mediation

Mediation will explore a potential deal to resurrect Project Carlisle type solution (now to be called 'Project Phoenix') as well as an option for a mature divorce settlement (now to be called 'Project Separation') that would involve the Infraco walking away with a payment of all sums due to them for work to date. This is likely also to include a settlement premium. The current status of the mediation arrangements is set out at Section 5 of this report. Dave Anderson, Director of City Development and project sponsor will represent CEC in the mediation discussions.

CEC Legal have stood down the external legal advisors at present but remain on standby to assist the CEC representative in the mediation and advise on other issues as required.

7 Finance Update (Presented by Donald McGougan/Alan Coyle)

Work to refine the cost estimates on the range of possible outcomes for the project has continued in the period. The 'Settle out of Court' scenario continues to be the working assumption for the most likely outcome at this point.

Low, Medium and High scenario's have been produced, and the most recent numbers are reconciled to the latest certificate from BSC to establish the cost of work done and the value of work done assessments. The 'Settle Out of Court' numbers are set out in detail below with high level notes providing explanation of the assumptions.

Based on the most recent certificate, the **tie ltd** commercial view continues to show that BSC have been paid £33m more than the actual value of work carried out, but this is because of the 20% upfront payment to BSC which totals £45.2m to allow for the procurement materials and long lead items.

The cost estimates have recently been updated to take account of a review of the evaluation of interim works. This was done with assistance from City Development staff which has resulted in a favourable change of £10m in the previous **tie ltd** assessment. This is largely due to a more conservative view of the interim works that would be completed in the period between BSC's exit from the project and the new contractor starting work.

New procurement costs have also reduced from the previous assessment. This is largely due to external advice from Cyril Sweet on market rates that should be applied for Prelims. The advice taken shows that greater value in the market could be achieved compared to the rates in the Infraco contract.

There has been a significant amount of work undertaken in the last few months to ensure robust numbers are available for each of the strategic options for the project and to aid decision making. The current numbers are a result of detailed analysis of the project cost base. To ensure the validity of the new procurement numbers, Cyril Sweet will be conducting there own evaluation of the new procurement costs for external validation, and this will be reported once complete.

The current numbers show that delivery of the project to St Andrew Square can still be achieved for £600m (£633.8m - £33.3m) if BSC are not paid the delta between the cost and value of work done, though this will be subject to the negotiations.

