

City of Edinburgh Council Independent Review

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1. Introduction / Executive Summary

This report seeks to validate the processes and procedures carried out in the McGrigors reports (Report on Certain Issues Concerning Edinburgh Tram Project – Options to York Place Revisions – 16th June 2011; 15th June 2011; & 17th June 2011) and to give a sense check on the figures taken forward to the Budget Analysis spreadsheet produced by the City of Edinburgh Council (CEC).

This has been a very high level review of those processes and procedures with information taken at face value. Faithful+Gould has not had access to the contract documents nor had the time to scrutinise at a molecular level the build up of costs/prices supplied.

The report is split into four areas;

- General – an overview of the report
- Specific Items for review – Chapters 3 to 7 as detailed
- Other Issues – covers items that were discussed at the various meeting attended
- Going Forward – we have included this to take into account items that we see as critical to the successful conclusion to this project.

We would conclude that the approach taken by McGrigors and CEC demonstrates an appropriate method of identifying the likely heads of liability and there is no indication of any internal conflicts within the drafting. We also consider the methods used to establish the quantum of those liabilities suitable and appropriate.

2. General

This section reviews the review of the separation issues completed on behalf of CEC by McGrigors LLP ('McGrigor'). The McGrigor review has considered the sequence of events and impacts in the event of 'separation' of the Infraco contract under the terms of the MOV in the event that the Settlement Agreement ('SA') is not signed. The McGrigor review then goes on to consider the scenarios of 'No settlement agreement but continuing with the Infraco contract', and 'No settlement agreement – termination' where termination is instigated by tie.

We have not received or reviewed the contract documentation.

Contract

We would expect any review of potential liabilities under a contract to be based on, and commence with, a review of the relevant contractual provisions. The McGrigor report incorporates a comprehensive review of the contract, establishing the basis of 'separation' in the event that the SA is not signed by the relevant timescales. The review further considers the provisions relating to Infraco's entitlement to recover monies under the contract and to establish the scope for the CEC liabilities.

The report considers the various heads of claim/recovery open to Infraco in the event of separation. Whilst we cannot comment on the accuracy or validity of the conclusions reached, we consider that the arguments are logically presented and do not indicate any internal conflicts within the drafting.

Heads of Claim/Recovery

The report considers the potential Infraco recovery under the following broad headings:

- Payments due under the contractual milestone mechanism
- Payments for preliminaries
- Payments for variations (Changes)
- Payments for extensions of time

We consider the approach adopted in this regard to be acceptable, although we cannot comment on the validity of the conclusions reached.

Further sections of the report review potential costs arising in connection with the separation comprising:

- Costs of completing a proportion of the outstanding construction works
- Costs of completing the outstanding design
- Costs of purchasing trams and tram equipment
- Costs of temporarily mothballing or permanently abandoning the project

Again, these headings appear to address all likely further tie liabilities.

Calculation of Potential Liabilities (From report 13-06-11)

The report discusses the likely level of recovery by Infraco in respect of the identified heads noted above. The source of and means of calculation of the sums identified under these heads are not entirely clear [reviewed elsewhere in this document]. We note however, that McGrigor has applied a varying level of 'discount' to sums claimed by Infraco to arrive at a 'prudent' assessment of the potential tie liabilities. The rationale for the level of discount identified is not clear; we also note that the sums detailed do not always reflect the level of discount proposed.

[Subsequently to this initial review this discount has been removed and the sums clarified.]

The report does not conclude or gather together the overall impact of the various sums assessed and discussed and the full extent of potential liability is not clearly identified. We would therefore suggest that a liability matrix be incorporated indicating:

- Current agreed values
- Disputed, outstanding or potential values

The following values against each disputed, outstanding or potential head should then be identified:

- Tie assessment – best case value
- InfraCo assessment – worst case value
- The value of payments already made

This will allow the potential net maximum and minimum liabilities to be clearly shown. At present, given the current development of discussions and presentation by Infraco of claims for reimbursement, it does not seem possible to identify a likely level of tie liability. An indication of the possible range of outcomes will however be useful

[McGrigors report did not initially have these comparison spreadsheets attached. Subsequently these have been provided and validated.]

