Tram Infrastructure Dispute

DLA Piper Response to CEC Questions

Dispute Resolution Procedure

Has the DRP been formally initiated?

Two Disputes have been initiated, and are currently in the 'Internal' stage of the DRP. This means that whilst these issues have been set out in formal position papers, debate currently still rests between the Chief Executives of **tie** and the Consortium, and the issues are capable of agreement at that level, rather than having yet been referred to an external party for determination in the second stage of the DRP.

What, in summary, are the matters in dispute?

The two disputes relate to:

(1) Whether the Infraco were contractually required to commence Princes Street works from 21st February (at the latest). This dispute will examine the validity of Infraco's reasoning for not commencing, the validity of instruction to proceed despite excuses being offered, and the time at which commencement (notwithstanding the known Client change relating to the bus lane reservation for 2 weeks) was required under the contract in the circumstances.

(2) The correct method of calculation of overheads, profit and preliminaries. This dispute focuses upon the Princes Street Estimate in particular, and tie seeks to establish a general principle about the true contractual method of calculation which can be applied elsewhere on the project.

tie have subsequently identified further matters which are of sufficient commercial significance to require resolution as soon as possible, and which have a good prospect of success. Following a DLA Piper forensic study of the project administration files, **tie** is gathering all evidence to support submission of a number of these into the DRP if the **tie** Board make a decision to proceed. This is part of **tie's** strategy to apply the terms of Contract evenly and forcefully.

Likely timescales for outcomes; initial and final

Assuming that the internal stage does not produce a final conclusion, the format and therefore the timescales of the external stage depend upon whether BSC and **tie** agree on which process to use - Mediation, Adjudication or Litigation. The decision of a mediator is not binding, and so the adjudication process is likely to be required before an outcome is achieved. The adjudication process has a potential outside duration of 42 days. It is binding unless taken to court.

Range of possible outcomes

(1) Principles all found in **tie**'s favour, paving the way to any delay in starting work to be done on Princes St being to the account of the Consortium and for preliminaries to be agreed as per **tie**'s interpretation. The extent to which BSC will agree that these principles apply elsewhere on the route and how material the difference in circumstances must be before these principles no longer apply will be determined later, but the precedent will be a strong tool.

(2) One or more key principles found against **tie** would be an undesirable outcome but nevertheless a risk. An appeal to the courts would be possible and similar careful consideration about the extent of application of the decision to different facts would be needed.

In either scenario, **tie** will be much closer to being able to accurately assess the true cost of similar situations across the route, and a number of non-agreed items will be resolved in those similar situations, providing an objective basis for agreement and progress in those areas , always assuming the absence of further unrelated points of dispute. **tie** will then be able to provide an enhanced cost and programme report to stakeholders and BSC will be obliged to programme out any obscurity or contingency left in place.

Is there more than one counter party to the dispute?

The Infraco Contract is entered into between **tie** and the Infraco. Therefore any dispute under the contract must necessarily be with the Consortium as a whole. We also believe that this is beneficial strategically, as it serves to underline the views and stance of **tie** on this issue to the Consortium and any outcome will bind all consortium members. If BSC were to consider that design were an issue, it is possible that they would commence DRP against the SDS Provider and conjoin this dispute. This does not appear a material risk at present although it should not be discounted as a tactic when it is evident from the position papers exchanged that BSC are being intentionally obscure.

Breach of Contract

*Are BB in breach of contract by refusing to commence works on Princes Street; what contractual terms can **tie** cite in support of this contention?*

No separate instruction by **tie** to BSC to commence in Princes Street was necessary. BSC's assertion on the eve of programmed start was what triggered tie to issue instructions under Clause 80.13 and 80.15. Clause 80.13 provides a **tie** ability to require work to commence in situations where Changes are not fully agreed, whilst 80.15 allows **tie** to require work at demonstrable cost, while DRP is completed. Instructions under both clauses have been issued in respect of Princes Street. Other breaches arise under the failure to progress provisions, the partnering provisions, and the avoidance of dispute provisions, amongst others, but none are so clear cut, relevant to a material breach claim, and directly citable in any calculation of relief and cost, as Clause 80.13 and 80.15.

Do BB have any sustainable counter arguments to the effect that tie have failed in any relevant contractual obligations; eg cleared site, completed MUDFA works?

We are relatively certain that at formal DRP stage, BSC will unwrap a series of "spaghetti" arguments to assert inability to proceed. Such arguments certainly reduce the clarity in relation to delay in the works and the cost thereof. **tie** accept that such items may be the cause of an assessable certain amount of delay and cost to the Infraco in certain parts of the route and for certain elements of the works but BSC's inability or unwillingness to report this to tie in an open and constructive manner will be exposed. **tie** generally dispute the levels of delay and cost which are claimed, and are of the view that the Infraco are fully able to carry out works in numerous areas of the scheme, regardless of the issues arising from items which are the responsibility of **tie** under the agreement. A justifiable problem affecting 10% of works in one discrete area does not entitle Infraco to fail to progress the balance of the works in that Section, or elsewhere on a project where the site is linear.

