

City of Edinburgh Council (the "Council") - Edinburgh Tram Inquiry (the "Inquiry")

S21 notice issued by the Inquiry on 28 August 2017, varied on 11 September 2017 (the "Notice")

1. This statement is concerned with the record of the basis of calculation or derivation of the settlement figures specified in paragraphs (a) and (b) in Annex to the Notice and, as such, has necessarily been prepared on the basis of historical contemporaneous records.

Period leading up to mediation

2. The evolution of the capital cost of the project from the period leading up to mediation and which formed the background to the position that was achieved at Mar Hall in March 2011 is described at section 7.0 of the "*Review of Progress and Management of the Project January 2011 to June 2012*" (the "Review Report")¹. The Review Report was co-authored by Colin Smith and Alan Coyle, both of whom were involved in the matters narrated at section 7.0. The documents referred to in the Review Report are described as having been extracted from the live project file.
3. Paragraph 7.2 of the Review Report explains the process of the analysis of cost prior to mediation, and the various inputs in relation to that analysis, which included the identification of the likely cost of the project within a range of possible outcomes, depending on whether the Infraco contract was progressed or terminated:

"In the period prior to mediation a significant amount of effort went into identifying the likely cost of the project within a range of possible outcomes should the contract with the Infraco consortium be progressed or terminated.

During the period in the lead up to mediation, the Council's then Director of Finance requested that a member of his own team form part of the finance team at tie Ltd (tie), with a view to the Council having a greater degree of transparency in relation to project costs.

As a result of this, a group was formed that included tie's senior team and commercial team to assess the range of possible outcomes. CEC finance were a strong part of this group to ensure that the process was driven hard and that a full financial picture could be understood by the Council in advance of mediation. In addition to this, tie had already had a number of views on the likely commercial/contractual impacts from a number of sources, including legal and quantity surveyors as a result of previous

¹ WED00000134 (longer version of report) and TRS00023933 (shorter version of report)

commercial settlements they had attempted with the Infraco consortium as part of the commercial strategy they were following at that time.

The results of the various financial outcomes were then plotted on a spreadsheet with a working title of "Deckchair".

Prior to mediation, tie had also employed consultants, Gordon Harris Partnership and Tony Rush to pursue settlement of the commercial issues with BBS..."

4. Paragraphs 7.2 to 7.7 of the Review Report set out the position in relation to costs from the period prior to the mediation, to the end of the mediation itself.
5. Paragraph 7.3 of the Review Report summarises tie's position in relation to its forecast costs of completing the line to Haymarket with Infraco, and completing the line between Haymarket and St Andrew Square with another contractor. tie's position was a range of figures between £646m and £698. The basis for these figures is set out in the Deckchair analysis version 1 at Appendix 2 of the Review Report and at TIE00355078.
6. Paragraph 7.4 of the Review Report identifies a number of what are described as "fatal flaws" in tie's assumptions in its forecast range between £646m and £698m.
 - 6.1 tie's forecast included for the cost of settlement with Infraco at £33m, being the balance of entitlement for work done against work certified to date. It did not take into account any contractual entitlement that Infraco had for delay, including MUDFA related delay, or disputed design changes for work that had already been undertaken.
 - 6.2 tie's forecast for the costs of a new contractor assumed that a new contractor would be able to take up where Infraco left off without any risk allowance or "bad project" premium being allowed for in the new contractor's price.
 - 6.3 tie's forecast did not contain any indexation for materials that would be required where the price would have changed by reference to the original contract sum.
 - 6.4 tie's forecast price of £19m for the on-street section from Haymarket to St Andrew Square did not allow for any significant risks for the on-street section
 - 6.5 tie's forecast did not allow for any extension to the programme as a result of having to re-procure.
7. tie's position proceeded on the assumption that Infraco would be prepared to agree to their contract being terminated, such that they would walk away from the project having completed the line only to Haymarket. Paragraph 7.6 of the Review Report

states that terminating the Infraco contract and reprocurring with another contractor "went against all the advice that was given by independent advisors at this time".

