



DLA Piper Scotland LLP  
Collins House  
Rutland Square  
Edinburgh  
EH1 2AA  
DX ED271 Edinburgh 1  
T +44 (0) [REDACTED]  
F +44 (0) [REDACTED]  
W www.dlapiper.com

**STRICTLY CONFIDENTIAL AND LEGALLY PRIVILEGED  
NOT FOR DISTRIBUTION**

Gill Lindsay  
Council Solicitor  
City Chambers (Legal Services)  
Anchor Close  
30 Cockburn Street  
EDINBURGH  
EH1 1YJ

**Our reference**

JLG/JLG/310299/15/  
18237137.2

12 March 2008

Dear Ms Lindsay,

**EDINBURGH TRAM NETWORK ("ETN")  
DRAFT CONTRACT SUITE AS AT 12 MARCH 2008**

This letter is our report to update you on the matters which we addressed in our letter of 16 December and to report further on the evolution of the contract documentation towards **tie's** planned close date of 24 March 2008. It has been produced under heavy time constraint which will explain the measure of overlap between this letter and Annex A. We are instructed that **tie's** intention is to issue a notification of intent to award the Infraco Contract and the Tramco Contracts on 13 March 2008. This letter therefore provides our view on the status of the contract suite and its readiness for this final stage of the procurement commenced in October 2006. In accordance with our agreement with the Council we have taken instructions from **tie** on all matters on the basis that those instructions are consistent in all respects with the Council's instructions and interests.

**PROGRAMME**

We have commented in this report on those elements of the procurement documentation and central contractual papers which when complete are viewed by **tie** as enabling Council officers to recommend Full Council authorisation for **tie** to enter into the ETN contract suite (as anticipated in the full Council Resolution of 20 December 2007):

**1. CORE INFRACO CONTRACT TERMS SETTLED AND ALIGNED WITH TRAMCO CONTRACT**

Our role in this process has been to support issue of the ITN and draft contracts, assist **tie** in legal evaluation of bids and to engage in final contract negotiation from late September 2007 until now, after **tie's** internal legal and commercial team had taken the draft contracts forward from May 2007 to September 2007, setting positions for preferred bidder phase.

Regulated by the Law Society of Scotland.

A limited liability partnership registered in Scotland (number 300365) which is a law firm and part of DLA Piper, a global organisation.

A list of members is open for inspection at its registered office and principal place of business, Collins House, Rutland Square, Edinburgh, EH1 2AA and at the address at the top of this letter. Partner denotes member of a limited liability partnership.

UK switchboard  
+44 (0)8700 111 111



INVESTOR IN PEOPLE

CEC01347797\_0001

We are able to report that by close of business today Wednesday 12 March the draft ETN contract suite will have been advanced to a point where there are only limited legal issues outstanding on the Infraco and Tramco core terms and conditions which, after a further full working session scheduled tomorrow, should not prevent the documentation being ready for signature by end of March. This forecast will rely also on the cooperation and focus of, and interaction with, the BBS Consortium. Detailed drafting remains necessary to ensure accurate and fully agreed reflection of myriad commercial aspects which have come together in the last 10 days. Annex A to this report, a report by **tie** with input by ourselves on contractual matters, provides more detailed analysis of the draft contracts. We are aware that the Tramco Contract section of the close out report requires further refinement but the report is included as an annex to our letter for the purposes of its protection from public disclosure at this point due to its commercial sensitivity within the procurement.

Infraco/Tramco Contract alignment has been completed to a painstakingly detailed level on all issues which were outstanding when we last reported. CAF has agreed to the terms of the Tram Supply Agreement and Tram Maintenance Agreement and BBS and CAF have agreed to the terms of the two related Novation Agreements, subject to their final review.

In our view the draft agreements in their current state adequately capture the commercial positions which **tie** has achieved. In our opinion, in order for **tie** to issue a notification of intent to award, the following tasks need to be urgently attended to tomorrow, resulting in BBS' agreement on:

- removal of all remaining major issues on Infraco and Tramco Contracts (these are all known items);
- completion of pricing negotiation;
- production of the agreed Master Programme;
- finalisation of Employer's Requirements;
- pricing for Phase 1b;
- close on Network Rail APA;
- agreed treatment of NR immunisation; and
- receipt of final Infraco Proposals.

Clearly this is a full and ambitious day's effort. BBS should be requested to confirm their commitment to close by latest 26 March (24 March being Easter weekend). That commitment would exclude any further visits to any of these core elements of the ETN contract suite.



## 2. UPDATED RISK ALLOCATION MATRICES

The Infraco Contract Risk Matrix is appended to this letter at Appendix B. It is updated to show change since our 16 December letter.