Conclusion

We consider that the approach to the demonstration of the contractual liability is appropriate and that the likely heads of liability have been identified.

The spreadsheets now give a certain amount of clarity in the liabilities considered in the report. But for a full understanding of the liabilities one has to factor in those items that are being considered by Hg Consulting. Although we have discussed the individual figures with Colin Smith (Hg Consulting) we have not been able to review his report. These headings have been included in the CEC Budget Analysis spreadsheets.

3. Section 9 - Extension of Time

The McGrigor report 'redacted draft' 17/6/11' page 28 Item 9.2 1st para states "To date, Infraco has sought the following extensions of time through the formal mechanism under the Infraco contract."

From the information available to Faithful+Gould to formulate a comment on the rational approach, EOT1 (INTC 1) was quantified, following adjudication, on the basis of tie letter of 5 November 2009 ref INF CORR 2773. This letter does not make reference to any contractual formal mechanism and therefore cannot be considered as a contractual document. However as the same approach was adopted for subsequent adjudication on MUDFA rev 8 / INTC 429, the question would be, is the method adopted for INTC 1 and INTC 429 applicable to INTC 536 and a claim in respect of the Depot and associated works?

The first two EOT claims are based on adjudication decisions so there can be no doubting there merit. Their quantum can be clearly identified and although Infraco attempted to seek a further extension to INTC 429, this was rejected by the Adjudicator. We can therefore assume that the value of these adjudications is as reported with little risk of further exposure.

The EOT claim INTC 536 and Depot works is less clear, as little information has been provided and it is stated that it has been incorrectly pleaded. The report accepts that Infraco are likely to be due a significant claim and therefore we would agree with the prudent approach of including Infraco figures of £43.670M and £20.080M.

It should be noted that if the contract progresses to completion with Infraco any further extension of time claims not already notified to date will be included within the completion contract cost to complete, and no further claims can be pursued.

If the contract Separation is instigated there could be further claims for Extension of time, this has been allowed for under the Primary Risk Items.

Financial analysis of Section 9 is now contained in Section 11 of the McGrigor report.

On balance the assessments used under this heading seem to be a sensible approach for evaluation of EOT claims.

4. Section 10 – Preliminaries

The question posed by the McGrigor report is what method of calculation should be used to calculate a claim for additional preliminaries associated with the granting of an extension of time claim. Two options were explored:

- Time based
- Additional Cost based

Having reviewed the information contained within the report and the commentary of the adjudication in November 2010 by Lord Dervaird, we are of the opinion that the most likely method of calculation is that of the Time Based method. It would seem to follow, most closely, the principle set out by the adjudication.

We would also agree with the general principle that the Contractor should not be 'entitled to make a second, double, recovery.' for loss & expense over the same period. But he would be entitled to loss & expense claim for work that he had already procured and had to terminate due to the delay.

Delay caused by inclement weather was an area where recovery of time can be gained against a delay that does not attract preliminaries. This was felt to have minimal impact when considered in parallel with that of the delay caused by the MUDFA delays

5. Section 12 - Mobilisation Payment

On the matter of recovery of an amount against this payment we first have to consider what would be standard practice within the industry. JCT Standard Building Contract 2005 (SBC05) and ECC NEC 3rd Edition make special reference to an Advanced Payment (Clause 4.8 and Option X14 respectively), whilst Government Accounting only allows for advance payments in exceptional circumstances. Such as in the 1991 New Roads and Street Works Act (NRSWA). This puts strict provisions for any advanced payment for Highway Works to Statutory Undertakers.

Advanced Payments are given with the expectation of deriving some benefit to the Employer. Whether that is a direct reduction in the contract sum, in the case of the NRSWA, or to procure specialist plant or materials with a high initial spend profiles. It is also industry practice to establish a mechanism for recovery of this payment through milestone repayments or percentage reductions to valuations. JCT SBC05 requires under clause 4.10.2 this repayment to be itemised in the valuation certificate. These repayment mechanisms are agreed and inserted in to the contract conditions. To reduce the Employer's risk of losing the advanced payment a Bond would normally be obtained as surety.

