REPORT ON CERTAIN ISSUES CONCERNING EDINBURGH TRAM PROJECT – OPTIONS TO YORK PLACE

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Privileged and confidential – prepared in contemplation of litigation
FOISA exempt

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1 Executive summary

1.1 This report addresses the principal options available to tie/CEC in connection with the future of the Edinburgh Tram Network, and the entitlement which Infraco might have for payment in connection with those options.

1.2 One of the options available to tie/CEC is to enter into the Settlement Agreement in relation to which certain principles were agreed at the mediation which took place at Mar Hall in March 2011 and in relation to which negotiations remain ongoing.

1.3 The other options are dependent on the reasons for which the Settlement Agreement is not entered into:

(a) In the event that the Settlement Agreement is not entered into for reasons associated with funding, the Infraco Contract will terminate automatically. This would leave tie/CEC free to proceed with another contractor if that was to be considered appropriate;

(b) In the event that the Settlement Agreement is not entered into for reasons other than those associated with funding, then the Infraco Contract will remain in place, unless grounds for termination can be identified. The termination provisions in the Infraco Contract are open to interpretation; in particular, there is a risk of parties remaining locked in to that contract.

1.4 A chart showing the various options is at page 9 of this report.

1.5 The approach taken to the assessment of the options in this report is to arrive at the prudent assessment that should made in relation to tie/CEC's exposure for the purposes of carrying out a comparison of the consequences of adopting the various options identified.

1.6 This does not involve arriving at a definitive view of the value and merits of each head of Infraco claim; that could only be achieved following detailed factual, legal and expert analysis. Instead, the approach that has been taken is to build up the commercial components of the various options in order to arrive at a working comparison between them.

1.7 The outcome of this exercise does not represent the starting point that would be adopted in the context of any negotiations with Infraco, nor does it necessarily reflect the approach that would be taken in the context of any formal dispute resolution proceedings. It provides a context in which to examine a number of potential options in order to provide a basis of comparison between them.

1.8 [*Text in relation to Settlement Agreement to be included.*]

1.9 The starting point for considering the options other than the Settlement Agreement is in relation to tie/CEC's exposure in the event of separation following automatic termination: this exposure contains a number of building blocks which have each been considered in turn.

1.10 In summary, these building blocks have been approached in an order of decreasing certainty:

(a) Infraco's entitlement to payment in respect of work, excluding any element of change, which has been carried out up to the date of separation, by reference to fully and partially completed Construction Milestones stipulated in the Infraco Contract, as well as sums agreed to be paid in terms of MOV4. There is relatively little controversy in relation to this category;

(b) The value of the many disputed changes to the Infraco Works, by reference to work actually carried out by Infraco at the point of separation. Within this category are different elements which again appear in order of decreasing certainty – the most certain being those elements of change where both principle and quantum have been agreed, the least certain being those where there is a dispute in principle between the parties, and Infraco has significant claims for additional payment which require to be resolved.

(c) The entitlement of Infraco to an extension of time. In broad terms, it is considered that Infraco is likely to be successful in securing an extension of time which would take it to the point of separation.

(d) Of critical importance is the consequent additional cost caused by delay, the value of which is difficult to predict with any degree of certainty. What ought to be the case, however, is that Infraco ought not to be entitled to recover both preliminaries and additional cost caused by delay in relation to the same period, as that would lead to a double recovery.

(e) On the basis of the foregoing approach, Infraco would be entitled to recover preliminaries until 31 March 2011 in terms of Schedule part 5 of the Infraco Contract. From that point until 1 September 2011, Infraco would be entitled to recover preliminaries in relation to the Prioritised Works in terms of MOV4. Infraco ought not to be entitled to recover additional cost caused by delay during this same period, other than to the extent that resources have had to increase during.

That thickening of resources is addressed by percentage increases of 7.4% and 17.5% agreed between tie and Infraco to be paid on the value of change.

(f) Infraco was paid a mobilisation payment of £45.2m at the outset of the contract. The Infraco Contract is silent in relation to what is to happen to this money in the event of an early termination; there is some force to the proposition that some of this money falls to be returned to tie in this event. However, it is not straightforward to arrive at a formulation of the way in which this repayment should be calculated.

(g) If the ETN is to be delivered to York Place, another contractor will require to be engaged to complete that work once Infraco is removed from the equation. tie has produced an assessment of that figure.

(h) There are other components to tie/CEC's exposure, including payment to CAF, and the legal/internal costs associated with any dispute(s) about the extent of Infraco's entitlement.

1.11 In the event that the Infraco Contract remains in place (because the Settlement Agreement is not entered into for reasons other than those associated with funding), tie/CEC's exposure will encompass all those matters referred to in the foregoing paragraph, *plus* a number of other factors, including the following:

(a) Infraco claims in relation to change *etc* in relation to work which has not yet been carried out;

(b) The costs associated with Infraco completing the work to York Place under the Infraco Contract, with the existing risk profile, including any claims which arise in relation to that work;

(c) Assuming that the project is only to continue to York Place, Infraco may be entitled to recover the profit that it would have earned in relation to the omitted section from York Place to Newhaven.

1.12 If the Infraco Contract remains in place, it may be open to tie to seek to terminate the contract. Amongst other things, that will require tie to establish that an Infraco Default has occurred. If the termination is challenged by Infraco, that is likely to result in lengthy and complicated legal proceedings. If tie is ultimately unsuccessful in those proceedings, the parties would remain locked in to the Infraco Contract at the end of the proceedings.

1.13 At Appendix 1 of this report are spreadsheets which pull together the conclusions reached in this report on the basis of the figures which have been produced by tie in relation to the various options identified.

2 Key principles

2.1 This report addresses the principal options available to tie/CEC in connection with the future of the Edinburgh Tram Network, and the entitlement which Infraco might have for payment in connection with those options.

2.2 It was envisaged at Mar Hall, and reflected in MOV4, that the Settlement Agreement would deliver a tram network as far as York Place. In order properly to compare like with like, the options have been explored on a similar basis, namely delivery of a tram network as far as York Place – whether that be executed by Infraco, or by some other contractor. Accordingly, the costs that would be involved in another contractor completing the work as far as York Place have also been taken into account. The report does not consider any issues extraneous to Infraco's entitlement, or the costs of another contractor to complete as far as York Place[1].

2.3 Following the mediation which took place at Mar Hall in April 2011, agreement was reached in relation to the broad basis upon which Infraco might proceed to complete the ETN as far as York Place. It is envisaged that if that new basis is taken forward, it will be incorporated in the Settlement Agreement. Amongst other things, it is intended that the Settlement Agreement would sweep away the existing issues and disputes which divide the parties, re-basing the contractual and commercial relationship, as well as making provision for the network to be delivered as far as York Place.

2.4 If the Settlement Agreement is not entered into, the many issues which divide the parties remain to be resolved.

2.5 The approach to these matters which has been taken in this report is to arrive at the prudent approach that should be taken to Infraco's entitlement, and the other exposure which tie/CEC might have, in the event that the Settlement Agreement is not entered into. This is done in order to identify potential risk in relation to various building blocks that have been identified as the components of the various options which include the Settlement Agreement, as well as cancellation of the project. The options are outlined in section 3 of this report.

2.6 This approach does not involve a definitive view on the merits of each head of Infraco claim, nor advice on the relative prospects of success. That could only be achieved following detailed factual investigation, the obtaining of expert evidence where appropriate, and further legal analysis.

[1] For example, any cost consequences which arise from the options referred to in this report in relation to third party agreements have not been considered.

2.7 In order to identify the potential commercial implications of the building blocks referred to above, tie has been asked to produce a series of figures using the building blocks as a structure for doing so, and those figures have been referred to in this report. tie has also been given the opportunity to comment on the incorporation of its figures into this report. Where appropriate, commentary has been made in this report on the approach taken by tie; however, the figures have been assumed to have been correct for the purposes of this report.

2.8 In relation to the evaluation of change, in the absence of any independent third party verification of tie's figures, a mid point has been taken between the tie figure and the Infraco figure in order to take a prudent account of the risk to tie/CEC. It is likely that the figures advanced by Infraco are high, based on Infraco's most optimistic approach to what its entitlement might be. This approach is not based on any scientific or definitive prediction of the sums which Infraco might recover. That could only be achieved by the detailed factual, expert and legal analysis referred to above. Instead, it represents a notional reduction. However, it is understood from tie that in the cases where the value of tie Changes has been agreed with Infraco, it has been on an average of 50 – 55% of the sums initially set out by Infraco in their first formal Estimate.

