

EDINBURGH TRAM PROJECT

ASSESSMENT OF RISK OF SUCCESSFUL PROCUREMENT CHALLENGE

Background

The Intention to Award notices were issued on 18th March and contract completion is imminent. The purpose of this paper is to summarise tie's assessment of the risk of a successful challenge under procurement regulations. Technically, a challenge could emerge from many quarters, but the most likely source in any procurement is from unsuccessful bidders, especially those who reached a late stage in the process. It is this threat which is addressed in this paper.

It must be borne in mind that the source and basis for a challenge cannot be predicted with certainty. This paper is not a substitute for the documentation that may be required to defend tie's actions in the event of a challenge.

The paper is supported by an Appendix containing detailed analysis of all aspects of the procurement process deployed and in particular the development of the final contract pricing. This Appendix has been prepared by Matthew Crosse who led the process for tie.

The Notification letters contained the information on the terms of award required to be provided under procurement regulations and debrief meetings have been requested by certain of the bidders.

The BBS consortium are in the process of finalising arrangements to include CAF in the consortium. In principle, tie is content that this should happen and indeed the concept was acknowledged at the time of preferred bidder selection, though with CAF Novation being the required approach to support Financial Close. tie and DLA are monitoring the BBS / CAF arrangements to ensure that no perception of a change in bid terms could be construed.

Subsequent to the position described in this paper being reached, a further round of negotiations instigated by Bilfinger Berger took place. The detail behind the final position reached has been documented separately for CEC in the parallel paper entitled "Close Considerations and event history".

Analysis

Process employed

A review of the procurement process was performed by Jim McEwan which covered the period from selection of the preferred bidders in October 2007 through to the end of January 2008. This was independent of those who had been involved in the procurement process and concluded that the processes and documentation were in order. This review is included in the Close Report which supports the decision-making on Financial Close. Because the Close Report is potentially a public document, the more commercially confidential information contained in this paper will not be reflected in the Close Report.

Overall outcome

The current position was summarised for the Tram Project Board on 12th March 2008, which concluded that the outcome of the contractual negotiations was in line in all material respects with the Business Case which supported the selection of the Preferred Bidders in October 2007.

There have been further amendments to the contractual terms since that date but tie does not believe these would be contentious in the view of a bidder. In addition, a challenger would have difficulty establishing prejudice because these amendments are the outcome of the process transparently declared in the ITN as part of post preferred bidder sessions. This does not of itself support a conclusion that principal Infraco / Tramco terms are materially unchanged. However, these contracts represent the core of the project and the majority of the funding. Compliance of the final position with the business case is therefore valid and influential background.

Elapse of time

The considerable elapse of time since selection is an unhelpful factor as it is prima facie indicative of a lengthy period of post-selection negotiation. The reality has been that the delay and most of the effort since October 2007 has been caused by the difficulty of aligning the SDS provider with its novation responsibilities under their contract, coupled with the volume of work involved in the alignment of the SDS design with critical interface documents including the Employer's Requirements and the BBS Proposal. It is considered unlikely that selection of a different bidder would have reduced the time required to reach today's position. All bidders were on notice that SDS Novation was a prerequisite to completion. A draft Novation agreement was incorporated in the tender documents. Both bidders had quite significant commercial and contractual qualifications on their offers.

Price

In the period post the selection of preferred Infraco bidder, there has, as normal and expected, been movement in the commercial pricing of the contract based on a number of key drivers:

- Both parties in the preferred bidder review had lodged substantial and material qualifications to their bids and it was a key requirement in the ensuing months and prior to contract close that these were understood and resolved/removed, leading inevitably to change in contract terms.
- The substantial revision of the Employer's requirements, which are now at version 4.0 (Version 2.4 at conclusion of preferred bidder selection). These changes in requirements have been crystallised as both parties went through a process of harmonising and clarifying the requisite specifications. Included amongst these were the CEC's requirement for tapered poles in the heritage areas.
- Completion of further elements of the overall design which were not available at the time of the preferred bidder selection.

- Following the recognised changes to Employer Requirements and the completion and refinement of further aspects of the overall design, a review of the programme timescale has seen the programme move from delivery at the end of March 2011 to 16th July 2011 with concomitant effect on price.
- Review of the Depot equipment base with the TRAMCO preferred bidder has seen a number of changes to said base to assure compliance.

Whilst the BBS price has been increased, in a directly comparative situation, the BBS relative competitive position remains the same as at preferred position. This is because the primary reasons for the price shift are not bidder specific. The detailed analysis is shown in the Appendix. Clearly, all of the price adjustments negotiated by BBS are under very different circumstances to those prior to preferred bidder as BBS's negotiating position strengthens.