8. Legal advice had been given by Richard Keen QC to tie that "*Tie can only be sure of termination of the Infraco Contract if they can prove an Infraco Default which results in a valid notice of termination... a purported termination by tie on grounds which are ultimately not upheld would amount to a repudiatory breach for which Infraco would be entitled to recover damages at common law. There would however be no termination of the Infraco Contract by virtue of such a repudiatory breach, even if Infraco wished to bring about such a result*"². Legal advice had also been given that there would be material risks in relying on the Remediable Termination Notices that had been issued by tie³.
9. The Review Report also states at paragraph 7.6 that during the initial stages of mediation it soon became clear, through discussion between tie and the Council "*that tie had not considered a number of cost headings at this time which would have had a significant impact on the final cost. In very broad terms, these items were in the order of £150m for settlement, professional costs, bad project premium risk, systems re-procurement risk and inflation, which would have potentially resulted in a final outturn cost of at least £800m*". In other words, it appeared that if some of the "*fatal flaws*" in tie's forecast were costed and added into the potential outturn cost for replacing Infraco with a new contractor, this would result in a forecast of at least £800m to St Andrew Square. This figure is also reflected in the PowerPoint presentation at CEC01927442 which contains a table headed "*Decision Tree Factors*"; in respect of "*agreed separation*", the range of figures is stated as "*Range from £624.1m - £740m - £800m*".
10. Paragraph 7.5 of the Review Report states that Infraco's Project Phoenix proposal "*would have resulted in an anticipated final cost of £747m*". The basis of this figure is in Deckchair Analysis version 1 at appendix 2, which shows that the Infraco element of this overall total was £449.9m. However, the Review Report notes at paragraph 7.5 that "*On closer examination of the Infraco Phoenix proposal it became clear that there was c£80m of exclusions in this proposal which may have resulted in a similar addition to the final cost of the project, had CEC signed up to the Phoenix proposal as it was*". Adding £80m to Infraco's Project Phoenix figure results in an anticipated final cost of £827m.

² Opinion of Richard Keen QC dated 22 November 2010 at Appendix 1 of the report at TIE00080959, paragraphs 10 and 14

³ Opinion of Richard Keen QC dated 1 December 2010 at Appendix 2 of the report at TIE00080959, paragraph 10; paragraph 1.5 of the McGrigors LLP "*Report for TIE Limited on certain issues concerning Edinburgh tram project*" dated 14 December 2010 at TIE00080959

11. In the spreadsheet entitled "*Optioneering Report*" dated 7 March 2011⁴ and therefore immediately prior to mediation, the first tab contains a summary showing the following total figures to Haymarket:

BSC offer	£449.2m	Excludes £236.5 of non BSC costs to date; excludes " <i>settlement</i> "
tie view – low	£639.8m	Excludes " <i>further EoT</i> "
tie view – high	£704.8	Excludes " <i>further EoT</i> "
BSC offer	£760.3m	

12. In the same document, under the tab "*Optioneering*", figures are provided for different outcomes for a line from the airport to St Andrew Square as follows:

Project Phoenix: £702m - £817m

Project Phoenix (BSC only): £463m

Separation (*i.e.* re-procure with a new contractor): £720m - £806m (although some elements of this were noted as "*Agree to Agree, the numbers are highly variable*")

Attrition (*i.e.* continue with Infracore): £867m (although it was noted that this contained an element "*that is very hard to quantify was a result of on going dispute, legal and delay costs*").

Mediation

13. The Chief Executive was authorised by Council at the Council meeting on 16 December 2010⁵ to take forward a mediation proposal, and the preparations for mediation included the analysis of costs set out above, captured in the deckchair analysis and the optioneering report, and summarised in the Review Report.
14. The position achieved at Mar Hall was as set out in the Agreed Key Points of Principle on 10 March 2011, which were effectively superseded by the Heads of Terms signed on or around 12 March 2011 (both at CEC02084685). These documents contained a lump sum price for the off street works of £362.5m which was eventually taken forward into the Settlement Agreement, and a target sum of £39m in respect of the on-street works. Eventually, this figure became £47.38m in the Settlement Agreement⁶.

⁴ Produced and marked CEC 1

⁵ Minute of Council meeting of 16 December 2010 at CEC02083128

⁶ CEC02085585

15. The negotiation process at Mar Hall is described at paragraph 7.7 of the Review Report⁷ as follows:

"During the course of negotiations over two to three days at mediation, there were a number of offers and counter offers exchanges between the parties.

