Paper to : **CEC IPG** **Meeting date : 26/10/10**
Subject : **Trams**
Preparer : **Alastair Richards**

Summary

In May 2008 the Tram Supply Agreement (TSA) and Tram Maintenance Agreement (TMA) were signed with CAF. Subsequently these contracts were Novated from tie as Client to the Infraco Consortium, as part of the Infraco Agreement.

Under TSA CAF have now completed and successfully factory tested 17 tram vehicles for Edinburgh, of which to date only 1 has been delivered and title transferred to CEC. The remaining 16 trams are capable of having title in them transferred by the issuance of a formal letter to Infraco. This paper recommends that this step be taken in the light of the situation with regard to the Infraco Agreement and seeks endorsement for this course of action.

The TMA has a 30 year Term, some 20 years longer than that of the envisaged term of the Infraco Agreement, and the TSA contains provisions for such items as extended warranty, spare parts support and the option for procurement of additional tram vehicles, as a result clauses were negotiated specifically into the TSA, the TMA and the Infraco Agreement, that in the event of either Termination or expiry of the Infraco Agreement then CAF must be offered for Novation back to tie/TEL or CEC. This paper outlines the mechanism for how this could happen and explains the preparatory work required to be effected.

The paper also explains the potential for leasing surplus trams due to the phased completion of Phase 1a and the value of the completed trams in current terms.

Discussion

<u>Decision 1 - Title to completed tram vehicles</u>

A clause was negotiated into the TSA, to provide the Client with the right, should it be desirable, to take Title in each tram after completion of the Factory Acceptance Test. Otherwise Title only transfers after each tram has completed the site Commissioning Test in Edinburgh. To date we have only taken Title of Tram 252, but we may take Title for trams 251 and 253 to 267 inclusive, which are currently being stored by CAF.

Establishing clarity of Title for CEC at this time has advantages in light of the current contractual situation between tie and the Infraco Consortium. The alternative is not attractive, as explained below.

In accordance with the Milestone Payment Schedule in the agreement, we have paid c.£40M for the tram vehicles to date. In the event of a termination of the Infraco Agreement, then although we have recourse to a 5% of contract value performance bond, it would be necessary to pursue legal action to recover the balance of money paid as a loss due to failure of the Infraco Agreement. Alternatively, should we wish to use the completed trams to complete the project, this would rely on complex negotiations with Bilfinger and Siemens where the trams would undoubtedly be used as leverage.

Taking title of the completed trams would result in the assets being added to the balance sheet and available to be deployed in a potential post termination world to complete the project. 17 trams is the size of fleet that would be required for providing an Airport to St. Andrews Square service.

Taking title of all 17 currently completed trams before any potential termination is recommended.

Decision 2 - Novation of the TSA and the TMA

Having taken title to the completed trams above, then in order to make operational use of them either ourselves in Edinburgh, and/or by leasing them to a third party for another system would require CAF support to completion of commissioning, provision of warranty and spares arrangements and the delivery of training and special tools. Obligations to provide this support are governed by the existing terms of the TSA agreement.

In the same manner as for supply of trams, fully comprehensive maintenance provisions are available through the terms of the TMA agreement, which although is fixed for the 30 year life of the trams, allows a 'No Fault Termination' by the Client after 5 years.

Opting to accept both the TSA and TMA agreements novated back is therefore recommended with the provision that as part of the novation negotiations we obtain CAF's firm commitment and price to support our leasing of surplus trams to a third party system. Because of this complication is further proposed that we hold without prejudice negotiations with CAF to draft acceptable terms of the Novation Agreement to be used.

A full risk and benefits matrix is attached as Appendix 1.

Decision 3 - Possible lease of surplus trams

As described above, taking title to the trams and accepting and agreeing to novation of both the TSA and TMA agreements would provide the ability to enter into a lease agreement with another system to use a number of the trams (of the order of 6). We have explored an interest from TFL at Croydon in this regard and have also asked CAF to explore on our behalf another potential opportunity in Scandinavia. The lease would be on a commercial terms basis including obligations to maintain the assets and restore them ready for use by us at the end of the lease period (likely to be 6 to 10 years in duration). The potential income from leasing is likely to be in the region of £150,000/tram/year.

Progressing negotiations on a potential leasing deal for surplus trams is recommended in conjunction with the discussions with CAF on commissioning and maintenance support of trams outwith Edinburgh associated with Decision 2 above.

Value of the Trams

Finally, it is worth noting that the capital cost for each of the trams is c.£2M per tram which compares favourably against current procurements for other systems which for comparable trams are in the region of £2.5 to £2.8M per tram. This fact underlines the rationale behind the recommended decisions contained in this paper as to replace each of these existing trams would be over 25% if reprocuring this element of the works as part of continuing the project.

Recommendation

IPG is requested to approve the following recommendations:

1) To take Title to the completed trams before any potential termination.
2) To endorse the negotiation of detailed novation terms upon which TSA and TMA would revert in the event of Termination of the Infraco Agreement.
3) To endorse the development of detailed options for leasing opportunities.