2.9 In relation to a number of the key issues which have been examined, the position which Infraco will take is not known. In the absence of any insight into the position which Infraco will take, nor the figures which they are likely to adopt, it is difficult to forecast the commercial outcome between the parties. It is only when Infraco's position is set out by them with any particularity that a more definitive approach can be taken in relation to the merits of their position.

2.10 The figures which have been utilised for this analysis in no way represent the starting point that would be adopted in the context of any negotiations with Infraco, nor do they necessarily reflect the approach that would be taken in the context of any formal dispute resolution proceedings. The aim of utilising certain figures is to provide a context in which to examine a number of potential options in order to provide a basis of comparison between them.

3 Options considered in this report

3.1 Broadly, the options available can be categorised as (on the one hand) the Settlement Agreement, and (on the other) the options other than the Settlement Agreement.

3.2 The way in which these other options play out depends on the reasons for which the Settlement Agreement has not been entered into: if the Settlement Agreement is not entered into for reasons associated with funding, then the Infraco Contract automatically terminates. If the reason is something other than the lack of availability of funding, then the Infraco Contract remains in existence.

3.3 On page 9 of this report is a schematic representation of the various options, which can be summarised as follows:

3.4 **Settlement Agreement entered into**: parties reach consensus on, and enter into, an agreement which revises the existing Infraco Contract in such a way as to realign the existing risk profile, provide greater price certainty, sweep up all existing disputes, and deliver the project as far as York Place with a completed design to Newhaven and materials purchased via MOV4. Parties remain in discussion in relation to the Settlement Agreement.

3.5 **Settlement Agreement not entered into for reasons associated with funding**: if the Settlement Agreement is not entered into on or before 1 July 2011[2] because tie and/or CEC do not have sufficient funding to meet tie's obligations, the Infraco Contract will terminate automatically on 1 September 2011 on a "*no fault*" basis – in other words a separation. In that situation, Infraco would be entitled to recover payment for work carried out to date. Any claims already accrued (for example, claims for extensions of time associated with utilities) would require to be met. If the project was to be delivered to York Place, another contractor would require to be appointed to complete the outstanding work.

3.6 **Settlement Agreement not entered into for reasons other than funding**: if the Settlement Agreement is not entered into on or before 1 July 2011 for reasons other than the availability of funding, there would be two principal options:

(a) **Continue with the Infraco Contract under existing terms, omitting York Place to Newhaven**: under this option, work would proceed with Infraco under the existing Infraco Contract[3]. The potential exposure on the part of tie/CEC would include all the elements referred to above in relation to separation, as well as a number of other components, such as the entitlements that Infraco would have in

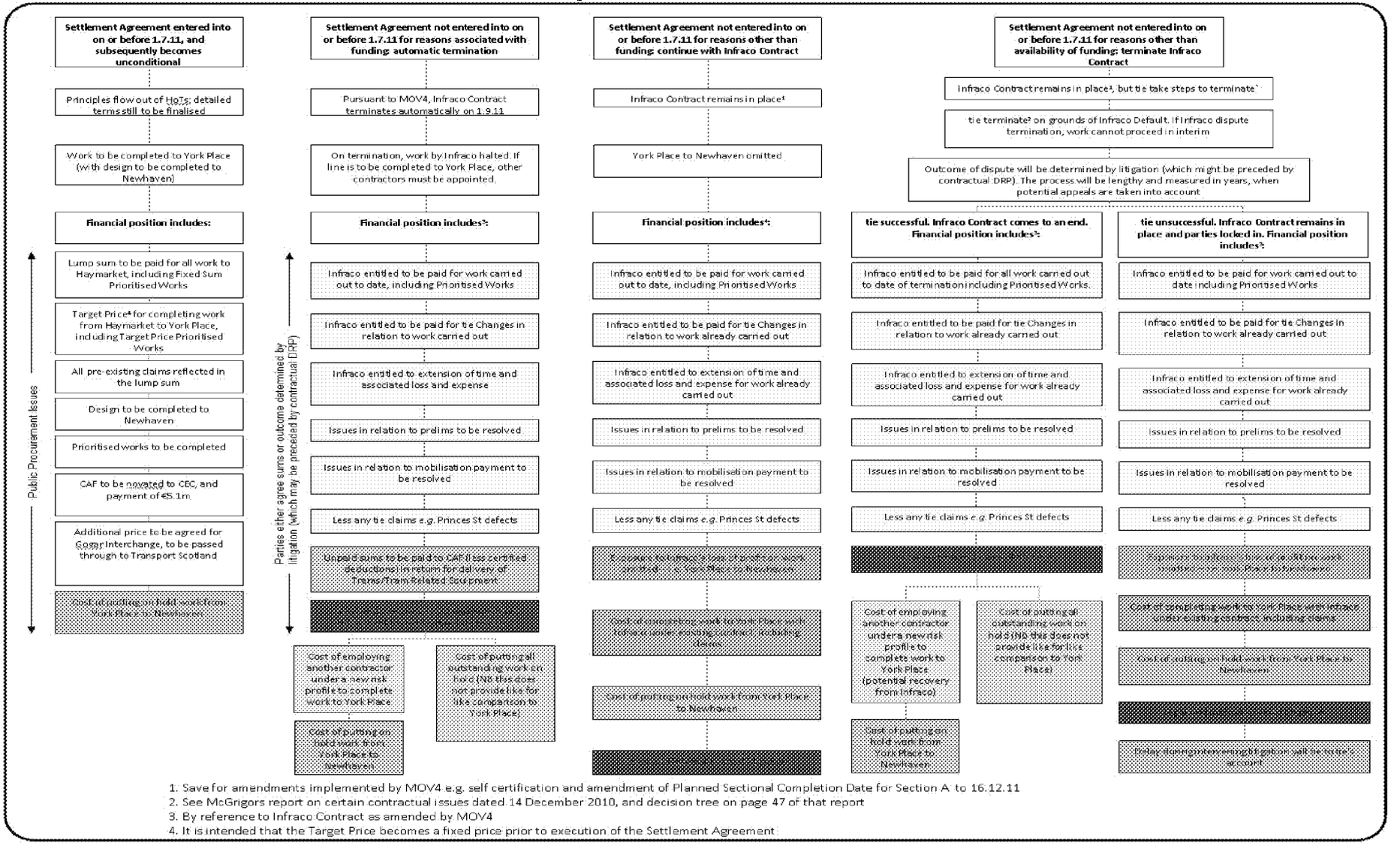
[2] This date could be extended by agreement between the parties
[3] Subject to some changes introduced by MOV4, considered in more detail in section 6 below

terms of the work still to be completed, and potential loss of profit on work from York Place to Newhaven.

(b) **Seek to terminate the Infraco Contract on grounds of Infraco Default**: the exposure of tie/CEC would potentially include the matters referred to above, as well the prospect that parties might remain locked in to the Infraco Contract after a lengthy dispute process if the termination is challenged by Infraco.

3.7 Each of these options is addressed in more detail in sections 4 to 18 below.

Options to York Place



1. Save for amendments implemented by MOV4 e.g. self certification and amendment of Planned Sectional Completion Date for Section A to 16.12.11
2. See McGrigors report on certain contractual issues dated 14 December 2010, and decision tree on page 47 of that report
3. By reference to Infraco Contract as amended by MOV4
4. It is intended that the Target Price becomes a fixed price prior to execution of the Settlement Agreement

4 The Settlement Agreement

4.1 [*The Settlement Agreement remains under negotiation.*]

4.2 Separate advice has been given in relation to public procurement issues.

5 Separation

5.1 The options available in the event that the Settlement Agreement is not entered into by the agreed deadline differ depending on the reasons why that agreement has not been entered into. This section of the report deals with the situation where the reason why the Settlement Agreement has not been entered into is associated with funding. In that event, there will be automatic termination, or separation.