CEC's first offer to BSC was for £304m for the off-street section. At this point there were still a significant number of exclusions that sat outside the off-street price which were estimated at £80m. This price did not include for the remainder of the on-street works, which were thought to have been in the region of £20m. When the shape of this deal was added to the rest of the project costs, the estimated anticipated final cost was thought to be in the order of £731m.

Infraco did not accept this offer and returned with essentially an updated Phoenix proposal of £404m, which was only for the off street section. When risk, exclusions and the remaining project costs were added to this number the final cost would have been £814m.

CEC then replied with a final offer of £362.5m for the off-street section, with no exclusions and Infraco taking all the risk with the exception of minor utilities. By adding the rest of the project costs, £30m for risk and £22.5m for the on street section (which was an estimated figure and hadn't yet been negotiated) the anticipated final cost was £743.5m. The breakdown of these numbers can be found in Appendix 4 (High Level Budget Proposal Total Project v1.1)." In the event, the target sum agreed at mediation for the on-street works was £39m.

16. Appendix 4 of the Review Report referred to above⁸ sets out how the various final cost figures were made up, as follows:

	CEC (9/3/11)	BSC Counter (9/3/11)	CEC Counter 1 (9/3/11)	Note
	£m	£m	£m	
BSC	384.0	404.0	362.5	
TR Exclusions	80.0			
Airport to Haymarket (Infraco) (Current Contract Arrangements)	304.0	404.0	362.5	
Haymarket to St Andrew Square (Target Cost/Pain Gain Share)	20.5		22.5	1
Infrastructure	324.5	404.0	385.0	
CAF	61.0	65.0	62.0	

⁷ WED00000134 (longer version of report) and TRS00023933 (shorter version of report)

⁸ WED00000134 (longer version of report) and TRS00023933 (shorter version of report)

Primary Risk	29.0	29.0		
Contingencies	25.0	25.0	30.0	2
Delay	25.0	25.0		
Total Budget "Final Account"	464.5	548.0	477.0	
Non BSC Costs to date	236.5	236.5	236.5	
Project Management Costs to go	30.0	30.0	30.0	3
	266.5	266.5	266.5	
Total Project Costs	731.0	814.5	743.5	
Less Agreed Funding			545.0	
GAP			198.5	

17. The notes to the table set out above state:

"1. Haymarket to St Andrew Square a variable item to be closed out in negotiations. The £22.5m is based on our original bottom up assessment. This includes 15% risk allowance and a sum for Siemens materials now covered elsewhere.

2. Client contingency/risk pot to be refined. Based on Infraco terms and conditions for Phoenix containing no exclusions of clarifications.

3. Project Mgt costs to go assume no future recoveries by CEC Legal, Finance and Lothian Buses.

This sum to be reviewed and to be subject of a line by line analysis once project delivery arrangements are confirmed. This figure includes preparation for operations.

4. Minimise Capital Gap for presentational purposes but maximise for TS recovery."

18. A version of the spreadsheet referred to in the foregoing paragraph can also be found in the Excel document entitled "Copy of High Level Budget Proposal Total Project"⁹. The tab entitled "CAF Re & Price Evolution" contains a very similar breakdown to that referred to above, save that in the column entitled "CEC Counter 1 (9/3/11)", the total figure is £751.5m rather than £743.5m because of the inclusion of £65m for CAF, rather than £62m, and £35m for Project Costs to go, rather than £30m. The spreadsheet also contains the note "Assumption that £362.5m is based on price certainty, allow 30 for risk (variable)". The figure of £731m referred to in this tab is also broken down in the tab entitled "High Level Price". The "CAF Re & Price Evolution" tab also contains a reference to certain opportunities, including "Current Non BSC Capex Savings", which are broken down in the tab entitled "Potential Capex Savings".

⁹ Produced and marked CEC 2

19. The Excel spreadsheet entitled "Cost Summary for Edinburgh Trams as at 2012/13 Period 6 Ending 15 September 2012" was produced some time after mediation. It contains a number of notes¹⁰. Note 1 states:

"As members are aware from the confidential appendix to the 25 August 2011 Council report the negotiations with the BBS consortium led to a figure of approximately £360m for (a) off street work; (b) settlement of claims in relation to off street; (c) settlement of claims in relation to on street; and (d) settlement of claims in relation to system wide work

In order to ascertain an allocation of that figure for the purposes of this summary we have calculated that;

(a) £204m relates to off street work;

(b) £25m relates to settlement of claims in relation to off street;

(c) £82m relates to settlement of claims in relation to on street; and

(d) £49m relates to settlement in relation to system wide work."