Settle Out of Court Scenario

	COWD	Terminate & Reprocure		
	to P9 Nov-10 Cert	Settle out of court	Settle out of court	Settle out of court
	A	Low	QS View H	High
Infrastructure ready to operate:				
Airport to Haymarket	n/a	Dec-12	Dec-12	Dec-12
Haymarket to St A Sq	n/a	Dec 13	Dec-13	Dec-13
St A Sq to FOW	n/a	Dec-15	Dec-15	Dec-15
FOW to Newhaven	n/a	Dec-17	Dec-17	Dec-17
BB+S				
Constn Works Price (BB+S)	66.8	66.8	66.8	66.8
Existing Change - Princes St	9.5	9.5	9.5	9.5
Existing Change - Other	12.7	12.7	12.7	12.7
Entitlement for work done (BB+S)	**89.0**	**89.0**	**89.0**	**89.0**
Certified in advance of work done (BB+S)	33.3	33.3	33.3	33.3
Certified to Date (BB+S)	**122.3**	**122.3**	**122.3**	**122.3**
	(8.7)			
Infrastructure (BB+S) Certified	**113.6**	**122.3**	**122.3**	**122.3**
Vehicles (CAF)	46.7	61.5	62.5	63.5
Design Post Novation (SDS)	8.0	8.0	8.0	8.0
SDS design risk		2.0	2.0	6.0
Total BSC	**168.3**	**193.8**	**194.8**	**199.8**
Interim Works & Reinstatement				
Interim Works during Reprocure		10.0	10.0	10.0
Reinstate/remedials during Reprocure		3.0	3.0	3.0
Reinstatement following cancellation				
Total		**13.0**	**13.0**	**13.0**
New Procurement Costs				
Infrastructure - to HYM		140.8	144.8	169.2
Infrastructure - to SAS		17.4	19.2	20.2
Infrastructure - to FOW		30.7	35.1	36.6
Infrastructure - to NHN		40.3	45.9	56.0
Further Risk allowance on new procurement		0.0	0.0	0.0
Value Engineering Opportunities		(4.3)	(4.3)	(4.3)
3rd Party funded (base allowed)				
Total New Procurement	**0.0**	**224.9**	**240.7**	**277.7**
Total Infrastructure & vehicles	**168.3**	**431.7**	**448.5**	**490.5**
Termination Costs				
Securing sites		2.0	2.0	2.0
Third party costs (Project Termination Scenario)				
Total Termination Costs		**2.0**	**2.0**	**2.0**
Other Costs				
Ph1b Payment to BSC	3.2	3.2	3.2	3.2
Design Pre Nov incl Ph1b and Utilities	28.7	28.7	28.7	28.7
Utilties and Other Infrastructure	92.9	98.2	98.2	98.2
Project Costs - to date	72.1	72.1	72.1	72.1
Project Costs - to go		22.5	22.5	22.5
Other Costs - Incl Land	33.4	37.1	37.1	37.1
Other Costs	**230.3**	**261.8**	**261.8**	**261.8**
Gross Outturn Costs	**398.6**	**695.6**	**712.3**	**754.3**
Highly Sensitive Variable Elements				
Bond call (BB+S)		(10.0)	(10.0)	(10.0)
BSC - Settlement Premium		**10.0**	**10.0**	**10.0**
Vehicles - Lease / Sale recoveries		**(10.5)**	**(10.5)**	**0.0**
Re-Design (risk of SDS not completing)		**5.0**	**10.0**	**15.0**
tie litigation & professional costs		**2.0**	**3.0**	**4.0**
BSC Loss of profits in case of **tie** default				
BSC Litigation Costs				
Recovery in case of Infraco Default				
Sub-total HS Variable Elements		**(3.5)**	**2.5**	**19.0**
Total Phase 1a	**398.6**	**692.1**	**714.8**	**773.3**

Incremental Options

Summary of Positions	Low	QS view	High
Sub-total - Newhaven	692.1	714.8	773.3
Sub-total - Foot of the Walk	651.8	668.9	717.3
Sub-total - St Andrews Square	621.0	633.8	680.7
Sub-total - Haymarket	603.6	614.6	660.5

8 Communications (Presented by Lynn McMath)

Media

Coverage over the last month has included the following:

- Mediation – from Council decision to go-ahead to speculation on the timing. Various outlets including the Herald, Scotsman, Radio Forth, Evening News and assorted trade journals.
- December Council report – BBC coverage on how the business case still stacks up with phased implementation. The Scotsman and Evening News covered the future for integration with Lothian Buses and the role of TEL.
- Tram in Broxburn – pictures appeared online of the 1st tram vehicle in storage at Broxburn industrial estate. Picked up by Evening News.
- Progress on Gogar depot - test track opening in summer 2011. Site tour with Eve News transport reporter.
- Shirley Anne Somerville press release on failings of the project. Nothing new but clever timing during Christmas break so a lot of pick up including Daily Mail, Express, Scotsman etc.
- Remedial work on Princes Street and costs to the contractor – interview with Cllr Mackenzie for Deadline press Association. Picked up by Daily Record.
- Consultants fees and senior salaries – stemmed from an FOI request. Some of the supporting information as deliberately ignored and so a letter to the editor was submitted and subsequently published.

Branding

Throughout the month of January, festive messaging will be removed from various sites along the tram route including Princes Street banners and West End pavement roundels.

Preparations are being made to host a mobile tram exhibition at several shopping centres, libraries, council buildings and museums from late February. This will follow on from the very successful exhibition recently held on the tram vehicle. The exhibition will incorporate images and information about original trams, modern tram construction, stories from people who worked on the old tram cars and from who have helped to build the new route.

Work continues with our partners to develop City wide messaging which will include a variety of Edinburgh campaigns throughout the year.

Stakeholder Communications

Preparation for the next phase of the school programme has begun. A strategy is in the process of being approved for moving forward with a revised and rebranded Tramformer programme for Primary Schools which will be supported by a new Kid Zone section on the Edinburgh Trams website. Materials for the scheme are currently in production and will be launched within the coming months.