5.2 In high level terms, the consequences of separation will include the following (addressed in more detail below):

1) Work by Infraco will halt on termination;

2) Infraco will be entitled to be paid for work carried out to date, including Prioritised Works;

3) Infraco will be entitled to be paid for tie Changes in relation to work carried out;

4) Infraco will be entitled to an extension of time in relation to delay for which tie bears contractual responsibility;

5) Infraco will be entitled to recover the additional cost caused by delay, subject to the issues which arise in relation to the treatment of preliminaries;

6) Issues in relation to mobilisation payments will require to be resolved;

7) Unpaid sums are to be paid to CAF (less certified deductions) in return for delivery of Trams and Tram Related Equipment;

8) Any claims which tie has against Infraco will require to be taken into account (for example, in relation to the defects at Princes Street);

9) Legal and internal costs in the event that the extent of Infraco's entitlement cannot be agreed;

10) The cost of employing another contractor to complete the work to York Place (and to put on hold the work from York Place to Newhaven);

11) Alternatively, the costs of putting the project on hold immediately following termination, without any further substantive work being carried out but taking into account legal and third party obligations.

6 The provisions of MOV4 in relation to separation

6.1 The provisions in relation to automatic termination, or separation, are to be found in MOV4. Clause 3.3 deals with the situation where:

"*If on or before 1 July 2011 the Parties have not entered into an MOV5 on an unconditional basis or on a conditional basis in either case because tie and/or CEC do not have sufficient funding to meet tie's obligations under the Infraco Contract…*"

6.2 If the factual situation is as envisaged by clause 3.3, then a number of consequences flow:

(a) The Infraco Contract automatically terminates on 1 September 2011. The consequences of this are addressed below;

(b) Infraco continues to carry out the Prioritised Works until 1 September 2011 – subject to tie having the option (before 2 July 2011) to confirm whether the Princes Street remedial works should proceed or not during the July – September 2011 period;

(c) Infraco does not carry out any further work other than the Prioritised Works;

(d) The three outstanding payments totalling £13m to be made in terms of clauses 8.1 to 8.3 still require to be made[4]. The payments of £27m and £9m provided for in clauses 6 and 7 have already been triggered.

Automatic termination

6.3 Clause 3.3.3 of MOV4 provides that the Infraco Contract will automatically terminate on 1 September 2011, and

"*…the Parties shall have no rights or obligations in respect of the future performance of the Infraco Works save as provided in Clause 94.6 of the Infraco Contract.*"

6.4 The automatic nature of this termination ought to mean that the provisions of the Infraco Contract that carry with them a risk of parties being "locked in" no longer have efficacy: there ought not to be any debate in relation to whether the Infraco Contract has been terminated, but only in relation to what the entitlements of the parties are once that termination has occurred.

[4] By 27 July 2011 and 24 August 2011 respectively, or in each when a Vesting Certificate has been produced by Siemens in relation to Materials and Equipment if that is later.

6.5 The difficulties associated with termination under the Infraco Contract (as opposed to automatic termination under MOV4) are addressed in section 20 of this report, and in the McGrigors LLP Report on Certain Issues Concerning Edinburgh Tram Project dated 14 December 2011.

6.6 Clause 94.6 of the Infraco Contract provides that certain obligations in the Infraco Contract survive termination. These include the following:

(a) Clause 67 – payments in respect of Applications for Milestone Payments;

(b) Clause 76 – required insurances;

(c) Clause 88 – termination or suspension for tie Default;

(d) Clause 90 – termination for Infraco Default;

(e) Clause 97 – Dispute Resolution Procedure.

6.7 Clause 3.3.3 of MOV4 provides that:

"*The Parties shall enter into discussions with a view to arriving at mutually acceptable terms to deal with the consequences of termination…*"

6.8 Save as agreed by these discussions, clause 3.3 provides that:

"*…such termination shall occur on a no fault basis and, no compensation shall be payable by either Party whether under contract, delict (including negligence), breach of (or compliance with) statutory duty, restitution or otherwise as a result of such termination of the Infraco Contract.*"

6.9 Taking these provisions together, it would appear that what is intended is that both parties will be entitled to recover entitlements which have accrued prior to the date of termination. These entitlements are dealt with in more detail below, but in summary:

(a) In Infraco's case, this will include an entitlement to be paid in accordance with the Infraco Contract for all work which has already been carried out (including the Prioritised Works), together with an entitlement to make recovery for all claims which have already arisen in respect of work already carried out (for example delays associated with utilities).

(b) In tie's case, this will include an entitlement in relation to defects in work already carried out. To the extent that there has been an overpayment in terms of the Infraco Contract, then this ought to be capable of being recovered.

(c) Certain issues arise in connection with the mobilisation payment made to Infraco, and in relation to preliminaries.

6.10 The entitlement of the parties ought not to include for any payments under the Infraco Contract which arise as a consequence of "fault": accordingly, any provisions of clause 88 (termination for tie Default) and clause 90 (termination for Infraco Default) which arise only as a consequence of the default of one or other of the parties ought not to apply[5], nor will any common law entitlement to damages for wrongful termination arise.

6.11 By way of example, clause 88.8.5 provides for Infraco to recover loss of profit in the event that the contract is terminated for tie Default[6]. There ought to be no entitlement on Infraco's part to recover loss of profit in the event of automatic termination.

6.12 On the same analysis, tie will not be entitled to make recovery of matters such as the "extra over" cost associated with engaging another contractor to complete the works which Infraco is no longer to carry out[7].

[5] Although see the comments below at section 12 in relation to the mobilisation payment
[6] Clause 88.8.5 is very difficult to interpret – it refers to loss of profit being "*calculated with reference to demobilisation costs*". See paragraph 10.8 of McGrigors Report on Certain Issues Concerning Edinburgh Tram Project dated 14 December 2010
[7] This arises from clause 90.14 of the Infraco Contract, subject to the cap on liability in clause 77.7. See section 9 of McGrigors' report of 14 December 2010

7 **Separation - Infraco's entitlement to be paid for work carried out (excluding change)**

7.1 The core of Infraco's entitlement to be paid for work carried out to date will consist of the Construction Milestones[8] which have been achieved by them pursuant to clause 67 and Schedule Part 5 of the Infraco Contract, which provide for payment of specified sums in the event that the Construction Milestones have been completed[9].

7.2 tie has approached this issue in two stages: the first is up to and including Certificate No. 42, which was the last Certificate issued under the Infraco Contract immediately prior to the mediation. The second is Certificate No. 43, which takes into account the payments which have fallen due for certification in terms of MOV4.

7.3 There are two components to this entitlement:

(a) Construction Milestones which have been completed;

(b) Construction Milestones which are only partially complete.

7.4 As at Certificate No.42, tie had certified the following sums in respect of completed Construction Milestones as having been completed:

BB	£17,178,733
Siemens	£3,420,545
	£20,599,278

7.5 In addition, milestones have been certified in respect of maintenance, trams and SDS as follows:

CAF	£46,996,608
Maintenance	£267,344
SDS	£6,032,000

[8] There are no values attached to the Critical Milestones in Schedule part 5, and they are therefore not relevant here

[9] As well as the exercise referred to in this report, further assessments have been carried out based on bills of quantities prepared by Cyril Sweett. These bills address all the work which has been carried out, and do not distinguish between work which was part of the original Infraco work scope, and that work which constitutes change. tie have valued the bills on the basis of the rates contained in schedule part 4, and Cyril Sweett have valued them on the basis of market rates, and it is understood that these two exercises produce outcomes which broadly correlate with each other (within a range of c. 5%). However, it is unlikely that this would be considered to be the correct approach. Firstly, the Infraco Contract contains a milestone mechanism, and there is no proper basis in the contract for abandoning that approach. Secondly, Schedule part 4 contains rates for valuing change. It is not intended to apply to work which was part of Infraco's original work scope.

£53,295,952

7.6 Accordingly, the total sum certified by tie in relation to these milestones is £73,895,230.

7.7 Infraco's position in relation to these milestones achieved as at Certificate No. 42 is that the sum of £75,717,171 should have been certified. It is understood from tie that the difference between tie and Infraco of £1.822m is principally accounted for by a dispute in relation to whether certain Construction Milestones have been completed by the relevant date or not. In the event of a dispute, this issue would require to be resolved by way of factual witness evidence, and possibly also evidence from an expert quantity surveyor.

7.8 For present purposes, the approach that has been adopted has been to take a mid point between tie and Infraco's disputed figures[10], as referred to at section 2 above. The disputed element is £1.822m. 50% of £1.822m is £0.911m. Accordingly, the revised total is £74.816m.

7.9 Further sums have been certified since Certificate No.42, namely the following:

MOV4 Certificate 1	£27,000,000
MOV4 Certificate 2	£9,000,000
Certificate No. 43	£6,160,000[11]
	£42,160,000

7.10 There appears to be a difference between the sums applied for by Infraco in relation to the foregoing figures, and the sums certified, of approximately £6.72m. Of this, it is understood from tie that £5.156m will not be pursued by Infraco, as Infraco does not seek to recover any sums beyond those provided for by MOV4 in relation to these certificates, its applications being produced in such as way as to demonstrate that it is entitled to *at least* the sums certified. On this basis, it would appear to be appropriate to use the certified sums in analysing Infraco's entitlement.