20. There is also a further version of this spreadsheet which breaks down the foregoing figures in a different way¹¹.

21. The position achieved at mediation, and referred to above, is reflected in the Heads of Terms and Agreed Key Points of Principle documents (CEC02084685), both of which are expressly stated to be non-binding and subject to contract. This was because, although the Council had authorised the Chief Executive to take forward mediation, the position agreed in principle at Mar Hall required to be considered and voted on by elected members.

22. For the same reason, the Minute of Variation to the Infraco Contract entered into on 20 May 2011 and known as MoV4 provided that if parties had not entered into a further variation of the Infraco Contract "*in respect of the off street and on street works as per the Heads of Terms on or before 1 July 2011*" (also known as Minute of Variation 5, or MoV5) "*on or before 1 July 2011...on an unconditional basis or on a conditional basis in either case because tie and/or CEC do not have sufficient funding to meet tie's obligations under the Infraco Contract...the Infraco Contract shall*

¹⁰ BFB00101644

¹¹ CEC01952969

automatically terminate at 5pm on 1 September 2011..."¹². In the event, this time limit was extended¹³.

Reporting and recommendations to members after mediation – June 2011

23. A special meeting of the Council was called by the Lord Provost on 16 May 2011 to consider an update on the Edinburgh Tram Project.
24. The Director of City Development produced a report for the meeting on 16 May 2011 in respect of the mediation¹⁴. The purpose of the report was to update the Council on the key outcomes arising from the mediation, asking Council to note those outcomes "*pending the detailed design and costing work that will be needed to provide a more complete picture of the full costs and revised programme for the Edinburgh Tram Project*" (paragraph 1.1).
25. The minute of the special meeting of the Council on 16 May 2011¹⁵ noted the outcomes of the mediation process and instructed the Chief Executive to take various steps including in respect of a further report to be presented to the Council for the meeting to be held on 30 June 2011. That further report was to include detailed figures and analysis of the cost of cancelling the project, so that members could weigh up adequately the financial options of cancellation as against proceeding to St Andrew Square.
26. Following the decision of the Council on 16 May 2011, the Director of City Development produced a report for the Council meeting on 30 June 2011¹⁶. In the summary at section 2 of the report, it was stated that the strategic rationale and business case for the tram project had been subject to further external review and validation, with the costs of terminating the project, or continuing under the terms of the existing contract, having also been examined in detail. Neither option was considered to be likely to be materially less expensive than completing the first phase of Line 1a. It was therefore recommended that the Council should pursue the completion of the first phase of Line 1a to St. Andrew Square/York Place, subject to identification and confirmation of funding. It was further noted that in light of the continuing negotiations, and the commercial sensitivity of the financial information, not all figures could be made public at that stage. Arrangements had therefore been made to brief all members and share this information on a confidential basis until final legal settlement was reached. The recommendation in the report was therefore based on the further external review and validation that had been carried out on behalf of the

¹² CEC01731817

¹³ See paragraph 2 of the report by the Chief Executive for the special meeting of the Council on 2 September 2011 - produced and marked CEC 3

¹⁴ BFB00096515

¹⁵ CEC01891389

¹⁶ CEC02044271

Council after the mediation at Mar Hall. Information in this respect was considered to be confidential.

27. The confidential information referred to in the summary of the report for the meeting of 30 June 2011 was also known as the "*confidential appendix*", for example at paragraph 3.33 of the report. Whilst the Council has been able to identify documents it believes to have formed part of the confidential appendix the Council is unable definitively to confirm exactly what documents were contained within this appendix, but has provided the Inquiry with the information believed to have been in that appendix under cover of the Council's letter to the Inquiry of 21 August 2017. However, material was made available to members on a confidential basis, and it is considered likely that it included financial information in relation to the forecast cost of the various options, such as the following:

27.1 The information shown on the spreadsheets entitled Edinburgh Tram Budget Settlement Agreement 24-06-11¹⁷. The spreadsheet at CEC02085605 shows a high (H) and low (L) outturn cost of £772.9m and £725.4m respectively for taking the line to St Andrew Square, the difference being the level of allowance for contingency and specified risk. In each case, the outturn cost includes the lump sum price of £362.5m for off street works.