Our internal newsletter "Tramlines" has been successfully refreshed and the next edition is currently being compiled for e-distribution at the end of January. The newsletter provides us a with a unique channel through which to communicate various aspects of the project to employees who would not normally come into contact with different elements such as construction work, finance team, operations etc.

Communication continues on a regular basis with businesses and residents to keep them informed of the progress being made in the ongoing contractual dispute and about when works could possibly commence again in their area. The following stakeholder group meetings were attended by a member of the Communications and Customer Service team over the last month:

- Leith Business Association
- Ocean Terminal
- Scottish Executive offices
- West End Traders
- Community Council Groups (various)
- Haymarket Traders

Website / Internet Communications

The Edinburgh Trams website sustained interest throughout the Christmas period albeit at reduced numbers. The number of people accessing the Media Updates section on edinburghtrams.com has increased significantly over the last couple of reporting periods, largely as a result of our proactive information on important news topics through this channel.

The Edinburghtrams.com site has been 're-skinned' to reflect changes to the logo and vehicle livery and is a more comprehensive refresh is under way for completion by the end of the first quarter of 2011. This will include a careers page, kid zone, FOISA section and a more user-friendly Community section. The homepage will also be altered for a more interactive user experience.

Freedom of Information Requests

There are currently 10 live FOI requests being dealt with. There are also a total of 3 appeals currently under review. The Council currently has no live FOI requests.

Over the last 6 months, there have been over 40 FOI requests made by the public of which six reviews were requested from the responses provided. Of the six requests three rulings have found in favour of **tie ltd**, while the remaining three are awaiting a decision by the Information Commissioner. The significance of these decisions is that they can be applied to any following requests on the same subject matter. In particular, a ruling regarding project board minutes means that while there is public interest in the information, it is possible to have an open and honest discussion of the project at this level which is free from public scrutiny. Most common topics for FOI are HR issues, Board Minutes, information surrounding contractor cost and requests regarding the contract.

List of Appendices

Appendix 1	Letter from TEL dated 17 January 2011 regarding Budget Commitments
Appendix 2	Legal Advice on Operating Agreement
Appendix 3	Legal Advice on Termination

Appendix 1

Transport Edinburgh
Edinburgh Trams
Lothian Buses

Mr Marshall Poulton
Tram Monitoring Officer
The City of Edinburgh Council
The City Chambers
High Street
Edinburgh
EH1 1YJ

Our Ref: INF CORR 7150/BC

17th January 2011

Dear Marshall,

Edinburgh Tram Project
Budget Commitments

I refer to the letter from David Mackay to the TMO on June 8th 2010.

On behalf of TEL and authorities delegated by TEL to the TPB, I am writing to inform you that under the CEC/**tie** Operating agreement and the subsequent TEL/CEC Operating agreement it is my obligation to inform you that we are now nearing a point where the Council may breach the terms of its funding agreement (clause 2.5 CEC/tie operating agreement). It is my obligation under clause 2.22 & 2.24 of the TEL/CEC operating agreement to inform you of all "matters affecting the programme, cost and scope of the project".

At the last TPB on 12th January 2011 it was reported that spend on the Edinburgh Tram Project is now £402m. The value of budget contingency remaining available to drawdown as at the end of Period 10–2010/11 was £3.1m. In order to remain within the Current Agreed Funding cap of £545m and to continue to drawdown against current commitments and spend on current areas of work we are proposing to release Baseline budgets (£12.6m) which are at this point in time 'uncommitted'. In other words, these are defined as future anticipated costs which will be required to deliver phase 1a but in relation to which no contracts have yet been entered into. These costs are likely to be incurred to deliver the full phase 1a project at a future point in time. Budgets proposed for release are detailed below:

Budget Commitments - end Period 10 2010/11

Action	Funding Available - end Period 10	P10 £k	P11 £k
	Funding Available	545,000	
	Current agreed budget end P9 (inc. MUDFA drawdown)	(541,107)	
	budget c/f from Period 10		**3,074**
release budget	DPOF budget uncommitted at end P13		4,809
release budget	Revised alignment to Picardy Pl, York Pl and London Rd junctions (Psum)		3,340
release budget	Major utility diversions Picardy Pl, York Pl and London Rd junctions (Psum)		2,515
release budget	UTC associated with the wider area impacts		1,973
	Sub-Total Budget Available		**15,712**

Following the approval to release these budgets items it is proposed that the TPB and TEL authorise the drawdown of budget changes against the increased 'uncommitted' contingency of £15.7m as detailed above.