7.11 Of the remaining amount of approximately £1.57m, it is understood that this relates to a dispute in relation to the extent to which work has been completed by Infraco. On the assumption that Infraco ought to have completed the relevant work by 1 September 2011 (when automatic termination would occur), Infraco's figure has been utilised in full. Accordingly, the sum taken forward in respect of Certificate No. 43 is:

[10] It should be noted that this does not relate to a dispute in relation to value (as referred to in section 2 above, but in relation to progress. However, for consistency, the midway point has been adopted here as well.
[11] This includes an element of £1.694m in relation to preliminaries

Certificate No. 43	£6.160m
Less prelims element (included elsewhere)	(£1.694m)
	£4.466m
Plus disputed element as above	£1.567m
	£6.033m

7.12 If automatic termination occurs on 1 September 2011, the further sum of £13m will have fallen due for certification and payment in terms of MOV4.

7.13 Beyond this, MOV4 also provides for Infraco to be paid in relation to Prioritised Works; this entitlement arises from 31 March 2011 until 1 September 2011[12]. This payment is calculated by reference to Fixed Sum and Target Price Prioritised Works Milestones. These Milestones include an element for completed work, and an element in relation to preliminaries.

7.14 If Infraco does not complete the Milestones in relation to physical work, it ought not to be entitled to payment in respect of the relevant Milestone[13]. If it delays in carrying out the Prioritised Works, then the Certifier may make a reasonable assessment of the (Prioritised Works) preliminaries which are properly due to Infraco[14].

7.15 It is impossible to predict whether Infraco will proceed to complete this work as envisaged by MOV4; however, for present purposes, it would be prudent to assume that it will do so, and provide for the cost of making the relevant payments to Infraco.

7.16 tie assess the likely cost in this respect to be as follows:

Certificate 44: £2.010m – certified on 15 June 2011, and due to be paid on 29 June 2011;

Certificate Hg 3A: £4.334m – certified on 15 June 2011[15], and due to be paid on 29 June 2011;

Certificate 45 £1.965m – due to be certified 13 July 2011;

Certificate Hg 3B: £4.333m – due to be certified 10 August 2011;

Certificate 46: £2.395m – due to be certified 10 August 2011;

Certificate Hg 3C: £4.333m – due to be certified 7 September 2011;

[12] Clause 3.3.1 of MOV4
[13] Clause 9.2 of MOV4
[14] Clause 9.8 of MOV4
[15] Certificate 44 and Hg Certificate 3A have already been certified, and these sums therefore ought not to change. The subsequent certificates (45 and 3B) onwards are subject to certification by the Certifier

Certificate 47: £2.415m – due to be certified 7 September 2011;

Certificate 48: £ 2.065m - due to be Certified 5th October, so a 50% allowance made to 1 September 2011 of £1.033m.

Total: £22.817m

Of this total it is understood that £9.818m relates to the Prioritised Works themselves, over and above the sum of £13m to be certified in terms of MOV4 (see paragraph 7.12 above).

7.17 Turning next to partially completed Construction Milestones, tie's view is that the value of Construction Milestones commenced, but not completed, is £5,680,483 on the basis of calculations carried out by tie Project Managers and/or Quantity Surveyors. There is no figure available in relation to the view which Infraco might take in relation to the incomplete Construction Milestones. It is understood from tie that Cyril Sweett have assessed this incomplete work, based on Bills of Quantities which Cyril Sweett prepared, and their conclusions broadly coincide with those of tie.

7.18 Whilst work under the Infraco Contract remains ongoing, there is no provision for part payment to be made towards incomplete Milestones. However, the termination provisions contained in clauses 88 and 90 do appear to envisage that in the event that the Infraco Contract is terminated, payment will be made to Infraco on a basis which acknowledges the work which has actually been executed.

(a) Clause 88.8 addresses the consequences of a termination for tie Default, and provides that:

"*tie…shall pay the Infraco…the value of all work carried out prior to the date of termination and in addition:*

88.8.1 the amounts payable in respect of any preliminary items so far as the work or service comprised therein has been carried out or performed and a proper proportion of any such items have been partially carried out or performed."

(b) Clause 90.12 addresses the consequences of a termination for Infraco Default, and provides that:

"*…the Parties shall agree…*

90.12.1 the amount (if any) which has been reasonably earned and not yet paid pursuant to this Agreement by the Infraco in respect of work actually done by it under this Agreement."

7.19 For the reasons explained above, where automatic termination occurs in terms of MOV4, it does so on a "no fault" basis: arguably this means that none of the provisions in relation to tie and Infraco Default (clauses 88 and 90 respectively) will apply. However, it is evident that both 88.8 and 90.12 envisage that, upon termination (irrespective of whether that termination was triggered by tie or Infraco Default), an exercise will be carried out whereby the payment to which Infraco is entitled will be proportionate to the work actually executed by them. Accordingly, it would be prudent to proceed on the basis that Infraco will be entitled to recover the value of partially completed Milestones.

7.20 As referred to above, Infraco's assessment of what this figure should be is not available, and no independent cross check has been carried out in relation to tie's assessment. In the absence of other information, it is appropriate to use tie's figure with regard to Infraco's potential entitlement.

Summary in relation to work carried out

7.21 On the basis of the foregoing, the sums which ought prudently to be taken into account in relation to work carried out by Infraco, which fall to be paid to them in terms of the Infraco Contract and MOV4 are as follows:

Completed Milestones Certificate No. 42[16]	£74,816,000
Sums certified MOV4	£36,000,000
Certificate No. 43	£6,033,000
Sums to be certified per MOV4	£13,000,000
Prioritised Works	£9,818,000
Partially completed Construction Milestones[17]	£5,680,483
	£145,347,483

7.22 These sums exclude any elements in relation to change, extension of time, additional cost caused by delay, preliminaries, mobilisation and so on, which are dealt with below.

[16] Infraco claim figure in relation to Construction Milestones, trams, SDS and maintenance
[17] tie assessment

8 Separation - change

8.1 There are a number of issues dividing the parties which arise out of Infraco's claims in relation to change. Prior to the mediation, Infraco claimed to be entitled to cease work as a consequence of its interpretation of a number of key contractual provisions, all of which interrelated to produce the situation where work had all but ground to a halt. These include:

(a) The allocation of risk, in terms of time and money, in relation to the development of Design, and in particular the proper interpretation of Pricing Assumption No. 1. This in turn leads to Infraco's contention that it is entitled to refuse to progress work which is the subject matter of a dispute[18] in relation to Pricing Assumption No.1;

(b) The interaction of Clauses 65 (Compensation Events) and 80 (tie Changes) of the Infraco Contract;

(c) Infraco's claim to be entitled to an extension of time and associated additional cost caused by delay in relation to MUDFA Works.

8.2 Upon separation, Infraco will be entitled to make recovery for tie Changes which it has carried out. To the extent Infraco has issued an INTC, the subject matter of which has not yet been commenced, Infraco ought not to be entitled to any payment therefor, save potentially in relation to the delaying consequences arising from the requirements set out in clause 80 in respect of each INTC. In other words, where an INTC has not been carried out prior to separation there may nevertheless be delay consequences pre separation which arise through the clause 80 mechanism for dealing with INTCs. Extension of time and Infraco's entitlement to additional cost caused by delay are addressed in section 9 below.

8.3 For the purposes of this report, INTCs have been categorised as follows:

(a) **Agreed changes**: where tie and Infraco have reached agreement, both in principle and in relation to quantum, and the work has been carried out, then Infraco will be entitled to recover the sum which has been agreed upon separation. In some cases, this sum will already have been certified and paid. Once agreement has been reached in the way described (whether through the regular administration of the Infraco Contract, or through formal or informal mediation), neither party ought to be entitled to have that tie Change opened up again.

[18] Or an unagreed Estimate

(b) **INTCs determined through adjudication**: where an adjudicator has issued a decision in relation to a tie Change, that decision will be binding on the parties unless and until the dispute is finally determined by legal proceedings or by agreement between the parties[19]. Accordingly, the outcome of the adjudications could be overturned at some later stage. In practical terms, however, it is prudent to use the decisions of the adjudicators as a starting point for assessing the risk associated with the subject matter of those disputes.