Although there is mention in the McGrigors report of an understanding between the parties that the payment amounting to £45.2M being an advanced payments, there does not seem to be any other evidence that would support this understanding i.e. repayment mechanism, bond. Schedule Part 5 (Milestone Payment Schedule) is also quite clear in dealing with this payment as milestone payments.

In conclusion, we would agree with McGrigors final paragraph at present the prudent approach would be to assume that there will be no recovery of the sums paid.

6. Section 15 - Cost of Employing Another Contractor

The process of assessing the potential cost of employing another contractor to complete the works to St Andrews Square appears to be based on the sums of completing the existing work as per the schedule of work or Bill of Quantities. The figure allowed of £189.4M only accounts for the direct cost of employing a new contractor. Other risk items have been included in Section 4 of the CEC Budget Appraisal spreadsheet. These include bad project risk, system integration risk and exclusion risks and are commented on below.

Other items that should be considered are:

- Materials off site - £16M of materials off site has been paid to the Contractor already. No reduction to completion cost is apparent. Although it is unlikely that the full sum would be realised.
- Design warranties – allowance for installed works to be adopted
- Princes Street – are the remedial works included in the works to complete element and if so, has there been a subsequent counter claim allowed for this work.
- Design Completion – allowance of £2m is include for the completion of design. This does not seem to included for the intellectual design of the system by Siemens. [£10M is included in the 'Systems Risk' element that would cover this item].
- Sub-contractor title claims – there is £20M included in the 'BSC Settlement Premium Risk' to deal with Sub-contractor claims
- Responsibility and costs for making good defects – there is an allowance of £22.3M that includes this item
- Responsibility for latent defects – a new contractor will be unwilling to pick up this risk and unless a clear delineation between different pieces of work can be established it will become very difficult to prove who is responsible. This risk will only become apparent if the defect is picked up during the life time of the construction project. Otherwise it is more than likely that the CEC will be come responsible and costs will have to be borne by the CEC's maintenance budget.

We are satisfied that between the McGrigor report and the Budget Analysis spreadsheet the relevant heads of liabilities have been covered.

7. Section 17 - Costs of putting the Project on Hold

As stated in the Appendix 'Legal analysis in relation to putting the project on hold' the costs in relation to putting the project on hold are dependent upon what is carried out and the extent of the 'hold' period.

The following are possible ways to maximisation the existing assets:

- With regards the depot buildings, these could be completed and marketed for sale / lease, dependant on the hold period. Employment of another contractor to carry out these works may result in additional cost of providing warranty on works carried out by previous contractor. Once complete, however the buildings would realise a return on the expenditure to date.
- The section of track constructed on previous green field land, again dependant on the hold time and dependant on the terms of any compulsory land purchase agreement could be utilised as, for example a walkway / cycle track. This would require the removal of any track currently in place. The value of the track materials removed will be negligible.

With regards the section between Haymarket and St Andrews Square, the costs will vary dependent upon what is carried out. Should the hold period be extensive, and as the tracks currently laid require remedial treatment to bring them up to the tendered specification, the costs to put on hold should be offset by a claim against Infraco based on the cost to carry out remedial work to bring up to specification. The basis of this claim against Infraco should start at the full reinstatement cost, for the Princes Street section, as the works were defective in this area.

Allowance within the McGrigor report and the Budget Analysis spreadsheet include for demobilisation, reinstatement costs, removal of certain infrastructure, maintenance costs and design completion. Other considerations that have been included for are compliance with "the Tram Act". No allowance for maximising the existing asset has been allowed for.

We consider that the appropriate headings of liabilities have been included for in the report.

8. Other Issues

Various meetings were held at the City of Edinburgh Council's (CEC) offices at Waverly Court to review and discuss the detail in McGrigor's report, supporting information to that report and CEC's Budget Appraisal spreadsheet.