27.2 The confidential appendix included a spreadsheet containing a budget appraisal¹⁸. It contains a summary of the outturn costs of various options as follows (shown here from highest to lowest):

Separate from Infraco and re-procure with another contractor (high)	£1,144.7m
Continue with Infraco to York Place (high)	£1,055.2m
Continue with Infraco to York Place (low)	£941.7m
Unsuccessful termination	£910m+
Settlement agreement (high)	£773.4m
Separate from Infraco and mothball/cancel the project (high)	£687.1m

The fixed lump sum from the airport to Haymarket was shown as £362.5m, and at that stage, the target cost for the on street section from Haymarket to St Andrew Square was shown as £22.5m.

27.3 The confidential appendix included a draft report by McGrigors LLP dated 29 June 2011¹⁹ (see below).

¹⁷ CEC02085604 and CEC02085605

¹⁸ Paragraph 3.42 of the report by the Director of City Development dated 30 June 2011; CEC02085613, CEC02085609, CEC02085610

- 27.4 The confidential appendix included a report by Atkins (through their subsidiary, Faithful & Gould) entitled "*Independent Review*" and dated 29 June 2011²⁰ (see below).
28. The report by McGrigors LLP referred to above states that the report "*addresses the principal options available to tie/CEC in connection with the future of the Edinburgh Tram Network, and the entitlement which Infraco might have for payment in connection with those options*". The sections in the draft report relating to the settlement agreement with Infraco (namely MoV5) have not been completed, because it is noted that the agreement remains under negotiation (section 4 of the draft report). Accordingly, the draft report does not address the settlement figure of £362.5m or the target cost for the on street works; it addresses a negotiated separation, continuing with Infraco under the existing contractual arrangements and termination, in order to provide a comparison between those options.
29. The Independent Review by Atkins referred to above reviewed some of the other material that is believed to have been available in the confidential appendix. Section 1 of the Independent Review states that the purpose of the report was to validate the processes and procedures in the draft McGrigors report and to provide a sense check of the figures taken forward to the Council's Budget Analysis (or appraisal) spreadsheet referred to above., on the basis of a high level review. The report concluded that "*the approach taken by McGrigors LLP and CEC demonstrates an appropriate method of identifying the likely heads of liability and there is no indication of any internal conflicts in the drafting. We also consider the methods used to establish the quantum of those liabilities suitable and appropriate*".
30. The report by the Director of City Development to the Council of 30 June 2011 referred to above included an appraisal of options, based on the workstreams that had been carried out and reflected in the confidential appendix. This appraisal was set out at paragraphs 3.31 to 3.46, with the conclusion at paragraph 3.47 that the option to complete the project to St Andrew Square was believed to yield the best prospect of a return on investment.
31. Paragraph 7.8 of the Review Report²¹ explains how the options were evaluated on the basis of the various documents referred to above, including the input of the Council, McGrigors and Faithful & Gould (Atkins).
32. At the Council meeting on 30 June 2011 the Council reached a decision²² to agree some of the recommendations by the Director of City Development in his report of 30

¹⁹ Paragraph 3.33 of the report of 30 June 2011; USB00000384, CEC01942217 to CEC01942225

²⁰ Paragraph 3.37 of the report by the Director of City Development dated 30 June 2011; CEC02085600

²¹ WED00000134 (longer version of report) and TRS00023933 (shorter version of report)

²² CEC02083232

June 2011, and in particular that of the options available, the option from the airport to St Andrew Square should be pursued, subject to funding.

33. It was also decided by the Council on 30 June 2011 that the Chief Executive was authorised to enter into the Settlement Agreement, substantially on the terms set out in the Settlement Agreement summary, subject to the Council being satisfied that there was sufficient funding available and the project has been sufficiently de-risked. It has not been possible to identify which document constitutes the Settlement Agreement summary, but it is presumed that it reflected the budget appraisal spreadsheets referred to above, which are dated 24 June 2011.