Programme

The programme to project completion has moved out by c3 months from the basis on which selection was made. The primary reason for this is the same as that described under elapse of time above, which affects the anticipated commencement of construction. The construction programme itself has not materially extended. It is considered that the delayed commencement and completion dates would have similarly arisen with alternative bidders.

Risk profile

It would be normal to expect that the risk profile will change as contracts are concluded, but only to a marginal degree. This is the case for the Infraco / Tramco contracts and risk profile. One specific area requires more detailed assessment – the risks arising from the overlap of design and construction.

This was anticipated at the time of bidder selection, but the detailed mechanics of dealing with the issue have been developed since selection. The issue of overlap would almost certainly have arisen in the same form with any bidder and it is believed that the solution would have been similarly concluded. This covers both the legal process and protections and the management processes.

Contract security terms

These terms could be relevant if any changes implied that the perceived risk were materially different from the basis of selection.

In substance the only material change in security terms between Preferred Bidder stage and the final negotiated deal is that the previous 30% liability cap during the construction phase (with no performance bond) on Infraco is now a 20% liability cap plus two separate on-demand bonds of a further c25% which is over and above the liability cap – therefore amounting to the same cover. There have been alterations to the duration and function of the liability cap post-construction, but within acceptable bounds. All security terms have been negotiated and have emerged broadly within the

range of expected market terms. The bonding support is on balance more advantageous to tie / CEC than might have been anticipated. The PCG arrangements are stated in acceptable terms but are complex and it is recognised that any material claim on these instruments will not be a straight-forward process.

Intimations

We have had no indications from any party that they are considering a challenge. Reaction to selection was normal although it should be noted that the losing bidder in Infracore has formally requested a de-brief and will take a close interest in the final terms of award, particularly final price, given the investment made in the bid process.

It is also worth noting that there may be a legal defect in the unsuccessful bidder's tender which would offer defensive material if a challenge is made although this has been explained by the bidder as a reaction to the PB deal they were asked to sign being incomplete. The issue is that tie does not have a valid Tramlines' committed commercial proposal on the same comparative basis as Tramlines because Tramlines refused to sign the draft deal document at the point of selection of preferred bidder.

DLA Letter

An accompanying letter from DLA provides their view of the content of this paper.

Conclusion

tie considers that the conduct of the procurement process and the management of contract completion since selection of preferred bidders have been in line with procurement regulation. Should a challenge be made, tie would be in a strong position to resist successfully. Accordingly, there should be no concern about contract award.

tie Limited
12.05.08

This appendix sets out important detailed information on the background, processes and movements since the preferred bidder award. It is intended to provide the basis to refute any challenge, though focussed on the possibility of a challenge by the losing Infracore bidder Tramlines.

1. Preferred Bidder Decision Basis

Preferred bidder appointment was made in October 2007.

The decision to select BBS over Tramlines was based on the agreed award criteria. In summary:

- **Price:** On a fully normalised CAPEX comparison, BBS were £7.6m (4%) lower than Tramlines. This delta increased to £10m (5%) on a PV comparison.
- **Programme and Project Execution:** Both bids were similarly matched and acceptable to tie. In respect of programme, Tramlines were penalised for the degree of overlap with the MUDFA programme. Efforts to close this gap were unsuccessful.
- **Legal and Commercial:** BBS proposal contained fewer mark ups and was generally in a more favourable position in respect of financial liability caps and latent defect periods. BBS showed a greater degree of flexibility and tractability compared to Tramlines.
- **Technical:** Both bidders were closely matched and were acceptable to tie. In view of its widespread application in Europe, BBS 'Sedra' trackform was generally preferred to Tramlines. BBS adopted a more competitive position in respect of NR immunisation which meant lower levels of residual risk for tie and a price reduction.
- **Maintenance:** Both proposals were similarly matched, but BBS was more competitive by some 16%. It was considered that BBS' overall approach arguably provided greater delivery certainty over Tramlines.

Both bidders negotiated a Draft Deal which consolidated their respective commercial and contractual positions and set out the basis for any future adjustments. Whilst BBS signed their agreement, Tramlines declined to sign. Importantly, this means that tie doesn't currently have a valid and confirmed Tramlines proposal against which we can compare.

2. Fixing the Price

Both bidders' civils' prices were based on the Preliminary Design prevailing at the time of the latter stages of the negotiated process. They were qualified accordingly with firm and provisional sums. The procurement strategy was based on re-measuring these price elements during the preferred bidder stage as designs were completed and prices adjusted at the declared rates from the Draft Deal.

