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Sent: 13 July 2006 15:40
To: Fitzgerald, Sharon
Subject: 06-06-20 Procurement Strategy

As discussed this morning - it's still half written, but you can see where I'm up to.

David

Procurement Strategy

A) SDS CONTRACT

Current Strategy

PB have been engaged to undertake the SDS contract on a Fixed Price basis, which includes preliminary & detailed design (not working drawings). Performance and functional specifications are being developed to deliver run-time requirements and whole life/maintenance requirements. PB's remit also includes obtaining all necessary 3rd Party Consents & Approvals

In the current strategy, this arrangement will novate to Infraco

- Effectively only works if Tramco are also novated or overall design liabilities transfer
- ? Mudfa design liabilities which doesn't novate.

Questions

Q Can we sensibly draw a line on some detailed design and allow Infraco's to undertake work?

A Yes, however the Infracos have differing views on where this line should be drawn. Their views have been sought and a consolidated position will be developed. It is likely that each of the Infracos will wish to undertake the following elements of design:

- Overhead Line
- Supervisory & telecommunications systems
- Substations
- Detail design of trackwork
- Depot equipment

Some of the Infraco bidders have indicated strongly that they would not wish for the PB design to extend much further than performance definition in these areas.

Q What would be the impact on design liabilities of reducing PB's cope of works?

A Potentially PB's liability would become significantly reduced, although from tie's

Q What Impact on run time Req/Risk Transfer (if this is real)

? Impact on Whole life/Maintenance requirements

? Likely savings to be accrued

? Impact on obtaining consents

? Is planned novation weakened if Tramco not novated

? What is risk premium for novation to Infraco in SDS contract & from Infraco

B) TRAMCO CONTRACT

Current Strategy

The Tramco contract will be on a fixed price basis for the design, manufacturing, testing and commissioning of the tram. A maintenance contract is also contemplated of up to 30 years in duration.

The current procurement strategy is for the Tram supply and maintenance contracts to be novated to Infraco, thereby passing the integration risk between Tram/Systems/Infrastructures to Infraco.

Questions

Q: Can we identify premium in Tramco for novation to Infraco?

A: Dialogue with Tramco bidders suggests that risk premium associated with novation will be low unless they perceive that they will be vulnerable to abuse by one of their rivals. This risk is more to do with perception and should be manageable.

Q: Can we identify the premium in Infraco for novation of Tramco?

A: The risk is more tangible and larger. There will be a genuine exposure for Infraco in that the liability caps/L.D.s for the Infraco will not be capable of being fully backed off onto Tramco.

The other risk driver would be where there is an “alien” vehicle novated to the Bombardier or Siemens Infracos. Competitive and Partner pressure should substantially mitigate this. Only Bombardier have highlighted this issue. Siemens have previously integrated 3rd party vehicles within a complete system and have declared that they would be happy to do so again. This issue does not apply to Amec Spie.

A risk value of £50-60m has previously been speculated, but had no substantiation and is believed to be excessive.

Although this risk is difficult to quantify, the author would suggest that this would be valued by the Infracos at up to £10m.

Q: If we don't novate Tramco what is the impact on SDS design contract?

A: Little, if anything. SDS's role in relation to the tram is limited essentially to performance definition and interface management.

Q: If we don't novate Tramco who undertakes integration with Infraco and at what cost:

The system integration role sits within Infraco as an integral feature of the current procurement strategy. If the Tramco novation was not to be implemented, this risk would pass back to tie. tie could manage this risk by the following routes:

- a) tie undertakes the role. The resources to undertake this would have to be recruited. Typically a team of 5-6 relatively skilled engineering/project management personnel would be required. Typically the direct cost of this would be £1m – 1.5m. tie's risk exposure would be significantly increased in this scenario. The key risks to be managed are:
 - a. Technical interfaces
 - b. Programme – tie would ultimately become directly responsible for the system opening date
 - c. Organisational interfaces during testing and commissioning
 - d. Commercial disputes/claims between the contractors
- b) A 3rd party could undertake the management of this risk under contract to tie. The value of this contract would be substantially higher (say 50-100%) than managing the risk with in-

house resources. There would be an opportunity to transfer some of the risk to the 3rd party, however this would be limited given the relatively modest size of the 3rd party's contract.