Decision(s) / support required

The IPG is requested to:

Edinburgh Trams

1. Note the recommendation presented herein.
2. Approve the recommendations as proposed.

Proposed	Name: Alastair Richards	Date: 26/10/10 Title: Operations Director, Edinburgh Tram
Recommended	Name: Richard Jeffrey	Date: 26/10/10 Title: CEO, Edinburgh Trams
Approved	……………………………. ……. on behalf of the CEC IPG	Date: …………

Appendix 1

Review of Tram Options Post-termination
Date: 23 August 2010 updated 26 September 2010

Option	Pros	Cons
1. Novation of Tram Supply Agreement to tie	Security of price Secures rights of product manufactured thus far Trams needed to operate service Trams have been built specifically for City of Edinburgh 16 of 27 are complete; 17 to 21 are under construction Could possibly be re-sold or leased Strong relationship between tie and CAF Time and cost savings	No use if project cancelled Potential post-termination storage liability until delivered to site Possible commercial opportunism Integration risk comes back to tie Infraco may seek to obstruct novation

Appendix 2

Challenge Questions and Answers
Date: 27 September 2010

Option	Question	Answer
Financial Implications	In the event that CEC does not take ownership of the completed tram sets;	
	What will financial exposure be?	Approximately £35.5M (cost paid to date less performance bond and value of 1st tram) plus legal costs to recover.
	What is cost and timescale for re-procurement should we terminate CAF without taking ownership of vehicles taking into account the re-procurement process and lead time?	The cost to re-procure would be £81M (27 trams) or £53M (17 trams) (Based on £2.8M per tram + £4M for spares, special tools etc + £1.5M for project management, procurement management and legal costs.)
	How do we ensure compatibility of new procurement with the tram systems/track?	We would vary the TSA and the TMA scope to include integration of the trams with the systems and track being procured seperately.

Option	Question	Answer
Contractual status relating to remaining trams sets	Does exiting contracts between CEC/Tie/BSC or BSC/CAF prohibit novation of CAF to Tie/CEC?	No, they explicitly provide for novation of TSA and TMA to tie/TEL/CEC. Please refer to DLA Advice Note TSA TMA novation transfer (31.10.10)
	If CAF is not novated to tie/CEC what are options for maintenance/repair?	We have certain rights that survive termination/expiry that could be used to obtain product support from CAF and the Key Equipment suppliers, however we have to recognise that without the contracts being novated to us we would not have any pre-agreed price or terms ~~agreed~~ which ~~would~~ could lead to a certain amount of commercial exploitation by ~~them~~CAF. With this support, we would then maintain them ourselves or compete ~~sub-contract~~ the maintenance potentially to another manufacturer or service provider familiar with this type of rolling stock.
	Can tie/CEC take title to the 17 trams then terminate CAF? What would be the downsides of this?	Tie/CEC cannot directly terminate CAF, they would have to terminate the Infraco Agreement and then decline to have CAF novated back. The downsides are as the question above that we ~~would~~ may lose the competitively obtained pricing and terms and conditions of the TSA and TMA and would be open to commercial exploitation. Although the commercial reality is that CAF and in any event the key equipment suppliers would support their products it may just cost more than the competitively obtained all inclusive TSA and TMA arrangements.
	In the event of taking title to the 17 trams and terminating CAF, can the vehicles be maintained by another party?	Yes, albeit it with the potential limitations expressed above. This is still a preferred alternative to having to fight for ownership of the already constructed trams or moneys paid.

Option	Question	Answer
Market options for leasing of CEC tram sets	Does CAF have Proprietor Rights in relating to software in order for the vehicles to operate?	They do, however we have a royalty, irrevocable licence to use which survives termination. The difficulty is when we require modifications to the software in the future.
	In absence of novation does this impair leasing/resale options?	Yes, without the commercial framework provided by the TSA and TMA it would be very difficult to determine what the lease cost should be and the potential lack of OEM support would make potential lessees nervous.
	In absence of novation does this impair TEL operation and maintenance of completed sets?	Yes, the completed sets have been factory and test track tested, however they remain to be commissioned and tuned with the specific infrastructure, power supply, track and systems of the Edinburgh System. Lack of support in this process would impair operation in Edinburgh or anywhere else.
	Details of market research for leasing options or resale, with suitable financial information to underpin the suggested value of £150k per tram in the event of a lease, and £2.8m per tram market value.	There is no market data for leasing of tram vehicles specifically as they are typically for one system and not moved on at the end of a lease term to another system. The value indicated is calculated based on a commercial leasing basis using the capital cost and depreciation of the tram. The £2.5M to £2.8M per tram is based upon recent tenders for similar trams (source CAF).
	What are the options for location for interim storage of completed tram sets and costs associated with options?	We would store them in the depot at Gogar taking delivery from the factory in the event of termination of Infraco Agreement.
	What are the Number of tram required for operation to St Andrew Sq?	A fleet of 17.

Option	Question	Answer