*Assuming BB to be in breach of contract, is this sufficiently material to allow **tie** to terminate the contract with BB, as opposed to the whole consortium?*

There are no contractual provisions which would allow termination of one constituent member of the Infraco consortium, nor would this be an acceptable provision in a contract of this kind. Any decision to change the constitution of the consortium would require a variation of the Infraco Contract, and such an action might be offered as a possible rectification plan by the Infraco under the termination provisions if **tie** seek to terminate for Infraco Default.[1] We are currently advising **tie** that though there are continuing breaches of the Infraco Contract, these are not significant enough yet to validly terminate for Infraco Default without an inevitable substantial argument and counter-assertion (on the Consortium's interpretation of the facts over the last 10 months) that **tie** has itself repudiated the Contract. We have been advising **tie** in action to lay the contractual groundwork to create stronger evidence as to **tie**'s dissatisfaction about BSC performance on all fronts which would give firmer support, should a termination option be under serious consideration. **tie** are also keen to avoid a situation where the non-BB consortium members seek additional monies in order to 'rescue' the project by stepping in for BB at **tie's** behest, as opposed to reaching that conclusion themselves and volunteering it to **tie**.

In terms of entitlement to terminate, it is worth saying that we would not have expected to see clear upfront material breaches and 'own goals' of a severity which would entitle **tie** to terminate. The wider issue around the whole course of Infraco behaviour is the key current point here, and more specifics in terms of breaches will be investigated, and potentially any case for termination bolstered, through the DRP process and otherwise as matters continue.

*Will **tie** have a sound claim against BB for refusing to undertake works on Princes Street even if BB were found entitled to payments as a result of variations approved through DRP? In other words, should BB not have continued work whilst pursuing remedies through DRP.*

Clause 80.15 clearly states that Infraco should continue works during the DRP process if **tie** requires Infraco to do so. This clause states that Infraco will receive its demonstrable costs. The only exception to this provision is where re-design work is required and the valuation of that design works is not agreed. The Infraco has not made such a claim for all works on Princes Street in general, and thus the contract requires Infraco to progress all works which do not fall within the re-design exception.

*What remedies are available to **tie** for breach of contract; damages, calling up Bonds etc.?*

The central contractual remedy for any Client is the application of liquidated damages for delayed completion. In this Contract, there are Sectional completion dates and damages attaching to each Section. This is why the dispute over culpable and non-culpable delay is at the core of BSC's position on responsibility for the consequences of Change. However, to deal with non performance or negligent performance, there are indemnity provisions to protect **tie** and CEC from third party claims. There are also Parent Company Guarantees issued by Bilfinger Berger AG and by Siemens AG. Calling upon a PCG would enable **tie** to seek both the recovery of monies which **tie** can prove are owed by the Infraco (including any liabilities incurred by **tie**/CEC because of Infraco breach), and can also be used to require either of the parents to perform in place of the Infraco under the Contract. A PCG call would also raise the profile of **tie**'s complaint to the highest levels of the Bilfinger parent company, but the parent can rely upon the defences of its subsidiary so that a PCG call would likely

[1] The Definition of which includes (1) a breach by the Infraco of any of its obligations under this Agreement which materially and adversely affects the carrying out and/or completion of the Infraco Works; and (2) the Infraco fails to commence the Infraco Works within 90 days of the Commencement Date or permanently abandons the Infraco Works (or a material part of them) at any time;

be disputed. There are also Bonds issued by ANZ bank and Deutsche Bank in place: the Infraco has provided a Performance Bond to a value of £23million, and a Retention Bond to a value of £2million, both of which can be called on demand by **tie** for performance failures, that is without requirement of proof only the giving of Notice under the Contract. Any bond call made where there are not sustainable damages suffered would be liable to be met by to a claim for restitution. Damages are recoverable under the Infraco Contract up to the Liability Cap which, though subject to exceptions and sub-caps, is essentially 20% of the Infraco Contract price , the equivalent of *ca* £46million.

*If BB depart the scene, what is the likely reaction from Siemens and CAF, firstly vis a vis BB, and secondly with **tie**?*

If BB unilaterally decided to withdraw, Siemens and CAF will look to their consortium agreement with BB to determine whether they have any redress against their former consortium member. Siemens and CAF will still be in the Infraco, and will be put into material breach of the Infraco Contract due to the disappearance of the core civils capability. They would need to propose a solution acceptable to **tie** to carry out and complete the civils works in order to avoid an Infraco Default termination.