## 3. PERFORMANCE SECURITY PACKAGE

3.1 There has been no material change to the structure of the main performance security package. The BBS Consortium will provide:

- (a) bonds/financial guarantees to be issued by ANZ Bank and/or Deutsche Bank (to cover the construction and commissioning of the ETN); and
- (b) German parent company guarantees to underwrite contractual performance and financial liability of the two UK contracting subsidiaries.

The scope, duration and level of cover from these instruments has altered since our report at preferred bidder appointment due to commercial negotiations. The package as a totality remains legally competent to protect **tie** and the Council's interests. It is clearly a judgment for **tie** regarding its financial worth but we view it as not outside market norm.

### 3.2 On Demand Bonds

Two "On Demand" Bonds offered by the BBS Consortium have been negotiated to a level (on proposed amounts and detailed acceptable terms and conditions), enabling the BBS Consortium to select their proposed sureties for confirmation of pricing. No issues of significance (aside from a possible adjustment to the value of the main performance bond to reflect final contract price) are outstanding. We are awaiting final confirmation on agreed terms accepted by the sureties.

### 3.3 Parent Company Guarantees

As you know, **tie** has advanced these negotiations in parallel with the negotiation of the terms of the Council's formal Guarantee of **tie's** payment obligations under the ETN suite of contracts. The key terms are now agreed. What remains is the precise liability cap for each Parent Company Guarantee, following final agreement reached on the liability cap, duration and scope for the Infraco Contract, which we expect will be settled by close on Thursday 13 March. Following this, the Parent Company Guarantees will finalise quickly.

## 4. CONFIRMATION OF NOVATION STRATEGY

Contrary to expectations in December 2007, the process of engagement on SDS Provider novation has proved arduous, with both BBS and SDS taking

positions at opposing ends of the negotiating spectrum. BBS have taken a most risk averse stance, due to their developing first hand views on SDS performance to date, in particular in relation to design Consent achievement, but also in relation to important aspects of scheme design quality.

BBS have insisted on reinforced contractual protection (in our view overplayed) and commercial support in the form of **tie** accepting compensation entitlement for BBS in the event of SDS default on its design production and Consent delivery obligations, which risk to **tie** is discussed further in section 7 below. This is predominately a function of SDS serial underperformance throughout its mandate and also at a time when the need for due and proper performance has been under close bidder scrutiny.

Nevertheless, an agreed form of draft Novation Agreement has been negotiated to close today. The terms of the Novation transfer responsibility for design, as required by the procurement strategy, to BBS (subject to the above). Further work will be necessary to enshrine all technical services and tasks in the final agreement, but **tie** holds a formal letter of commitment to the process signed by SDS Senior UK Management.

## 5. RISK

5.1 Our view on the contractual allocation of risk and responsibility between **tie** and the competitively selected private sector providers remains that the Infraco Contract and the Tram Supply and Maintenance Agreements are broadly aligned with the market norm for UK urban light rail projects, taking into account the distinct characteristics of the ETN and the attitudes of BBS and SDS to novation. The project's state of technical and commercial readiness has matured since Christmas. However, the fact that work still continues on the Employer's Requirements Schedule - the core project scope - at this very late stage (resulting in SDS requiring an instruction to align their designs with **tie's** Employer's Requirements and the Infraco Proposals) means that technical ambiguity (and therefore delay/cost risk) may exist in the interplay between design, scope and method of execution. There is contractual mitigation available whereby (1) the Infraco is under a duty to bring any ambiguity in technical documentation to the attention of **tie**; (2) **tie's** authority to direct resolution of such issues; (3) the precedence of core terms and conditions over Schedules; and (4) the exercise of SDS now instructed by **tie** to align their designs with the Employers' Requirements and the Infraco Proposals so as to eliminate mismatches.

5.2 We are not in a position to comment in relation to the Project Master Programme which remains under development. There is a risk that the SDS exercise in aligning design with Infraco Proposals and Employer's Requirements could have impact on Project Programme both before and after contract award. We are aware that **tie** is endeavouring to mitigate this risk by careful management of the alignment process.

## 6. THIRD PARTY AGREEMENTS

The position achieved regarding Third Party commitments made by the ETN project is as follows:

- 6.1 At ITN issue in October 2006, DLA Piper had included all major third party agreements **tie** had concluded at that time (plus SRU agreement in draft) in the Infraco Contract Schedule 13 (these agreements were prepared by Dundas & Wilson). This exercise put Infraco on notice of the requirements to carry out work and/or observe constraints in these agreements. The inclusion of these agreements in the ITN documentation was carried out by DLA Piper without detailed **tie** instruction or review and that remains the case - that is to say the obligations selected for step down are DLA Piper's judgement, but not informed by any commercial or engineering view from **tie**. This step down is mechanical and neither improves nor detracts from the effect of the original obligation.