Please can you confirm that you are satisfied that this is consistent with the obligations of the parties under the TEL/CEC and CEC/tie operating agreements.

Yours sincerely,

[redacted]

Brian Cox
Interim Chairman - TEL

cc: Internal Planning Group, CEC

Appendix 2

Text from email sent on 1 January 2011 from Nick Smith to Dave Anderson and Donald McGougan:

We have been asked:

1. whether or not TEL is obliged to report to CEC that there will an increase in costs beyond 545m; and
2. if TEL/tie are obliged not to incur that expenditure until approved by CEC.

At this stage I have restricted this email to the Director of City Development (as project sponsor) and the Director of Finance, copied in to the Head of Legal and Administrative Services with whom I have discussed matter in detail.

The answers to these as are in the revised TEL Operating Agreement (Dec 09)("OA"):

A. The OA provides includes the following:

Clause 2.22:

"The following matters will be for the TEL Board to determine and report to the Council as appropriate in terms of the governance arrangements set out in Schedule 2:

All matters affecting the programme, cost and scope of the Project ***except the following which are matters*** reserved to the Council:

(i) any actual or reasonably expected delay beyond 3 months after the Baseline Date; or (ii) any ***actual or reasonably expected*** increase in capital cost which would mean that the [***estimated capital cost of the Project which may not exceed £545m***] is exceeded by greater than £1,000,000; or (iii) any substantial change to the design, scope or service pattern set out in the Final Business Case."

Clause 2.24

"Immediately that TEL becomes aware of the likelihood of delay to, or overspend in, the Project it will ensure that notification is given to the Tram Monitoring Officer at the earliest opportunity, informing them of the reasons for the potential delay or overspend and detailing any measures (together with costs) which may mitigate such potential delay or overspend."

B. In summary TEL must report:

1. under clause 2.24 to the TMO that the spend is likely to exceed £546m - I understand that was done on 8 June 2010; and
2. under clause 2.22 to CEC in terms of exceeding the £545 (likely to effectively be covered by the intimation under 2.24 above).

The intention of 2.24 appears to be that the TEL board are not entitled to incur expenditure in excess of £546m without the prior approval of the Council. That clearly does not sit well with the fact that TEL may well already be contractually liable to the consortium under the original agreement for an unquantifiable amount.

The reason it was drafted this way was that people were operating on the basis that it was a fixed price contract and that it would not be possible to incur or commit to expenditure in excess of 545m. It is now clear that is not the case.

It certainly places TEL in an awkward position in that it may well have two competing obligations:

(a) one to pay up to the consortium (and all other creditors) if it/tie are legally obliged to do so;and
(b) one to CEC to seek prior approval before exceeding the approved threshold.

It also raises the question about how TEL should behave if the Council refuses to increase the expenditure limit when it may or may not already be legally obliged to the consortium for sums in taking the Project cost in excess of 545m.

Whilst this is a matter for the TEL board to address it seems clear that the only practical way of dealing with this situation is:

1. for TEL to report the expenditure breach to CEC (if that has not already been done - see above) together with any possible mitigating measures;
2. CEC to decide whether or not the Council/Committee needs to be made aware of this - it does as the OA requires it and in any event there would be no delegated authority to decide a politically contentious matter which this would be. Ideally this would be going to the next available CEC meeting;
3. Council to determine if the Chief Executive is authorised to allow the expenditure to increase above 546m - under clause 2.22 of the OA (not quoted above).
4. if Council approval is not forthcoming, TEL would (or could, depending on how you interpret the drafting) be placed in a breach event to CEC which legally and commercially is academic given that it is wholly owned by CEC. Politically of course that would be another matter altogether and would place the board of TEL in (as indicated above) an awkward (or more likely an untenable) position.