Procurement Implications

If BB were to depart the scene, for whatever reason, is there capability with Siemens to assume the obligations previously contracted to BB?

This is a technical rather than a legal question. Our view is that Siemens could potentially draw upon their subcontractor BAM (already working on the project) to discharge the majority of the civils functions and, either through BAM or directly, are sufficiently large that they could put all other required sub-contractors in place to complete the works.

Are there any procurement implications arising from a restructuring of the consortium described above?

If the Consortium is restructured in response to an Infraco Default termination notice, this would not be subject to challenge. Were a Consortium restructuring agreed absent any clear default position, then a challenge and claim for damages from the unsuccessful Tramlines consortium might be possible in theory. The challenge, to be successful, would need to establish that a Siemens-led bid (rather than a BB-Siemens bid) would have resulted in the evaluation selecting the reserve bidder Tramlines and then Tramlines showing loss. Such a scenario cannot be discounted entirely as a tactical move by Tramlines to assert their candidacy but we would assess it as a remote risk - since (a) Tramlines was itself a Consortium assembled for the bid and the members will have since gone onto other project and different market opportunities (b) if right, the reconstituted Consortium could be demonstrated by **tie** to be as strong as or stronger than BSC. If the Consortium as a whole were to be sacked from the project, then an open and compliant retendering process would be required.

*If it is not possible to pass on BB's function to Siemens, will **tie** have to procure a new contractor to fulfil this role and responsibilities?*

The safest and most conservative solution from a procurement process point of view would be to dismiss the Infraco as a whole and re-procure a new Infraco. Given that Tram Supply and Tram Maintenance followed a separate procurement and are separate contracts subsequently novated to the Infraco, it is possible to arrange contractually for CAF to be retained without procurement challenge concerns.

A second solution would be for **tie** to re-procure a civils partner only to enter into a Siemens-CAF consortium and fulfil the Infraco Contract. This could be expected to attract a high risk and interface premium from potential bidders, and be subject to potential challenge because the original procurement required an integrated civils and systems supplier. A third option of **tie** carrying out the civils under sub-contract would require procurements (unless the existing subcontracts of the Consortium could be taken over by step in), and in any event would likely see **tie** take on a number of risks which are currently transferred under the Infraco Contract, including engineering interface risk (ie wheel - rail-OLE -systems).

What is the likely timescale for procuring a new contractor in place of BB?

Depending upon which option above is pursued, any replacement of BB is likely to take a number of months, especially given the amount of due diligence that will need to be undertaken by potential civil partners into the work done to date and the reasons for BB failing. **tie** could seek to use one of the swifter forms of procurement process. It is realistic to assume that 9 months plus of delay to civils works during re-procurement would be required, plus the mobilisation time required by the successful replacement. In respect of re-procurement and re-mobilisation timescales, note that where a replacement civils contractor is already working on the project in some capacity, this previous knowledge could be expected to significantly reduce the time which the process requires. **tie** is in the process of developing clear commercial views on this point which are beyond this paper.

At what level of 'award' in favour of BB through the DRP process would procurement implications kick in? Is this dependent on simply cost, or is it determined by the need for extra works?

If a DRP process found that all extra costs claimed by Infraco since contract award are for genuine change process and compensation event reasons, then no procurement challenge could be mounted, as it is then reasonable to suppose that this would have been the case no matter who the contractor might be. The concern in such a scenario would be whether an extra step eventuated determining that **tie** should have anticipated this level of extra costs at contract award, exposing the question whether competing bidders were offering an opportunity to accept these changes as risks for the contractor within their bid price. A legal analysis of this could only be done when there is a complete understanding on the reasons for cost increases (i.e. actual changes or increased scope, as opposed to delay related cost).

Are there any residual risks of challenge by previously unsuccessful bidders, or has that opportunity gone for good?

In Scotland, a procurement challenge of this sort is not time-barred. Our advice on this issue is consistently that courts will look less favourably on a challenge the later it comes, and that evidence of breach of procurement rules is much less likely to be discovered long after the contract has begun implementation. There is a very large step between a DRP finding that the Tram Project has cost more than was bid, and having a claim by an unsuccessful party that, on the balance of probability, the outcome should have been anticipated on the original procurement, evidencing in a **tie** breach of the procurement process. There is jurisprudence to the effect that relatively large Client led scope changes in complex projects are not *prime facie* evidence of a breach of the procurement rules in a negotiated procurement procedure because this is inherent to and foreseeable in large infrastructure schemes.

Given that we understand that the core financial bids at BAFO stage in October 2007 were very close indeed, there is no obvious reason why Tramlines could assert successfully that they predicted the real price and BB underbid to the extent that **tie**'s evaluation was unfair , incompetent or was not transparent.

DLA Piper Scotland LLP - March 12th 2009