



2008/426

FOISA EXEMPT
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**DLA PIPER REPORT TO TIE LIMITED
AND THE CITY OF EDINBURGH COUNCIL SOLICITOR**

CAF JOINS BBS CONSORTIUM

DLA PIPER REPORT

1. Purpose

The purpose of this report is to analyse the effect of CAF, the selected Tram Supplier and Maintainer, joining the BBS Consortium at date of the Contract Close. This matter has been driven predominantly by Siemens plc: without the entry of CAF to the BBS Consortium (and becoming a party to the Infraco Contract) there would be a potential financial impact consequent upon a 17.5% mark up on the Siemens component of the BBS Contract Price and a risk that Siemens supply chain seek price increases. These issues has been reviewed and evaluated separately by tie.

This report is to assist tie and CEC in their internal approvals processes. It relies upon the positions reached as at 8:00pm, 9 May 2008 which are not yet fully contractualised and it should be understood that what has shaped this outcome has been significantly influenced by tie's absolute imperative to reach Close on 13 May 2008 and to have a fully negotiated, settled set of documentation to serve that imperative as soon as possible.

The position between tie and BBS regarding BB's 29th April demand for an additional £12,000,000 was finally concluded at 6:45pm on 9 May 2008. tie's response on CAF joining therefore required to take into account that no settled position (i.e. the need to negotiate further) would have undoubtedly stalled the mandated Tuesday, 13th May Close. A firm outcome had added advantage in providing stability for Siemens and CAF and exerting more pressure on BB to conclude which was proving extremely arduous.

2. tie's Protections

- 2.1 CAF are to join as a party to the Infraco Contract on the basis of a joint and several liability so that, in practice, their covenant as a contracting party also becomes available directly to tie .
- 2.2 tie's access to and entitlements under the Bilfinger Berger AG and Siemens AG parent company guarantees are unaffected, as these instruments remain in place to cover the entirety of the Infraco new entity's (BB, S and CAF) performance and financial obligations. This is to be verified by a supplemental German legal opinion provided by BB and S.

- 2.3 The Infraco security package is to provide for an express mention in each bond (performance and retention) that CAF is an Infraco Member contracting with tie. No other changes are made or needed.
- 2.4 tie and CEC remain with direct contractual recourse (in any event) to CAF through Collateral Warranties from the Tram Supply and Maintenance Contracts at Novation.
- 2.5 tie obtains an express indemnity (up to a cap of £8,000,000) against any demonstrable adverse effect (on scope, price, programme) of CAF being a party to the Infraco Contract. This indemnity is in addition to and outside the contractual liability cap for the Infraco and would not erode it if enforced.
- 2.6 tie retains the full Infraco indemnity (under Clause 77 of the Infraco Contract) for any breach or negligent act or omission of the Infraco (including CAF) up to the ceiling of approximately £43,000,000 as laid out in the Infraco Contract.
- 2.7 OCIP insurances remain in position as settled (CAF to be renamed as an insured party, if required).
- 2.8 The indemnity from BB and Siemens is "evergreen" and puts tie in a good position if tie wished to exchange it for revisions to the Infraco Contract in due course. Its terms are attached.

3. The CEC Guarantee

Pressure from BBS to introduce language to mention CAF's position in the CEC Guarantee explicitly has been resisted. It is proposed that CEC issued a simple letter of "no objection" to CAF been party to the Infraco Contract and confirming that CEC is on notice of the Infraco Contract Minute of Variation. This process exposes CEC to no increase in liability and no provision of any kind to the Infraco existing entitlements under the CEC Guarantee. Its purpose is to give BBS comfort that CEC would not seek to refuse access to the guarantee on grounds of CAF being a Consortium Member. This is acceptable since under the current structure all tie's obligations vis a vis CAF payment entitlement (through the Infraco) are already underwritten by CEC and the acknowledgement changes nothing.

4. Commentary

- 4.1 tie had little idea what type of indemnity might be on the table when CEC Legal was briefed last week by tie's Financial Director. 24 hours after that briefing, all communications were suspended and the draft indemnity DLA Piper had prepared

following discussion with tie simply sat in the email inbox until Thursday night (8th May) when DLA Piper had instructions to talk to BBS legal again.