In addition to the Schedule 13 agreements (which Schedule has been updated to introduce further agreements concluded since ITN issue date), **tie** had entered into a range of commitments with private individuals and smaller businesses during the parliamentary phase and beyond. Following preferred bidder appointment, BBS took the position that they had never been shown or given access to these papers by **tie** (contained on two CDs "CD Commitments"). Whether this assertion is accurate or not, that is the preferred bid qualification BBS held to, with considerable determination. This situation was negotiated strenuously by **tie**.

- 6.2 Positively, BBS have accepted the contractual outcome that:
- (a) BBS must comply with the obligations set out in Schedule 13;
  - (b) BBS must not put **tie**/CEC in breach of (or in a position where they cannot use entitlement under) the Schedule 13 Agreements (which include, in essence, SRU, Network Rail APA and EAL Agreements);
  - (c) BBS undertakes to take all reasonable steps to ensure not to cause **tie**/CEC to be in breach of the CD Commitments;
  - (d) if BBS Construction Programme or normal activity is impaired by constraints/requirements in the CD Commitments which are unusual or could not reasonably have been foreseen by an experienced contractor, BBS will be entitled to apply for relief and any demonstrable additional cost.

Having reviewed a random sample of the CD Commitments agreements, we are of the view that there are unlikely to be any

agreements which contain an unforeseeable or unduly onerous commitment **tie** is to abide by.

- 6.3 SDS are contractually obliged to ensure that their design deliverables take account of all third party agreements and commitments made by **tie** and known to SDS and they are warranting this to BBS under the Novation Agreement.

6.4 **EAL**

This matter was finally negotiated to conclusion in February this year. DLA Piper has been involved in the Licence negotiations.

A number of issues have arisen from mismatches between the Licence, agreed to permit construction activity at the airport under MUDFA and the **tie**-Infraco Contract, and the terms of the permanent lease **tie** has negotiated with EAL, which was to reflect the Licence. These are required to be corrected to remove risk and a Minute of Variation is under preparation to propose to EAL regarding access under the Lease to safeguard the right to maintain the tramway post service commencement.

A future risk is uncovered at present. The Lease terms under which EAL is entitled to require the tramway to be shifted (post 1 January 2013) do not include an indemnity to the Council/**tie** in relation to any defects or unforeseen interference in the ETN system which might result from this intrusive construction activity and its ultimate interface with the existing ETN system. **tie** is assessing this and will act to resolve this by means of documenting the precise terms of any shift.

7. **CONSENTS**

- 7.1 The terms of the novation of SDS have been settled on the basis that BBS risk adversity required accommodation, otherwise no transfer of responsibility for design production and consent management could have been achieved on acceptable terms. Two prime concessions have therefore been made by **tie**:

*B*

- to the extent the CEC consenting process is delayed through no fault of the SDS Provider, that delay will entitle BBS to claim a Compensation Event under the Infraco Contract (time relief and additional cost). Such a claim would also encompass SDS Provider delay costs. Although the SDS Contract provided that SDS would take all consent risk, without exception, BBS were not prepared to absorb this risk (through direct recourse to SDS Provider) having carried out post preferred bidder due diligence on the status and history of SDS design and the consent process within CEC.

- If through its own fault or dilatoriness SDS is late in delivering a design into the CEC Consent process and this in turn delays the issue of construction drawings to BBS, BBS will be entitled to apply liquidated damages up to an agreed level (currently proposed by **tie** at £1,000,000 and with an approximate minimum rate of £20,000 per week).
- BBS would have recovery risk on such liquidated and ascertained damages<sup>1</sup> but beyond the cap, **tie** would be required to recompense BBS.

B

- The current position is that any damages or loss suffered by BBS beyond the £10,000,000 cap under SDS novated contract (in relation to deficiency in SDS design) would be a **tie** risk.

7.2 Following the novation of SDS, **tie** will hold an assignable collateral warranty from SDS regarding SDS services and work product prior to novation. The terms of the Collateral Warranty will be standard for a design and engineering services consultancy and were substantially contained in the annex to the SDS Contract when it was executed in September 2005.

## 8. NETWORK RAIL ("NR") ASSET PROTECTION AGREEMENT

8.1 The Asset Protection Agreement with NR has been fully negotiated and is ready to close. This has been an arduous process, however the outcome is a document which achieves significant commercial improvements for **tie**/CEC on what was originally offered by Network Rail. The arrangement remains heavily tilted in Network Rail's favour, as is inevitable given the starting point of the regulatory template agreements. The main improvements secured have been:

- (a) Significant widening of the circumstances in which **tie** can recover money from Network Rail;
- (b) Reasonableness in Network Rail actions and ability to refer to the Infracore ETN Suite form of Dispute Resolution Procedure; and
- (c) Dilution of indemnities given by **tie** to Network Rail to a mutually acceptable level.

