



**LEGALLY PRIVILEGED AND
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Our ref REMD/TRA046.0011
Your ref

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Dear John

Edinburgh Trams

We have discussed the Grant funding for this project on a number of occasions and I have already given you a note on the remedies which Ministers have under the Grant Agreement and I attach a copy for ease of reference.

Introduction

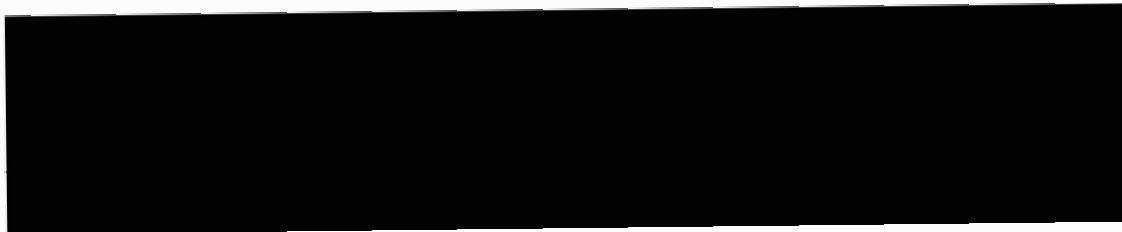
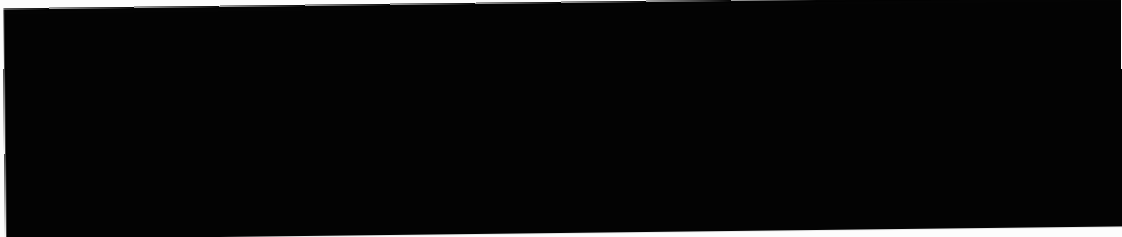
At our most recent meeting you asked me to consider a number of issues and their relevance for Transport Scotland and ministers in terms of the ongoing negotiations over contractual disruption, programme slippage and outstanding commercial settlement. There is no significance in the order in which I place the various issues.

1. Background

- 1.1 It will help if I set out some of the circumstances which make it necessary to review the issues.
- 1.2 There have been literally hundreds of claims made by Infraco against **tie**. Nearly all, if not all, of these arise from the civil engineering works undertaken by Bilfinger Berger UK Ltd ("BBUK") and few of them have been resolved. There has been a very public dispute about Princes Street which was finally settled by an Agreement Supplemental to the Infraco Contract. I comment on this Supplemental Agreement below.

A brief review of the Infraco Contract suggests that the form of contract, although it contains extensive Dispute Resolution Procedures, may tend to encourage disputes. In particular the Change Mechanisms seem to be derived from and may be more appropriate to a PFI/PPP structure rather than a traditionally funded major infrastructure project. The provisions relating to Change and the strict time limit encourage notification of Changes which if not accepted may create a hostile atmosphere and divert management from the important task of delivery.

As will be seen from our commentary on the Supplemental Agreement the accommodation reached in March does not finally resolve any of the underlying issues and may have opened the way to further disputes not necessarily limited to the matters originally in dispute. It is not evident that this agreement offers a sound basis upon which the parties can develop a commercially agreed recovery programme. It would certainly not be a good precedent for the final documentation.



2. Infraco

- 2.1 From papers received from Transport Scotland it is evident that **tie** on behalf of City of Edinburgh Council are undertaking a strategic review of the contract given their concerns about Bilfinger Berger.
- 2.2 It would be helpful to understand the contractual arrangements among the members of Infraco. This is because an option identified by **tie** involves removing BBUK. Whether it is a realistic option depends to some extent on the structure of Infraco.
- 2.3 The Infraco Contract and the other documentation on the discs give no information about the relationship among BBUK, Siemens and CAF and how it is managed or about their decision-making processes as Infraco. It is reasonable to conclude from the provisions of the Parent Company Guarantees that the interest of BBUK was 55% and the interest of Siemens 45% in each case before CAF became a member of Infraco. It is reasonable to assume that there is some sort of Contribution Agreement among BBUK, Siemens and CAF but it has not been exhibited. A Contribution Agreement would allocate any liabilities of Infraco to **tie** among the members of Infraco.
- 2.4 The available information does not permit me to draw any conclusions about the availability of a process to replace a member of Infraco; there is not even sufficient information to permit informed speculation. It may be that **tie** has some information and we suggest enquiries should be made.