- 4.2 tie considered the position on CAF joining on 29th April, focussing on whether any assessable risk would eventuate to tie/CEC. The conclusion was that it is beneficial and, in worst case neutral. tie could envisage a commercial, technical or financial risk eventuating which would somehow lie outside the range of the contractual remedies (including indemnity for breach or negligence) which tie will continue to enjoy unaltered.
- 4.3 The legal risk is, in our opinion, confined to the margins and to the special area of guarantee law governing the security package. Subject to seeing that this has been done properly, we are satisfied that a simple and clear reference to CAF being a consortium member and party to the Infraco Contract in the two "on demand" bonds themselves which are to be issued for tie's benefit (plus the parent company guarantees' amendments being reflected as we have drafted and the supplemental German legal opinion) will insulate tie from any potential issue whereby the sureties could assert that their obligations are affected or diminished by CAF joining. The instruments already contain such conventional protection for tie. As we have reported, the other point that was introduced by BBS is that they wished to have the CEC Guarantee amended to refer specifically to CAF joining (and CEC underwriting this). We refused firmly this on the basis that (a) it was not *'tit for tat* with the parent company guarantees - tie's payment obligations do not change as a result of CAF joining, (b) that CEC renegeing on its guarantee with such an argument would be inconceivable for a Scottish public authority, backed by Transport Scotland funding and would inflict major damage on its creditworthiness. This was eventually accepted and dropped after Siemens had persuaded Siemens Corporate.
- 4.4 The indemnity cap was set by tie on the basis of a £10,000,000 opening position (after brief discussion with DLA Piper as to how such a cap would sit with other liability positions in the ETN contract suite (for example: Tramco caps, the Maintenance Cap (£3.5m), the SDS cap (£10m each and every) and the thirty party liability for latent defects cap (£9m)) reduced to £7m by Siemens and increased in final discussion to £8m). Unlike as previously proposed by Siemens, there is no sunset for this indemnity and it sits outside the overall Infraco liability cap of 20%. The indemnity is taken in lieu of tie's ability to conduct proper diligence (within the time permitted) to check if changes beyond the proposed Minute of Variation are needed to the Infraco Contract.

4.5 The final discussions on this had all the hall marks of spiralling into a stand - off once Siemens Corporate became involved at 6.45pm on Friday night. Settling the indemnity on these terms and on tie's instructions represented in our opinion a sensible outcome for tie and CEC and a major push through on the CAF process which would have stalled Siemens from signing completely and re-invoked the spectre of 17% mark up. The "evergreen" indemnity puts tie in a good position, if diligence does reveal that there are concrete changes on the Infracore Minute of Variation which tie would like to have in exchange for releasing the indemnity.

DLA Piper Scotland LLP
Sunday, 10 May 2008

Appendix

Extract from Minute of Variation

Subject to Clauses 77.1, 77.2, 77.3 and 77.8 of the Infraco Contract, Bilfinger Berger and Siemens shall indemnify **tie** up to a maximum aggregated amount of £8 million (eight million pounds) in respect of losses (excluding any uninsured third party economic and consequential loss or Indirect Loss (as such term is defined in the Infraco Contract)) incurred by **tie** in relation to any changes which are required to the Contract Price, Programme, Employer's Requirements or the Infraco Proposals (as such terms are defined in the Infraco Contract) provided that:

- such loss is directly attributable to the consequences of CAF becoming a party to the Infraco Contract; and
- as soon as practicable upon **tie** becoming aware of any matter or thing which might lead **tie** to making a claim against Bilfinger Berger and Siemens under this Clause, **tie** will so notify Bilfinger Berger and Siemens and provide them at that time with all the information that **tie** has about such matter or thing and why it might lead to such a claim.

For the avoidance of doubt, any sum paid to **tie** pursuant to the indemnity set out in this provision shall be expressly excluded from the Liability Cap (as defined in the Infraco Contract) and for the purposes of Clause 77.7 of the Infraco Contract.