- c) Have the O&M contractor undertake the system integration. This currently sits outside the DPOFA, but Transdev could call on their overseas resources, which would possibly result in a direct cost similar to or above that of utilising a 3rd party. If this were to be pursued, the Transdev resource would have to be fully considered. The characteristics of this approach are:
- a. There would be no question of Transdev's motivation to manage the integration.
 - b. We would in all probability be dealing with overseas personnel with whom there may be language difficulties
 - c. There may be more ability to offset the risk, although inevitably there would be a value above which this would revert to tie.
 - d. Work on the ground during testing and commissioning may be smoother

In each of these approaches, tie would substantially retain the risk as well as incurring the cost of the resources to manage the risk.

Q What is the best approach to maintenance pricing

- Full life duration with breaks at 2, 15 and 30 years.
- ? If at nil years does this effect Ansaldo "Foul" call
- Does full life option include ½ life & replacement?
- Will maintenance bid identify Rec. reliability and Performance & component life as part of the regime.

C) INFRACO CONTRACT

Current Strategy

The Infraco contract is currently envisaged on a fixed price basis incorporating the provision of all of the project facilities on a turnkey basis, together with their maintenance for a period of six years. Options for 15 and 30 year maintenance terms are to be sought through the tendering process.

The Tramco, SDS and elements of the DPOF contracts are to be novated to Infraco to allow the turnkey delivery to be delivered.

Questions

Q Can the turnkey and maintenance elements of the Infraco contract be separated?

A Not as currently drafted. If more flexibility in the route by which maintenance is to be sourced is required, the maintenance works need to be provided under a separate contract.

Q Are the Infracos well positioned to undertake the system integration role between the trams and the infrastructure?

A Yes. Each of the potential Infracos has a credible systems integration pedigree and has this skill as a core competence.

D) PROVISION OF MAINTENANCE

Current Strategy

It is currently envisaged that Tramco and Infraco will provide the maintenance of the trams and the infrastructure respectively, with the tram maintenance activity undertaken as a subcontract to Infraco, mirroring the arrangement during the design & construction phase.

Within Tramco, warranty and spares are part of the supply contract, while the maintenance is provided through a separate maintenance agreement. A maintenance term of 6, 15 or 30 years has been considered.

Infraco has an integrated supply and maintenance contract, with the duration of the maintenance period aligned with the options within the Tramco maintenance contract.

A payment mechanism has been developed which ties the three contractors (Infraco, Tramco & Operator) into a common basis for payment. This is different to the mechanism originally considered in the DPOF contract and will require re-negotiation.

Questions

Q Are Tramco and Infraco Requirements aligned?

A Yes. The common payment mechanism for punctuality will tie the two together. The mechanisms for warranty, provision of spares and the duration of the maintenance obligations have been established for Tramco – Infraco will be aligned.

Q Is it envisaged that Tramco maintenance novates to Infraco maintenance – if not who manages?

A Novation is the currently considered approach, mirroring the arrangements during the supply phase. If this approach is not followed,

Q Could these contracts fully/partially novate to tie or operator at any time from Day 1?

A In theory, yes. We will need to explore this issue further within the constraints of what we have stated in the OJEU notices.

Q Do the contracts recognise sequential handover?

A No. To date this has not been considered, however the handover from the supply side of the contract to the maintenance part has been developed for Tramco – a similar arrangement will be established for Infraco.

Q What is the impact of going to market for O&M services prior to start of operations –

a) On DPOFA?

A This would necessitate termination of the current contract.

b) Infraco and Infraco maintenance?

A The Infraco bidders would become aware that the maintenance element of their work is out to tender and may not

c) Tramco and Tramco maintenance?

A The same argument as applies for the Infraco would apply to the prequalified tram suppliers, all of whom have a positive appetite for the maintenance work. The issue is complicated by the fact that one unsuccessful applicant (Ansaldo) was not taken forward, primarily as a result of a lack of track record in tram maintenance. A legal challenge could be anticipated.

SDS overall design liabilities around reliability and whole life regulations?

E) RECOMMENDED STRATEGY

The existing strategy has been communicated to the market via market consultation, the OJEU process, presentations and ongoing dialogue with the potential contractors. This communication has shaped the decisions of a number of organisations as to whether or not to participate in the project. Against this background, substantial change to the original procurement strategy will have to be very carefully considered to avoid the risk of legal challenge.

Nonetheless, there are a number of elements of flexibility which can be

1. Integrated operations and maintenance may provide considerable benefit.

F) NEXT STEPS

Procurement Strategy IV

Legal

What are issues with these approaches and how can we overcome them?

- Reduce design element in SDS
- Establish O&M capability for Day 1
- Changes to novation – establish price and have alternate plan to manage downstream effects
- Simplify evaluation and two stage clarification/negotiation process
- Mechanism to avoid differing tram and systems providers to avoid commercial disincentives and competitive advantages.