(c) **INTCs agreed in principle, but where there is a dispute in quantum**: in certain cases, tie accepts that a tie Change has occurred, but the difference between the parties lies in how that difference has been evaluated.

(d) **INTCs where there is a dispute in principle, as well as in quantum**: in these cases, tie will dispute that a tie Change has occurred. A number of these INTCs relate to the issue of design development in terms of Pricing Assumption No.1: where Infraco has refused to execute the purported change until that issue has been resolved, then the work in question will not have been commenced, and there ought not to be any recovery on Infraco's part, save in relation to the potential relaying consequences referred to at paragraph 8.2 above. Separately, tie has produced a secondary figure which is its assessment of the proper value of the work in question, should it be determined or agreed that a tie Change has, in fact, occurred.

8.4 tie has been asked to produce figures in relation to each of these categories, and each of these is addressed in turn below.

Agreed INTCs

8.5 These have been divided by tie into two categories:

(a) The first category is where there is no dispute between tie and Infraco in relation to principle, quantum or progress. The INTC has been agreed in full, work carried out in full, certified and paid. tie's figure in relation to this category is £5,295,235. On the basis that this represents those INTCs which have been agreed in full, certified and paid, there ought not to be any controversy in relation to this figure.

(b) The second category is those INTCs where the INTC has been agreed, but there is a dispute in relation to the extent to which the work in question has been completed. To the extent that there is agreement, certification has been made, and

[19] Clause 51 of Schedule Part 9 of the Infraco Contract

sums paid over – however, in the interim, there is a dispute about an element of progress. If work were to continue, the subject matter of the INTC would eventually be completed, and in that event, tie and Infraco ought to be in agreement in relation to the eventual payment to be certified and paid. tie has assessed this as follows:

Infraco value	£5,079,449
tie value	£4,127,237
Difference	£952,121

For the reasons explained above, in the absence of any independent verification of tie's figures, the prudent approach would be to use Infraco's figures for the purposes of this analysis. As referred to at section 2 above, a mid point between tie and Infraco's figures has been utilised[20].

INTCs determined through adjudication

8.6 tie's figures report in relation to this category are as follows:

Sums applied for by Infraco	£3,087,330
Certified by tie	£2,839,494
Difference	£247,836

8.7 It is understood from tie that there is a difference between the parties in relation to the extent to which work has been completed pursuant to the adjudication decisions, and that accounts for the figure of c. £250k.

8.8 For present purposes, the prudent starting point is to take the values unlocked by the adjudicator's decisions into the financial assessment based on Infraco's approach. As referred to at section 2 above, a midway point has then been taken between tie and Infraco's figures.

INTCs where there is a dispute on quantum

8.9 tie has carried out an assessment of INTCs where there is no dispute in relation to the principle that a tie Change has occurred, but there is a dispute in relation to the valuation of that tie Change.

8.10 tie's assessment of work carried out in this category is as follows:

[20] It should be noted that this does not relate to a dispute in relation to value (as referred to at section 2 above, but in relation to progress. However, for consistency, the midway point has been adopted here as well.

Infraco value	£3,119,629
tie value	£1,588,588
Difference	£1,531,041

8.11 There is no independent analysis of tie's figures available; in the event of a dispute in relation to this issue, it is likely that factual and expert quantity surveying evidence would be required to determine the correct value. For present purposes, as referred to at section 2 above, a mid point between tie and Infraco's figures has been utilised.

8.12 In addition, there is an issue between the parties in relation to the uplift payable to Infraco in relation to SDS: the percentage uplift to be applied is not in dispute. What is in dispute is the underlying value of the SDS account to which that percentage ought to be applied. There is no information available that would enable an assessment to be made in relation to how this account should be treated; accordingly, a mid point between tie and Infraco's figures has been adopted as referred to at section 2 above.

INTCs where there is a dispute in principle

8.13 There are a number of INTCs in relation to which tie dispute (in full or in part) that a tie Change has occurred. In those cases, there is also a dispute on quantum, in the event that tie is unsuccessful in its primary argument.

8.14 tie has been requested to approach its categorisation of these INTCs by reference to the underlying basis for the dispute. There are three principal categories in this respect:

(a) Design development/misalignment;

(b) Issues in relation to clause 22, and the interaction of clauses 65 and 80;

(c) Miscellaneous changes.

Each of these is dealt with in turn below.

Design development/Pricing Assumption No.1 and misalignment

8.15 Infraco claims to be entitled to recover the cost and time consequences associated with changes in the design between BDDI and IFC as Notified Departures. That claim is based on a literal interpretation of the wording in Pricing Assumption No.1, and in particular that tie bears the risk of all changes of "*design principle, shape and form and outline specification*". These words on the face of it appear to narrow substantially the scope or content of what

would otherwise form part of normal design development, for which Infraco would bear the risk.

8.16 There are two categories of design change where it would produce an irrational or absurd result if Infraco were to be entitled to recover cost and time:

(a) Where a change is driven by Infraco, for example to improve the buildability of the project;

(b) Where something is required by the Employer's Requirements, but not shown on the BDDI.

8.17 Beyond these categories, there are difficulties with an interpretation that leads to the conclusion that Infraco bears the risk of all design development other than substantial or material changes.

8.18 The legal issues involved in this dispute are set out in Appendix 3 of this report; despite a number of adjudications between the parties in relation to specific INTCs and structures, no determinations have been issued which bind the parties in relation to the proper interpretation to be given to the relevant provisions of the Infraco Contract.

8.19 For the reasons explained in the discussion at Appendix 3 of this report, the issue is a difficult one: Infraco's argument is the more straightforward, since it proceeds on a literal interpretation of the words which are used in the Infraco Contract. tie is undoubtedly confronted with the more difficult argument.

8.20 Even if it is the case that tie's legal interpretation is upheld, this then requires the exercise of expert engineering judgement on the facts of each INTC. That exercise has not been undertaken in relation to each of the INTCs; however, at the highest level, even on tie's interpretation, there are likely to be some INTCs in this category for which tie bears the risk.

8.21 tie has carried out an assessment of the value of each of the relevant INTCs in relation to work which has already been carried out, as follows:

Pricing Assumption No.1

Infraco value:	£2,421,905
tie value:	£60,865
Difference	£2,361,040

Misalignment

Infraco value:	£848,424

tie value:	£255,287
Difference	£593,137

8.22 In some cases, tie has assessed a value against an INTC even where it considers that there has been no tie Change. It is understood that this is because the INTC in question covers some elements which are accepted to be a tie Change, and others which are not.

8.23 tie has also produced an alternative figure in each case which evaluates the INTC in question on the assumption that Infraco is correct in principle to assert that there has been a tie Change, but tie takes issue with the quantum of Infraco's figure. This would reduce the value of Infraco's claim to £1,259,249 in relation to Pricing Assumption No.1, and £410,322 in relation to misalignment.

8.24 On the basis of the comments above in relation to the relative prospects of success of the competing arguments, it can be seen that it would be prudent to proceed, for present purposes, on the basis that Infraco will be entitled to make recovery in relation to these INTCs. There is no independent verification of Infraco's alternative assessment on quantum, and accordingly, as referred to at section 2 above, a mid way point has been taken between tie and Infraco's figures.

Clause 22/65

8.25 Infraco has chosen to present a number of claims which, it says, constitute *Change* as properly defined under the Contract. In order to do so, Infraco has submitted an INTC in relation to a specific set of facts which, it suggests, is a departure form the original scope of Works and as such entitles it to an amendment to the CWP.

8.26 Assuming that Infraco's interpretation of an issue apparently affecting the works is correct, then that matter may well constitute a tie Change, and Infraco is entitled to submit an Estimate requiring more time and money in relation to the issue. It is then incumbent upon tie to assess that Estimate and, until such time as agreement is reached (unless tie serves a Notice under clause 80.15 requiring the "changed" works to be carried out), Infraco may cease work.

8.27 This has proved an effective tactic for Infraco, by which it has placed undue pressure upon tie to settle claims; however, tie has sought to question whether Infraco's approach is correct in contract. It is considered that that there are grounds to suggest that Infraco's approach is flawed, and that the issues being complained of properly constitute Compensation Events and, as such, require Infraco to comply with a number of onerous

contractual provisions not least of which are the numerous conditions precedent to any entitlement.