After selection of BBS and the commencement of due diligence, a number of circumstances made it more difficult for BBS to firm up the provisional elements of their bid (structures, roads, pavings and drainage). These were:

- The SDS design was taking longer to be completed, and also being finished in a piecemeal fashion making it difficult to price.
- The design that was emerging contained a greater number of differences than anticipated at preliminary design stage (the BaFO datum) . For example structures and tram stops.
- BBS were not sufficiently resourced to quickly turn the emerging designs into quantities and prices. Other activities on the programme such as VE and due diligence distracted the team from the core pricing requirements.

The net affect of this was to frustrate tie's attempt to gain a greater 'fix' on the price and hence the budget in order to progress the FBC v2 approval with the Council and Transport Scotland. In response to this dilemma tie requested that BBS consider fixing their price.

Wiesbaden

Following protracted negotiations covering a range of contractual, technical and importantly commercial issues, BBS finally agreed to fix their price albeit with qualifications. This culminated in senior level negotiations in Wiesbaden and tie/BBS signing an agreement the following week (20 December 2007). In addition to fixing their price the deal also committed BBS to accepting a number of VE initiatives, again subject to a number of qualifications.

3. Closing negotiations and adjustments

Following the FBC approval milestone in December, both parties have since worked strenuously to close out all remaining aspects of the contract suite. The work has been extensive and required good faith negotiations to:

1. Finalise the remaining Contract terms
2. Deal with the CAF novation alignment issues
3. Deal with the SDS novation alignment issues
4. Finalise the Employers Requirements
5. Consolidate the BBS proposal
6. Ensure alignment with the SDS design

BBS have increasingly hardened their negotiation game as tie have approached specific procurement milestone dates. This is not untypical for contractors in this phase as their bargaining power increases considerably. In each case tie have pushed back and been prepared to move a milestone in order to get a better deal for tie/CEC.

During this period BBS have continued to reappraise their commercial position as more and more knowledge becomes available. They have now completed their due diligence on all aspects of the project. This has included ascertaining the quality of SDS outputs and gaps, the reliability of the design programme and a review of the design work and resources going forward. This due diligence has informed their negotiating stance in all regards and has remained at the top of their 'deal breaker' list.

In summary, areas where BBS have needed to move their commercial position are:

- **Systems resources:** BBS (Siemens) have re-evaluated the level of resources they would need to fill any gaps within the scope to ensure successful completion. Prior to preferred bidder tie encouraged both BBS and Tramlines to reduce their engineering resources on the grounds that SDS were carrying out these activities.
- **SDS civils design quality:** This is seen as a significant risk to BBS which in their view, could cause delay costs whilst designs are reworked.
- **CAF alignment:** in contract negotiations both CAF and BBS expressed concern that commercial alignment between the two contracts placed them both at risk. To the extent possible, these misalignments were remedied in each contract. However, some unforeseen alignment risks remained. BBS insisted on pricing the typical time impact of such risks as well covering with contingency sums which was negotiated done.
- **Programme:** This has moved 3 months, largely reflecting a longer than forecast close programme (+2 months) and the need to have complete acceptance by BBS, CAF, SDS and CEC of the design construction master programme.
- **ER changes.** Reasons include assumed VE changes that are now unacceptable, the Council's preference on equipment specifications (e.g. tapered poles) and the need for pricing of previously excluded items (e.g. Scottish Power breakers). In virtually every case Tramlines would have needed to revise their price in the same way that BBS have done.

4. Comparison between Preferred Bidder and Close position

Table 1 provides a summary comparison of BBS competitive position at time of preferred bidder with their position at today. It also indicates a hypothetical position from Tramlines based on the discussion above.

5. Conclusions from the detailed analysis in this Appendix

The evaluation decision at preferred bidder remains robust. Tramlines have few grounds for challenging the decision and the current financial close outcome. If they chose to do so, the arguments and adjudication would be complex, lengthy and in some cases subjective.

Whilst the BBS price has been increased, in a directly comparative situation, the BBS relative competitive position remains the same as at preferred position. This is because the primary reasons for the price shift are not bidder specific: the SDS design emerging with a higher specification and cost than at preliminary design (the BaFo price datum); the SDS due diligence findings including design quality, systems resources, gaps etc; contractual alignment issues with CAF; the time taken to close out the complex contract and novation process; and the many ER/ VE related changes. In virtually every case, Tramlines would have needed to increase their price on broadly the same basis as BBS.

In respect of the technical changes, the preferred bidder situation remains materially unaltered.