8.2 The unreasonable position taken by Network Rail regarding the indemnities contained in the Protection Provisions Agreement (entered into to remove Network Rail's objection to the tram scheme) delayed closure for a considerable time. This has now been resolved

---

<sup>1</sup> Note that the enforceability of such LADs is open to question unless they represent a genuine pre-estimate of BBS loss from the delay. **tie** is working with BBS to achieve this.



to restrict the scope and duration of this indemnity, particularly during construction.

- 8.3 Network Rail require a collateral warranty from BBS. BBS has, until yesterday, refused to disclose the entirety of the draft Infraco Contract to Network Rail, resulting in Network Rail insisting that BBS would not be able to rely upon any part of the Infraco Contract not disclosed. A solution to this impasse is imminent, in our view.

## 9. CEC GUARANTEE

- 9.1 The terms and conditions of the CEC Guarantee and in particular its call mechanics, liability cap and protections are in line with market practice for this type of instrument. It should be noted that the Guarantee may be called upon by the Infraco on multiple occasions if **tie** is in payment default more than once. The instrument has been drafted, negotiated and settled with direct involvement and support of CEC Legal and Finance.
- 9.2 CEC will benefit from the same contractual defences and entitlements to set off as **tie** and will have no liability greater than **tie**'s. No claim can be made for an amount which is in dispute if **tie** has referred the matter under the dispute resolution provisions of the Infraco contract. The Guarantee is released at issue of Reliability Certificate.

## 10. PROCUREMENT RISK

You have asked for our opinion in relation to procurement risk imported on account of adjustment to price, contract terms and commercial risk allocation post preferred bidder. Our view is as follows:

- 10.1 The time which has elapsed since preferred bidder announcement is appreciable, particularly when an outside observer may not have a detailed understanding of the procurement strategy and the considerable difficulty caused by SDS Provider's underperformance. With that passing of time before an award, comes the risk of increased perception that the final deal has been restructured to accommodate the winning party on different and more favourable terms. This may influence both participants in the procurement and interested but disaffected parties.
- 10.2 Both bidders final submissions were qualified as to acceptance of contractual terms and therefore their risk acceptance. It would be difficult, in our view, for a challenge to be upheld on the sole grounds that the settled position on Contractual Risk Allocation is a position that the losing bidder could point to and say: "that is far beyond what I would have required to maintain my price." There have been shifts in risk allocation, but in most key cases, this relates to the process of the novations, which was clearly identified as a post preferred bidder process. Both bidders' positions on novation were heavily qualified.



A very detailed analysis would be needed to rank and analyse the changes introduced post preferred bidder and that is beyond the scope of this letter and not possible in the time permitted for this report's preparation.

- 10.3 We have commented upon a shift in the security package (linked to latent defects). Here, we regard BBS's approach has been partially dictated by the UK representatives overreaching their authority and Germany has intervened. **tie's** acceptance of the revised position does represent a concession post preferred bidder. But the competitor's offering was also qualified.
- 10.4 The area where we have very limited visibility is price. We played a role in bid evaluation only in relation to the two bidders' response to the draft contracts. We note that Tramlines expressly raised this in an informal debrief last autumn. We have been shown today a document prepared by **tie** entitled "Edinburgh Tram Project Assessment of Risk of Successful Procurement Challenge", appended to this letter at Appendix C. Our view as to the likely incidence of challenge or source of such challenge does not differ from **tie's**. In order to fully evaluate the strength of **tie's** ability to resist a challenge we would need to understand the analysis of how the final contract price has been arrived at and to understand how this compares to Tramlines final bid price.
- 10.5 We are not instructed in relation to any matter on the tram supply and maintenance procurements which would alert us to any evident or latent risk of a challenge once CAF are formally awarded the contracts. However, BBS have discussed with **tie** CAF joining the BBS Consortium. If this occurred prior to contract award, it would necessitate a re-evaluation of the bid Consortium. Present indications are that CAF may join post contract award, a matter for BBS to handle, with **tie's** consent.

All our efforts over the next 10 days are focussed in supporting **tie** on an efficient and optimal close out of the contract documentation by authorised representatives to record settled positions from which the award documentation will be prepared and signed.

This report itself has needed to strike a difficult balance between commenting upon what is still under final discussion and what we can reasonably anticipate as a firm, frozen outcome.



Gill Lindsay  
Continuation 10  
12 March 2008

We are proud to have been given the chance to work with **tie** on this challenge.

Yours faithfully

A handwritten signature in black ink, appearing to read 'DLA Bissett'.

**DLA PIPER SCOTLAND LLP**

cc Graeme Bissett, **tie** Limited Strategic Planning Director