8.28 In the main, on encountering issues relating to ground conditions (which are governed by clause 22), Infraco has failed to comply with the time limits set out in Clause 65 of the Infraco Contract. However, Infraco has sought to avoid the provisions of Clause 65 and has argued that the issue relates to the Pricing Assumptions[21] and, as such, the issue complained of constitutes a Change.

8.29 There are two main reasons why Infraco has sought to adopt this contractual interpretation; first it obviates the need to comply with the conditions precedent which may well be fatal to its claim. Second; the resultant disagreement allows Infraco to suspend the works.

8.30 It is considered that there are strong grounds to believe that the issues being complained of should be more properly considered to be Compensation Events rather than Changes as they constitute the same (unchanged) scope being undertaken in differing circumstances, as opposed to different work being undertaken in normal circumstances.

8.31 In short, having obtained Senior Counsel's Opinion on the matter it is considered that the correct interpretation of clause 80 is that it relates to what are more traditionally thought of as variations (changes of scope), whereas clause 22.5 and clause 60 relate to what would normally be considered to be delaying events under a more traditional construction contract (that is the same scope undertaken in changed circumstances).

8.32 tie has assessed the value of these INTCs as no more than £229k, whereas Infraco believes the value to be in the region of £640k. tie, on the basis that its arguments as to principle fall away, but the issue of quantum remained to be assessed or challenged, has stated that the likely value of the changes would be £435k.

8.33 There are three "gates" which Infraco has to get through:

(a) Firstly, Infraco has to either succeed with its contention that it can claim under clause 80 or alternatively that it is still open for Infraco to bring a claim under clause 65;

(b) Secondly, Infraco would have to establish its entitlement under clause 80; and

(c) Thirdly, Infraco would have to establish the quantum which it contends for.

[21] At Schedule part 4, clause 3.4.1

8.34 For the reasons explained above, the prudent approach would be to take a comparison between tie's figures in relation to quantum (assuming that the point of principle is lost) and Infraco's figures, and adopt the mid point between these two figures in the analysis as referred to at section 2 above.

Miscellaneous INTCs

8.35 Beyond the categories identified above, there are further INTCs which have been grouped together in a miscellaneous category. The issues raised by these INTCs are well rehearsed between the parties and typically relate to matters of expert engineering opinion (such as the necessity to undertake works in a certain way, or design solutions to problems encountered at site). There are, for example, arguments as to which party takes the risk for contamination or ground conditions at various locations.

8.36 It is understood from tie that the two largest INTCs which fall into this category are as follows:

(a) A dispute in relation to the Principal Contractor's Licence of approximately £1.089m. BB has sought reimbursement of the costs of procuring and maintaining a licence for working in or adjacent to Network Rail property. tie does not consider this to be a change. In any event, tie considers that BB ought to be able to operate under a licence already held by Siemens.

(b) A dispute in relation to Pricing Assumption 12 of approximately £1.421m.

8.37 The report produced by tie has indicated a range of potential liabilities arising from the various INTCs (which total nearly 200 in number). Infraco has valued those apparent changes in the sum of £3.471m whereas, on a point of principle, tie believes the value of the changes to be no more than £499k.

8.38 tie's valuation is assessed on the basis that the principle relied upon to defeat Infraco's claim is sound and therefore the remaining value (£499k) simply reflects those elements of the various Estimates which are agreed (with the bulk of the figure falling away as a result of the principle.

8.39 In order to take a prudent account of the possible risk in relation to these items, tie has been asked to provide an assessment of the likely value of these INTCs on the assumption that the point of principle in each case is lost, and the subject matter falls to be treated as a tie Change. On this basis, tie has assessed the likely exposure at £2.305m.

8.40 For the reasons explained above, the prudent approach would be to take a comparison between tie's figures in relation to quantum (assuming that the point of principle is lost) and Infraco's figures, and adopt the mid point between these two figures in the analysis as referred to at section 2 above.

9 **Separation - extension of time**

9.1 There is no controversy that the Infraco Works have been delayed; as at the original scheduled Completion Date of 11 February 2011, the overall project was substantially in delay. Some of the reasons for those delays have been rehearsed between the parties at length and Infraco has made a number of claims for extensions of time.

9.2 To date, Infraco has sought the following extensions of time through the formal mechanism under the Infraco Contract:

(a) EOT 1 (INTC 1);

(b) MUDFA rev 8 (INTC 429);

(c) MUDFA 2 (INTC 536);

(d) A claim in respect of the Depot and associated works.

9.3 In addition, further claims exist and have either been intimated as part of the INTC process, or are matters for which tie has a reasonable contemplation that a claim will be made in due course. Claims under these heads can be considered as:

(a) Claims arising in relation to the operation of the change and Estimate mechanism in clause 80 of the Infraco Contract;

(b) Various "sweeper" claims for which outline details have been provided in correspondence;

(c) A potential claim touching on the "standstill" period following the Mar Hall mediation in which the parties have been negotiating the MOV4 and the Settlement Agreement, during which all works other than the Prioritised Works have been placed on hold.

9.4 With regard to the first claim – EOT 1 (or INTC 1) - this related to a misalignment between the SDS design programme and the construction programme which occurred during the contract tender and execution stage. The parties were able to resolve their differences and agree an extension of 7.6 weeks to the contract programme.

9.5 The second claim (MUDFA rev 8/INTC 429) was far more contentious and involved the parties referring the consequent dispute to adjudication. The result of the referral was that

Infraco's claim, as to Section A, was set at an extension of 154 days but the remaining three Sections remained unamended[22].

9.6 The next category of claims submitted by Infraco relate to the failure to divert Utilities ahead of the construction works (INTC 536) and various alleged delaying changes at the Depot works. As to the first of these claims, it is considered that whilst tie may have good procedural defences to the claims and whilst Infraco's case presently may be incorrectly pleaded, it remains the case that Infraco is likely to receive a substantial extension of time.

9.7 Despite the size of this claim, Infraco has submitted little supporting evidence which has meant that tie has only been able to undertake narrow (although detailed) interrogation. That exercise indicates that the grounds relied upon by Infraco may be misconceived but it is accepted that a substantial extension (on other grounds) may well be due.

9.8 The second claim in this category was submitted immediately prior to the Mar Hall mediation, and seeks an extension of time in connection with the Depot.

9.9 Over and above the first two categories of claim there are the three remaining claims as set out above. In broad terms, these claims can be considered to be sweep-up claims extending to the present hiatus in construction work (as a result of MOV 4) and general claims relating to INTCs and any other, at present unknown, heads of claim. It is almost impossible to gainsay the likely nature of these claims and even harder to predict any financial outcome.

9.10 Pulling together the threads of the foregoing, it can be concluded that it would be prudent to assume that Infraco are likely to be entitled to an extension of time that would cover at least the period to the point at which separation occurs. Infraco has submitted substantial claims in relation to delays caused by utilities, and beyond that are likely to advance further claims in relation to delays associated with the operation of the change mechanism in clause 80.

9.11 Whilst there are arguments available to tie in relation to issues of causation, conditions precedent, and so on, it is more likely than not that such an extension would be granted.

9.12 The critical issue is then whether Infraco would be entitled to make any financial recovery in relation to additional costs sustained by them which have been caused by the delay.

9.13 A key principle in this context is that Infraco ought not to be entitled to make any double recovery in relation to costs incurred by it as a result of any prolongation to the Infraco

[22] Although Infraco attempted to obtain a further 28 days extension to Section B arguing a logic link between sections, the Adjudicator refused to amend his decision

Works – both in terms of the provisions of clause 121 of the Infraco Contract, and in terms of general legal principles.

9.14 In particular:

(a) There ought not to be any overlap between Infraco's entitlement to be paid for Preliminaries in terms of Schedule part 5, and any entitlement to additional cost caused by delay. This issue is addressed in more detail below;

(b) There ought not to be any overlap between Infraco's entitlement to be paid for preliminaries in relation to Prioritised Works pursuant to MOV4.

9.15 The following section 10 of this report addresses the treatment of preliminaries in the Infraco Contract and MOV4. Section 11 addresses the questions of how the contractual principles in relation to both preliminaries and additional cost caused by delay interact in order to arrive at the appropriate financial position to be reached for the purposes of this report.

10 **Separation - preliminaries**

10.1 One of the issues which has divided tie and Infraco is the question of whether preliminaries fall to be paid on a purely time related basis, or whether Infraco are required to demonstrate progress and expenditure in order to release the payment of preliminaries.