Contractually, there have been small movements which have may have arguably bought BBS and Tramlines closer together, but overall, the comparative situation remains similar. The principal contract changes in BBS position, relate to consents and approvals where tie/CEC are now accepting more risk. Here tie is confident Tramlines would have adopted a similar negotiating stance because they were similarly qualified at the time of preferred bidder.

Clearly, all of the recent price adjustments by BBS are under very different circumstances to those prior to preferred bidder. The closer tie get to financial close, the more difficult and costly it becomes for tie to revert to Tramlines. BBS are using this vast reduction in competitive pressure to their commercial advantage. Would Tramlines have been less aggressive, or priced changes more economically? The procurement team strongly believe that they would not. Indeed BBS' 'new entrant' position in the market suggests that relative to Tramlines they would be tactically more cautious, since a high profile failure at this stage would create large repercussions in the market. This would damage future prospects for BBS' target order book.

Today, tie does not have a valid Tramlines' committed commercial proposal on the same comparative basis as Tramlines. If they were today asked to sign the draft deal, there is no reason to suggest that the terms or price wouldn't increase reflecting the change in commercial circumstances.

Table 1 Summary comparison of BBS competitive position at time of preferred bidder with their position at today

| Key BBS Differentiator | BBS Summary Shifts to Close | £M | Hypothetical Tramlines Position | Challenge risk? |
|--------------------------------|---|-------------|---|-----------------|
| PRICE Price was 4-10% lower | Wiesbaden Fixed Price including: Earthworks, Landscaping, Traffic Signals, Noise and Vibration, Tramstops, Balgreen Road Bridge. Subject to conditions. | +8 | Increase relates to design completion risk and would have also been priced by Tramlines. The amount would have been based on negotiation tactics and judgement. | Unlikely |
| | VE acceptance (with conditions) | - (13.8) | It is uncertain that whether Tramlines have been as bullish in accepting this level of reductions. | No! |
| | Rutland Square CAF alignment risks | +0.5 | Tramlines position on acceptance of CAF novation was the same at preferred bidder. | No |
| | SDS systems resources | +2.5 | Tramlines were also pressurised by tie to remove systems resources. It is probable that Tramlines would do likewise. | No |
| | BBS resources to manage CAF | +0.8 | It is unclear if Tramlines would have responded in this way. | Possible |
| | Brunel Price changes | | | |
| | ER's compliance | 1.4 | Mostly tie changes which were unagreed at preferred bidder. | No |
| | SDS civil's quality | 2.8 | Tramlines would have discovered similar issues (e.g earth works etc) which would have made them reluctant to accept novation related risks with price adjustment. | Unlikely |
| | Programme shift + 3 months | 3.5 | Mostly results from delays in closing. Unlikely that Tramlines would have closed more quickly. Tramlines may be probably more cautious. | No |
| | Tapered poles | 0.9 | Tramlines (likewise did not) propose these. | No |

| Key BBS Differentiator | BBS Summary Shifts to Close | Impact | Hypothetical Tramlines Position | Challenge risk? |
|---|--|-------------------------|---|-------------------------------------|
| <p>Programme and Project Execution</p> <p>BBS Programme worked with few MUDFA clashes</p> | Programme shift + 3 months | + 3 months | Position could worsen because their proposal was poorer to start with. See comments above too. | No |
| <p>Maintenance</p> <p>Price was ~16% lower</p> | Price | Nil | No shift | No |
| <p>Technical</p> <p>Trackform preferred</p> <p>NR Immunisation risks</p> | <p>Rheda City now proposed (c.f Sedra)</p> <p>Some attempt to shift position from that at PB</p> | <p>Nil</p> <p>3m</p> | <p>No price impact. Tie still regard this as a more reliable Trackform than Tramlines proposal</p> <p>Tramlines were considerably less competitive and would have been unlikely to have moved to the BBS position without greater competitive pressure.</p> | <p>No</p> <p>Possible</p> |
| <p>Legal & Commercial</p> | <p>Attitude – has hardened as procurement milestones are approached.</p> <p>Defect liability periods now reduced from 20 years.</p> <p>Consents changes/ relations (partial risk shift to tie)</p> | <p>Nil</p> <p>12yrs</p> | <p>Tramlines would have no doubt played a harder game as these same deadlines approach.</p> <p>Tramlines offered a qualified 15 years considerably less competitive at the time and would have been unlikely to have moved to the BBS position without greater competitive pressure.</p> <p>Consent was also qualified by Tramlines. Unlikely tie would end up in a better position with Tramlines.</p> | <p>No</p> <p>Possible</p> <p>No</p> |