A handwritten signature in black ink, appearing to be a stylized 'E' or similar character.

3. **Supplemental Agreement among tie, BBUK, Siemens and CAF dated 20 March 2009**

3.1 The Supplemental Agreement effects a significant amendment to the Infraco Contract. In Clause 2 it provides that Infraco's sole entitlement to payment, extension of time or other relief in respect of the Princess Street Works and the impact of the Princess Street Works on the Infraco Works are as set out in the Supplemental Agreement.

3.2 A detailed analysis of the Supplemental Agreement and its relation to the relevant provisions of the Infraco Contract is set out in Annex 1.

3.3 The effect is that:-

- (a) **tie**, must pay for the Princes Street Works on a cost (at some agreed rates) plus basis ("the Demonstrable Costs") in effect as though such work were a **tie** Change but there is no tie Change Order and the Princess Street Works will not otherwise be treated as an event giving Infraco further rights to payment, time or relief (but see paragraphs (c) and (d) below);
- (b) **tie** is to get a credit for the price relevant already included in the Construction Works Price;
- (c) if additional cost (or delay) is caused to remaining Infraco Works **tie** is to certify and pay monthly, under Clause 67.5 of the Infraco Contract, reasonable amounts involved as additional costs including Head Office, overheads profit percentage and Consortium Preliminaries;
- (d) Infraco is entitled to claim for time for delay on the Princes Street Works and consequential delay on the remaining Infraco Works as a result of "events effecting and the circumstances in which the Princess Street Works are being undertaken." Time is to be given as if the delay had been caused by a **tie** Change.

3.4 The Supplemental Agreement takes the Princes Street Works out of the fixed price structure and the discipline of the Relief and Compensation Events and **tie** Changes in the Infraco Contract and the effect is a transfer of risk from Infraco to **tie** both as to costs and time and this could knock on to the whole of the Infraco Works.

There are three separate but related risk transfers for Infraco to **tie** in the Supplemental Agreement:

- (a) Infraco are to be paid for the Princes Street Works not under the Infraco Contract but under the Supplemental Agreement. Infraco is to be paid Demonstrable Costs. In addition Infraco is to be paid head office overhead, profit and preliminaries (referred to in Appendix C of the Schedule Part 4 of the Infraco Contract) as if the Princess Street Works were **tie** Change. There is no fixed price element at all (Clauses 2 and 3.1);

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- (b) Infraco is entitled to the additional costs and time caused to the remaining Infraco Works "as a consequence of events effecting and circumstances in which Princes Street Works are being undertaken". There is no mechanism for measuring, controlling or agreeing this additional time and cost except that it is to be reasonable. Head office overheads, profit and preliminaries are also to be paid. Further **tie** is to ensure that the **tie** representative certifies such reasonable amounts monthly (Clause 3.2). Again there is no fixed price; and
- (c) Infraco is entitled to an extension of time for the Princes Street Works and any direct consequential delay to the Infraco Works (unless the fault of Infraco) and time is to be worded "as if the delay had been caused by a **tie** change" (Clause 3.4). This means claims can be made for time (and therefore money) in respect of other parts of the Infraco Works if their delay can be traced back to Princes Street.

3.5 It follows that **tie's** ability to manage these additional risks within the financial resources available to CEC is a matter of vital significance.

3.6 In fairness I should point out that when Infraco claim for payment in respect of the Princes Street Works the valuation (which must mean the demand for payment of Demonstrable Costs) is to include a credit for **tie** for "the price already included in the Construction Works Price for all construction activity required for excavation to the Infraco Proposal tender information level". I am not able to say whether there is sufficient information available to **tie** to enable **tie** to be comfortable with any credit offered or to challenge or audit the credit.

3.7 The Update for Transport Scotland issued on 26/03/09 refers to the preparation of a work plan by Infraco, **tie** and CEC "to re-confirm and monitor the adequacy of the risk allowances, funding headroom and re-baselined programme".

Transport Scotland will no doubt find it essential to be kept fully informed as to the progress of this work plan and in particular of the allocation to date and proposed allocation (if any) of the risk allowances. I discuss this further below.

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Kind regards

[Redacted]

Yours sincerely

[Redacted]

R E M Davidson

Enc