10.2 Until April 2010, payment was certified by tie to Infraco on a time related basis, with a sum equivalent to the value of each item for preliminaries shown in Schedule part 5 being released on a 4 weekly basis, without any application having been made by Infraco. As at April 2010, the sum of £35.367m had been certified in this way, representing approximately 75% of the overall total for preliminaries. tie then stopped making any further certification or payment of preliminaries, in the absence of information that would demonstrate the actual costs that had been incurred by Infraco.

10.3 Infraco commenced an adjudication in November 2010, seeking a decision, in principle, in relation to the way in which preliminaries ought to be treated under the Infraco Contract.

10.4 The central issue in this adjudication, before Lord Dervaird, was whether preliminaries are to be treated as a Construction Milestone within the meaning of the Infraco Contract.

10.5 Clause 66.2 of the Infraco Contract states:

"*Any application for payment of sums due in respect of Construction Milestones, Critical Milestones and Tram Milestones and any payment to be made in respect of Construction Milestones, Critical Milestones and Tram Milestones shall be made in accordance with the procedure set out in Clause 67 (Payment in Respect of Applications for Milestone Payments)*."

10.6 If preliminaries fall to be treated as Construction Milestone, then payment in relation to the preliminaries would only fall to be made if Infraco made application for them in the same way as any Construction Milestones: prior to the adjudication, Infraco had not applied for preliminaries, which (until April 2010) had been paid to them irrespective of the absence of any application.

10.7 "Milestone" is defined in the Infraco Contract as "*a Construction Milestone, a Critical Milestone, a Mobilisation Milestone, a Tram Milestone and/or a Tram Maintenance Mobilisation Milestone.*"

10.8 "Construction Milestone" is in turn defined as "*any milestone…which has been identified and defined as a construction milestone in of* [sic] *Schedule Part 5 (Milestone Payment).*"

Schedule part 5 does not specifically define any particular items as construction milestones, but is headed "*Milestone Payment Schedule.*"

10.9 Lord Dervaird held that preliminaries are not a Construction or Critical Milestone but "*are simply a time based cost*". Because that is the case, preliminaries do not have to be applied for in accordance with the procedure in clause 66.2 referred to above.

10.10 This then leads to the question of how prelims are to be treated in terms of the payment mechanism in the Infraco Contract. Clause 67.4 provides that:

"*Each Application for Milestone Payment and/or an application for payment for any other fees, costs and/or expenses in respect of Permitted Variations* ***or other costs or expenses which have been expressly approved by tie and/or to which the Infraco is entitled in accordance with this Agreement*** *shall:*

67.4.1 *set out the Milestones and Critical Milestones progressed in that Reporting period and the Milestone Payment due in respect of the same;*

67.4.2 *set out any other agreed adjustments pursuant to a Permitted Variation; and*

67.4.3 *any other sums due to or from the Infraco under and/or arising out of this Agreement in accordance with its terms,*

(together with reasonable supporting documentation establishing the basis of such sums being claimed)." [emphasis added]

10.11 If the preliminaries are not to be treated as a Construction Milestone (and they are clearly not a Permitted Variation), then it appears that the only place where provision is made for them to be paid is as part of the "*other costs and expenses*" referred to in clause 67.4.

10.12 It is for this reason that Lord Dervaird concluded that Infraco must provide "*reasonable supporting documentation establishing the basis of such sums being claimed*" before its entitlement to payment arises.

10.13 It is not easy to reconcile these two aspects of the Infraco Contract. Lord Dervaird was asked by Infraco to clarify this point after the adjudication; he responded in an e-mail which does not form part of the binding elements of his decision. That non-binding e-mail states: "*As I have determined that Preliminaries are a time based cost, it appears to me that the documents required to establish the basis of sums…will be those necessary to establish the particular period or periods for which the sums are claimed, together with those which determine the rate or rates payable in relation to the period or periods. Those rates will it*

appears to me generally be found by reference to the appropriate part or parts of Schedule 5…It is possible that consideration may also have to be given to the items referred to as Preliminaries in Schedule Part 4 page 39 headed Method Related Charges (some of which are described as fixed, and others as Time Related), but no issue was raised before me in respect of those items…"

10.14 Infraco has interpreted the decision as meaning that it has to do no more than produce information which confirms the period for which it is seeking payment of preliminaries, linking this to the relevant value shown for those periods in schedule part 5. tie has interpreted the decision to mean that Infraco will be entitled to recover only preliminaries linked to progress, and which have therefore actually been expended.

10.15 On balance, it is considered that a court would be more likely to follow the straightforward approach taken by Lord Dervaird. This would entitle Infraco to recover the preliminaries, subject to the provision of vouching which addresses the passage of time, thereby yielding the sums set out in Schedule part 5.

10.16 However, in the event that this interpretation is upheld, it would mean that Infraco would continue to be entitled to recover preliminaries, which would recompense it for its costs of being on site.

10.17 Schedule part 5 provides for preliminaries to be paid in this way until 16 July 2011. However, MOV4 provides that Infraco will be entitled to recover preliminaries in relation to the Prioritised Works for the period between 31 March 2011 and 1 September 2011 in the event of automatic termination.

10.18 In terms of clause 9.6 of MOV4, Preliminaries are "*a time based payment and shall be certified for payment once the relevant time period has elapsed without the need for further valuation or substantiation*". However, in the event that Infraco do not progress the Prioritised Works in accordance with the Prioritised Works Programme as a result of matters which are not tie's responsibility, the Certifier is to make a reasonable assessment of the preliminaries properly due to Infraco.

10.19 Infraco ought not to be entitled to recover both Schedule 5 preliminaries and MOV4 Prioritised Works preliminaries for the same period of time: the Prioritised Works preliminaries cover the period between 31 March and 1 September 2011 when no work other than the Prioritised Works are being carried out[23].

[23] Clause 3.2 of MOV4

10.20 This can be seen from the diagram on page 36 of this report, where the overlapping periods can be seen shown in blue and red.

10.21 Furthermore, Infraco ought to not to be entitled to make a second, double, recovery for this same period by way of additional cost caused by delay (the green line shown on the diagram): if Infraco is being delayed during the period up to 1 September 2011, it is making recovery either through the Schedule part 5 preliminaries or the Prioritised Works preliminaries.

10.22 To the extent that Infraco has had to increase, or thicken, its resources as a result of the tie Changes for which it would be entitled to an extension of time, that increase is already recompensed by reference to the rates paid for change. Schedule part 4 contains a rate of 7.4% to be added to the value of change in relation to Infraco's preliminaries[24]. Furthermore, the parties agreed a variation to the Infraco Contract on 3 June 2009, in terms of which an amendment was made to Appendix G in Schedule part 4 which provided that:

"*Further, 17.5% to be added to the Actual Cost to cover any other Preliminaries (in addition to the Consortium Preliminaries) with regard to any tie Change associated with Civil Engineering Works, provided that this calculation shall in no case apply to Systems and Trackworks or claims for other Preliminaries in relation to prolongations costs arising from extensions of time or delay*".

