

## **LEGALLY PRIVILEGED AND CONFIDENTIAL**

### **REVISED CONTRACTUAL ARRANGEMENTS – UPDATE**

#### **1. Current status of contractual negotiations**

1.1 There are a number of key outstanding issues that remain to be resolved before the Settlement Agreement and Interface Agreement can be signed:

(a) I have already outlined the risks in relation to system integration in my email dated 11 August 2011.

(b) At a meeting with Ashurst on Friday 19 August 2011 to review the current status of negotiations on the revised contract, they highlighted two critical areas of risk. These are the same issues which have caused significant delay and cost increases to the project from the outset:

(i) Firstly, the incomplete state of the design; and

(ii) Secondly, the additional delays and work that will arise as a result of known utilities conflicts in the on-street section of the works.

These are discussed further below.

(c) Finally, the issue of procurement risk that has been sidelined throughout the substantive negotiations has now come to the fore, with the Infracore setting out their proposals for dealing with a potential procurement challenge. This is also outlined in more detail below.

#### **2. Design**

2.1 The Infracore will be liable for delivering an integrated design to meet the Employer's Requirements. If CEC requires to make any changes to the design because its requirements are not finalised, or because of the requirements of any third party or approval body this will allow the contractor to make additional claims.

2.2 The way to de-risk this issue is to complete the design and clear all outstanding third party issues before the contract is signed. As I understand it, the design is still not final and I am not certain whether third party issues have been cleared. Until the design process is complete there also remains a risk that satisfactory technical solutions may not be achievable (for example I understand there may be an issue in relation to the York Place turnback).

2.3 This is a commercial and technical, not a legal risk but it is clearly a fundamental one.

#### **3. Utilities**

3.1 It is important to keep in mind that the on-street contract price is subject to variation in the event of a departure from certain agreed pricing assumptions. One of the key pricing assumptions is that there are no utilities which require to be diverted. This means that the risk of the programme delay and costs of dealing with utilities will sit with CEC.

3.2 We now know that there are over 500 conflicts with utilities of which around 100 may be on the critical path. The increased costs and effect on the programme of dealing with the utilities is likely to be significant. If the decision is taken to proceed on this basis it will be

critical to ensure that there are adequate processes and personnel in place to manage that risk and financial contingencies in place to cover it.

3.3 It has been apparent throughout the negotiations relating to the on-street pricing that BBS are unwilling to accept any weakening of their existing contractual position in so far as the on-street works are concerned. In light of the known utilities conflicts, there are a number of provisions of the existing Infraco contract that are particularly problematic:

- (a) The Infraco are seeking to have exclusive access to defined areas of the site (Designated Working Areas). Failure to give exclusive access would give rise to additional claims by the Infraco. Clearly there will require to be sharing of work sites to some extent by the Infraco and the utilities contractors in order to deal with the diversion of conflicting utilities. Far from being given a right of exclusive access, we would expect the Infraco to have an obligation to reprogramme their own works as required and to mitigate the effects of the utilities works in so far as possible. This is being strongly resisted.
- (b) There is presently a 'contractualised' programme, namely a requirement in the contract to comply with the programme on a line by line basis. Failure to do so would allow the contractor to make additional claims. Again this does not give the necessary flexibility to deal with the utilities and could significantly increase costs.
- (c) Any variation to the on-street contract price following a departure from the pricing assumptions (including utilities) could impact on the agreed programme for the off-street works, which would give rise to a claim for prolongation costs in respect of the off-street works. CEC needs to negotiate a change to the contract that would split the on-street and off-street sections of the programme to remove the risk of this consequential effect.

3.4 Clearly the approach taken by BBS in relation to the contract runs contrary to the collaborative partnering approach they agreed to adopt following mediation, with the object of achieving the best position for the client as well as their own. As matters stand there would be no incentive on the Infraco to work with CEC in mitigating the effects of the utilities clashes as they stand to gain from any delay or disruption to the works. Unless there is some movement on these points, CEC will remain vulnerable to a return to previous behaviours and to the contractor maximising claims.

3.5 A walk away figure has been agreed (£3.5m) which would allow CEC to terminate the on street element of the works when unresolved claims in relation to the on-street works reach that level. Although the principle has been agreed, the detail of how this would work in practice has not yet been bottomed out. This is likely to require some restructuring of the existing contract as well as technical input, with a view to ensuring that the Infraco would be required to deliver a system as far as Haymarket. For example, the existing contractual sections of works would require to be redefined and the impact on the feasibility of system-wide testing would require to be understood.

#### 4. **Procurement**

4.1 Our stance in relation to procurement has been that this must be a shared risk, and that CEC will not indemnify the Infraco in respect of any costs arising from a procurement challenge. The Infraco are continuing to press for recovery of costs from CEC in the event of a challenge and have outlined a proposal as follows:

- (a) If a challenge arises, CEC will have the option of continuing with the works, terminating or suspending.
- (b) If we elect to carry on, we bear the risk of a damages claim.

(c) If we elect to terminate the contract, we would meet the Infraco's contractual claims up to the point of termination. In addition, CEC would indemnify them for their demobilisation costs (including subcontractors), and potentially for their loss of profit. CEC would also have the option to suspend the works pending determination of the procurement challenge. In that event the position would be the same as (b) above, but CEC would also be liable for remobilisation costs if and when CEC was in a position to continue with the works following resolution of the challenge.

4.2 CEC would be liable for a damages claim by a third party and for paying the sums due to the Infraco up to the point of termination in any event. I have made it clear that we would not be prepared to meet the Infraco's loss of profits. Where there may be some scope for negotiation is in relation to the costs of demobilisation/remobilisation, and I have agreed to take your instructions on this. Although I do not believe CEC should indemnify the Infraco in full, you may be prepared to consider meeting 50% of those costs. This represents a significant concession from our previous position that each party should bear its own procurement risk, but may be justifiable in the circumstances.

20 August 2011