Reporting and recommendations to members after mediation – July and August 2011

34. Following the decision of the Council on 30 June 2011, further work was carried out as described at paragraphs 7.9 and 7.10 in the Review Report²³.
35. At paragraph 7.9 of the Review Report, reference is made to a Business Case Audit carried out by Atkins. Paragraph 7.9 summarises the Atkins report, a full copy of which is found at Appendix 8 of the Review Report and which is dated July 2011. Atkins overall conclusions are to be found at paragraph 8.11, namely that the tools, assumptions and outputs are broadly fit for purpose. Atkins concluded that the economic case for the St Andrew Square option delivered a Benefit Cost Ratio greater than 1, even on the basis of pessimistic tests.
36. Paragraph 7.10 of the Review Report describes other work carried out after the Council meeting on 30 June 2011, which included a report by Faithful & Gould entitled "*Post Settlement Agreement Budget, Budget Report*" dated 19 August 2011, which is included at Appendix 10 in the Review Report.
37. Paragraph 4.1 of the report of 19 August 2011 deals with the lump sum figure of £362.5m for the off street works, which had been achieved through extensive mediation, and was not part of the Faithful & Gould scope. The report stated that of the total, £194.99m had been committed in assessments, with a further £19.68m committed as part of the Prioritised Works provided for by MoV4. This left a total of £147.83m of works to be completed.
38. Paragraph 4.2 of the report of 19 August 2011 deals with the target, or budget price, for the on-street works, stating that "*The budget was compiled by tie Ltd, using the difference between the valuation of work carried out to the end of March 2011 and the estimated cost to complete from the contract sum. Following the submission of prices by the*

²³ WED00000134 (longer version of report) and TRS00023933 (shorter version of report)

contractor the budget had to be revised so that a more like for like comparison could be carried out". Paragraph 4.2.4.1 of the report of 19 August 2011 shows a revised on-street works total of £41,722,603, made up as set out in detail in section 4.2 of the report. At paragraph 4.2.2.4 of the report, Faithful & Gould state that they are of the opinion that "certain items are overpriced" within the total figure; at paragraph 2.7, the report states that Faithful & Gould "are of the opinion that the on-street work costs are grossly inflated by INFRACO, both for the civil works and the Siemens work".

39. A meeting of the Council was held on 25 August 2011. The Director of City Development produced a report for that meeting²⁴. The report noted, amongst other things, that a detailed review of the key project risks had been carried out and validated by Faithful & Gould. The Council declined to accept the recommendations of the report from the Director of City Development (other than in respect of project governance), and decided²⁵ a Settlement Agreement should be negotiated and finalised by the Chief Executive, after consultation with political group leaders, taking the line only to Haymarket.

Reporting and recommendations to elected members after mediation – September 2011

40. Following the meeting and decision of the Council on 25 August 2011, a special meeting of the Council was held on 2 September 2011.
41. The Chief Executive produced a report to the Council for the meeting on 2 September 2011²⁶ *"to update Council on critical developments following that decision that have had a material effect on the Haymarket option, and to make recommendations about the future delivery of the project"* (paragraph 1). Those critical developments related to the letter which was received by the Council from Transport Scotland which stated that, in light of the Council's decision of 25 August 2011, Ministers were not prepared to make any further payments to the project and would not extend the existing grant arrangements beyond 31 August 2011. The Chief Executive's report stated this would create a capital shortfall resulting in additional revenue pressure of c.£4.8m per annum for 30 years in the Council's revenue budget, which have a material impact on the Council's ability to finance the Haymarket option from revenue sources.
42. At the special meeting of the Council on 2 September 2011, it was decided by the Council to approve the recommendations by the Chief Executive taking trams to St Andrew Square in the first instance, with an amendment to those recommendations, such that the Chief Executive was authorised to enter into a Settlement Agreement on an unconditional basis as to funding, but otherwise substantially on the terms of the

²⁴ TRS00011725

²⁵ See Committee Minutes of Council meeting of 25 August 2011 (CEC02083194)

²⁶ Produced and marked as CEC 3

settlement summary in the confidential appendix to the 30 June 2011 Council report, with such amendments as may be considered appropriate²⁷.

25 September 2017

²⁷ See Committee Minutes of Council meeting of 2 September 2011 produced and marked CEC 4

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