Some of the issues that were raised and dealt with at those meetings were as follows:

- **Third party Agreements –**
 - An allowance of £3M had been included for unknown 3rd Party Agreements in the "Exclusions Risk" item of the CEC spreadsheet.
 - A further £9M needed to be added to this figure for identified 3rd Party Agreement Claims, as identified at the meeting of 20th June 2011.
- **Pricing Exclusions –** these are items that have been identified as exclusions by the Contractor should they complete the project. They will therefore be risk item for any contractor completing the works. These items included costs for disruption caused by for other events, ordinance, post adoption maintenance of roads and bridges, and storage of materials. These were also identified in the "Exclusions Risk" allowance.
- **Claims that have not been as yet identified –** there is a definite period when the claims 'begin to dry up'. Thus meaning that if the project was to terminate either amicably or not further claims would be forthcoming. Additional risk allowances had been made under the 'Primary Risk' and 'Further Risk/Contingency' items.
- **Integration of Design –** this relates to section 6 above and is a significant factor. This is the ability of Siemens or CAF holding CEC 'to ransom' should another contractor complete the works. The CEC would be forced into buying the rights to use the system as in stalled by Siemens / CAF. An allowance of £10M has been included.
- **Putting Project on Hold –** this included items such as demobilisation, removal of certain infrastructure, remedial works, reinstatements costs and design completion costs. An allowance of £22.3M has been included.
- **Bad Press / 'Tram Factor' –** this item is included for any re-procurement scenario. It is likely a future contractor would add a percentage increase to their tenders for the uncertainty in working on a project that has now a bad reputation.
- **BSC Settlement Premium + Risk –** The £80M allowed is broken down into three parts; payment to Sub Contractors £20M; payment to BBS £50M; and a sum of £10M split between the two for them to walk away from the project. These sums are very global but are depended on the parties' attitudes to settlement.
- **Utility Works –** this was considered a major concern that further (unknown) utility works will be required in the Shandwick Place. Allowances to carry out the works have been included in the 'Further Risk / Contingencies' item. To mitigate this risk from any completion contract we believe that any works to this area should be dealt with by sectional completion and no date given for site possession but only on successful completion of the utilities works.

9. Settlement Figure Analysis

Having reviewed the Settlement Figure Analysis brief, we would agree with the 'tactics' portrayed by Hg Consulting in bullet points 1 to 8. As stated above (8 Other Issues, bullet point 'BSC Settlement Premium + Risk') the figures quoted are very global and the deciding factor will be on how aggressive and intransigent the Infraco attitude is to settlement.

On termination of a contract it is normal practice to only to deal with the Main Contractor and responsibility for the settlement of sub-contracts is the responsibility of the Main Contractor. Any sub-contract claims are fed through the Main Contractor. We therefore assume that the allowance of £20M for Sub-contractors is either an allowance to deal with those secondary claims or a legal obligation as part of the Infraco / tie contract.

10. Going Forward

Should the project be completed either by the incumbent contractor or a new contractor we would consider some of the following to be critical for a successful delivery of the project going forward:

- Novation agreement with Design Team and Main Contractor to be adjusted - all design risk with the Main Contractor.
- No payment for materials off site.
- On site materials only paid where the Main Contractor can prove he has title to the materials.
- Activity Payment Schedule to be amended - to make it more flexible.
- Any existing underground services work to be carried out either prior to the Main Contractor gaining possession or transfer the risk for this work to the Main Contractor.
- Possible Sectional handover of site to the Main Contractor - Haymarket to Airport - then Haymarket to York Place - helps to give more time to organise the on-street works and any design issues and agreement on remedial works to Princess Street.
- Withholding notices / mechanism to be issued on defective work - so payment is not made to Main Contractor.
- No advance payments.
- Strict Change Order procedure - agreement before work is carried out.
- A mechanism for informal dispute resolution, with clear stages/levels of hierarchy

The above items are only some of the points that should be part of the negotiation with the Main Contractor prior to contract agreement. We have not had sight of the original contract but believe these are areas of contention.

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