Three matters I have not addressed above are:

(a) TEL/tie's funding arrangements and the position of their boards to assess whether or not they are either cash flow or balance sheet insolvent and again this is clearly a matter for TEL/tie and their advisers to consider. The implication for CEC is that it could trigger a call under the guarantee by the consortium;
(b) that reporting would be politically sensitive; and
(c) that reporting at this time will be commercially sensitive given the stage of the dispute ie about to head into mediation.

The use of a B agenda may deal with some of the potential issues. However, this clearly needs further discussion at a senior commercial level but the above simply sets out the (unfortunately inconvenient) position under the existing documentation.

Ability to terminate the Infraco contract

1. tie's ability to terminate is dependent on being able to prove an Infraco Default (a breach of contract by the Infraco that has a material and adverse effect on the carrying on of the works). Unless and until they can do so, the contract remains extant. To be clear, there is no provision in the contract for tie to simply walk away from the contract, trigger a tie default and accept the financial consequences. In the event of tie default, Infraco would have the option to continue with the contract.

Effect of successful termination for Infraco Default

2. In any event, the Infraco will have to be paid for all work done to date in accordance with the terms of the contract.

3. Any sum recoverable from the Infraco on an Infraco Default is subject to a liability cap equal to 20 % of the construction works price under the Infraco contract.

4. If tie does not complete the works to Newhaven, they will have no claim against the Infraco. The contract does not allow a claim of damages against the Infraco even although the partially completed works for which they have been paid are arguably worthless in their present form. They would in effect walk away despite being in default.

5. If tie complete the works from the Airport to Newhaven, they would be able to recover the additional cost of completing the works with a different contractor, but this would be subject to the liability cap. It is important to note that tie would not be entitled to recover any costs from the Infraco if the scheme is truncated.

6. There is no time limit in the contract for tie to finish the works to Newhaven and claim the additional costs, but other considerations such as expiry of permissions, land agreements, Tram Acts etc would need to be borne in mind, as well as the financial ability and political will to complete the tram works to Newhaven.

Effect of incorrect termination

7. Richard Keen Q.C, has advised that the effect of the contract wording is to effectively 'lock in' the parties. If the contract is terminated for an alleged Infraco Default that tie cannot subsequently prove in court, the contract would remain in place.

8. On a purported termination by tie, there is a risk that the Infraco would be successful in obtaining an interim interdict preventing tie from securing access to carry on the works. The project would then be in a potentially lengthy period of limbo pending resolution of the litigation.

9. This has obvious implications as to whether or not CEC/tie can carry on with the project with another contractor, should they wish to do so. It also informs tie's possible strategy and role going forward.

10. If tie cannot prove Infraco Default they will be liable in damages to the Infraco for the additional cost of completing the works as a result of the delay caused by the wrongful termination notice. As any litigation could last 2 years or more, the costs are likely to be significant. CEC, as financial guarantor, would be liable for those costs which are unquantifiable at this stage.

Recommended strategy

11. Richard Keen Q.C has advised that in light of the above, there is a real danger that in terminating the contract tie would be playing into the hands of the Infraco. A better strategy may be to hold the Infraco to the contract.

12. The Infraco could be called upon to remedy the Princes Street works. There is a Bilfinger Berger parent company guarantee/bond in relation to this and although capped at around £20 million, it could cause them some pain if called.

13. The current problems with the contract in relation to pricing and tie changes would remain, but forcing the Infraco to get on with the works could exert some pressure on them to agree a commercial settlement. The tensions that exist between the three Infraco members, who are jointly and severally liable, could assist in achieving this.

14. CEC's Q.C. is also of the view that the strategy should be to force the contractor to perform the contract and incur expense. Assessing the design and programme of works and enforcing performance of the contract as a whole is the preferred option.

15. If that does not yield a result by unlocking the present contractual deadlock and providing tie with a stronger position from which to agree a commercial settlement, the contract would need to be terminated. It is hoped that pursuit of the strategy of enforced performance should assist in that event, by providing fresh and more compelling grounds for termination linked to the Infraco's failure to progress the works.