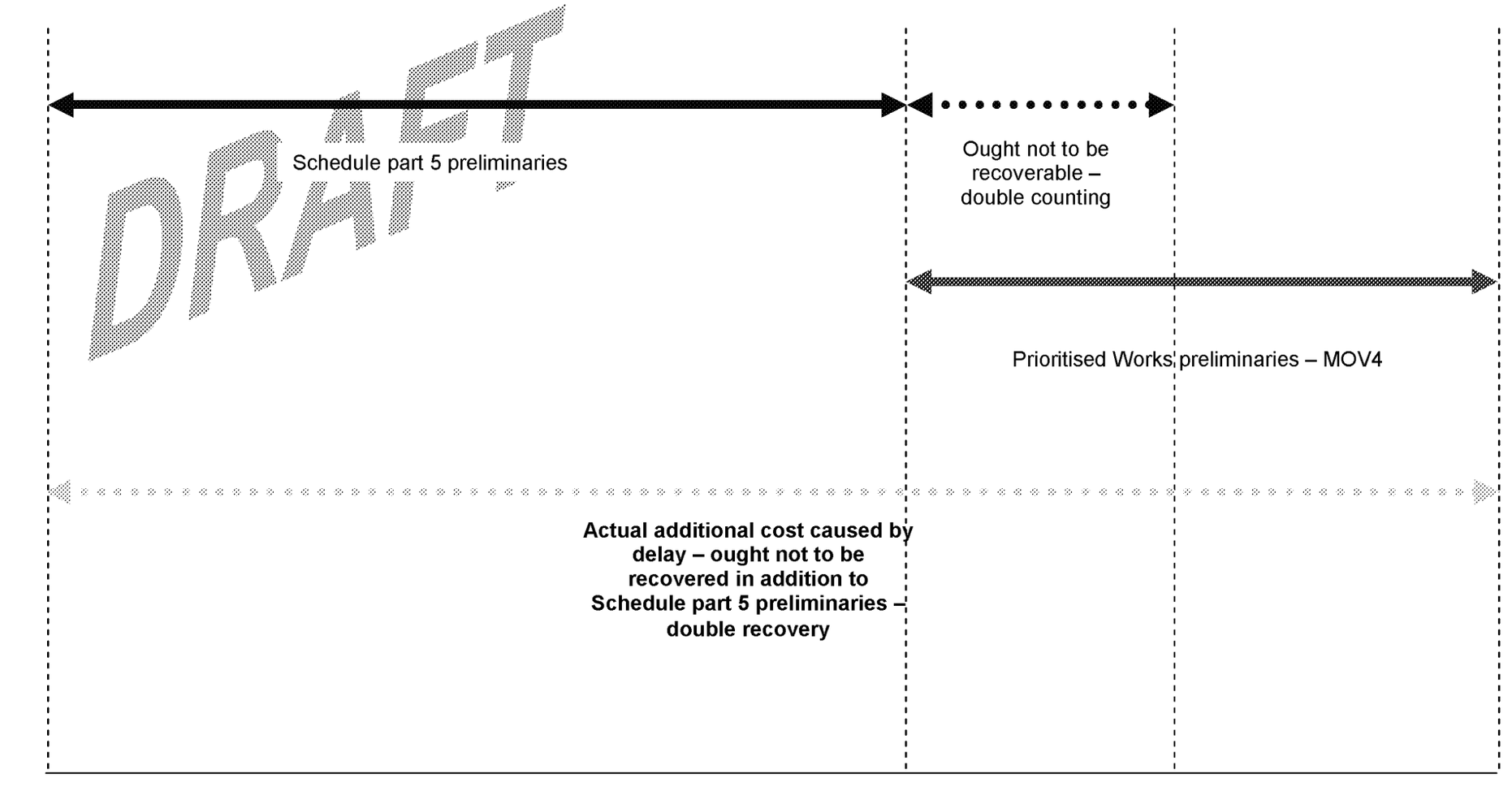
10.23 Accordingly, to the extent that the Infraco resources originally contemplated have been delayed on site up to 1 September 2011, this ought to be paid for as a function of preliminaries (Schedule part 5 and Prioritised Works). To the extent that those resources have had to be increased during that same period, this ought to be paid for as a function of the agreed rates for change.

10.24 Once Infraco has passed the point where preliminaries are no longer being paid through Schedule part 5 or through MOV4, then Infraco's entitlement to make recovery of its actual additional cost caused by delay will be activated (subject to it establishing an underlying entitlement for such recovery). That will only apply after 1 September 2011, and will therefore only be relevant if the Infraco Contract survives beyond that point (either because the Settlement Agreement is entered into, or because it has not been entered into for reasons not associated with funding).

10.25 The following section 11 deals with the financial consequences of the foregoing analysis.

[24] Clause 1.3 of Appendix G to Schedule part 4

Preliminaries and additional cost caused by delay



11 **Financial consequences of analysis in relation to additional cost caused by delay and preliminaries**

11.1 For the reasons explained in the foregoing section, it is considered that Infraco ought not to be entitled to recover both preliminaries and additional cost caused by delay in relation to the same period.

11.2 *Either* preliminaries are solely a function of time (in which case no additional cost caused by delay falls to be recovered during the period for which preliminaries are being paid), *or* entitlement to preliminaries requires to be vouched by reference to actual progress and expenditure, in which case, Infraco will also be entitled to make a recovery for its additional cost caused by delay.

11.3 The following section addresses what the entitlement of Infraco might be under each of these alternatives, and then sets out some conclusion in relation to the approach which ought to be taken for present purposes.

Additional cost

11.4 As referred to at section 9 above, the parties agreed an extension of 7.6 weeks in relation to EOT 1. The additional cost flowing from this extension of time was agreed at £3.542m, but this sum has not yet been paid because tie do not consider it to have fallen due – the parties still being within the period covered by Schedule part 5 preliminaries. Furthermore, only £2.8m of the total has yet been claimed by Infraco

11.5 In relation to second tranche of extension of time (MUDFA rev 8 / INTC 429), the additional cost connected with the extension of 154 days awarded by Robert Howie at adjudication has been partly agreed. tie has agreed payments of £210,715 and €785,797[25] respectively with Siemens and CAF. These sums have not yet been paid because tie does not consider that they have yet fallen due (as referred to in the previous paragraph). BB has claimed the sum of £565,455, but this figure is disputed by tie.

11.6 Infraco seek payment of £39.306m (BB and Siemens) and €4.971m (CAF) in relation to the extension of time sought in INTC 536 (which also relates to Utilities). For consistency, these sums have been converted to a total sterling amount of £43.670m. This figure is disputed by tie.

11.7 The final claim which has actually been submitted is that produced by Infraco immediately prior to the mediation in relation to the Depot. This seeks payment of the sum of £20.08m.

[25] In order to produce a consistent value, this report will amalgamate the costs sought by Bilfinger Berger and Siemens (in sterling) with costs sought by CAF (in Euros) into sterling utilising, an exchange rate of £1.00 = €1.139

11.8 The total of Infraco's claims as submitted, or agreed (aggregating 11.4 to 11.7), to date is approximately £68.7m. It remains open to Infraco to revisit the claims which they have submitted but which have not yet been agreed. For example, in the context of litigation, they might seek to change the approach which they have adopted. Furthermore, the figure of £68.7m does not take into account any claims yet to be made by Infraco, for example in relation to the operation of the change mechanism in clause 80.

11.9 tie's assessment of Infraco's entitlement to additional cost caused by delay on the basis of the foregoing claims for extensions of time amounts to £20.244m. However, this represents tie's view in relation to additional cost, on the basis of an extension of time that would *not* take Infraco all the way to 31 March 2011 (see comments above in relation to MOV4 and the provision for Prioritised Works preliminaries from 31 March 2011 onwards).

11.10 tie has also carried out a further exercise, in terms of which tie has assessed what Infraco's entitlement to additional cost caused by delay might be, if the period in question was taken all the way to 31 March 2011. tie's assessment of this figure is £46.974m

11.11 For the reasons explained in section 9 above, it is considered more likely than not than Infraco would be awarded an extension of time up to at least separation. The prudent approach would therefore be to use the higher figure of £46.974m as a starting point for the appropriate evaluation of additional cost caused by delay.

11.12 It is understood from tie that the basis of its approach has been the following:

(a) In relation to BB, the starting point for the assessment has been to apply the process set out in Appendix G of Schedule part 4 (*Process for agreement of value of tie Changes*). Clause 1.3 ends as follows:

"*If appropriate to the particular tie Change, any other Preliminaries elements, valued in accordance with the Spreadsheet 2 set out in Appendix F.*"

tie has interpreted the use of the phrase "*if appropriate*" to mean that only those figures in relation to which work was actually being carried out and costs therefore being incurred, should be taken into account. There would appear to be some force in this interpretation.

(b) In relation to Siemens, tie's approach has been to use the weekly figure agreed with Siemens in connection with EOT1, and pro rate that to cover the entire period to 31 March 2011.

(c) It should be noted that no figure is included in relation to CAF. That figure is taken account of in section 13 which addresses additional consequences of separation, and includes payments to CAF.

11.13 Conceptually, the approach taken by tie in arriving at its totals appear to be sound (subject to the comments below in relation to double recovery); however, it would be prudent to allow for a figure beyond that which has been calculated by them:

11.13.1 The first reason for this is that there is risk associated with the tie approach in connection with BB: specifically, BB may well seek to argue that it should be entitled to make recovery in relation to all areas, not just those being worked on (in other words, a differing interpretation of the meaning of "*if appropriate*" within the context of Appendix G to Schedule part 4). Furthermore, there may be a dispute in fact in relation to the areas in which Infraco were actually working.

11.13.2 The second reason is in connection with tie's approach to Siemens: the weekly figure agreed in connection with EOT1 was a sum negotiated close to the outset of the project. It may well be the case that Siemens seeks to revisit this number, and it is unlikely that it would be held to be bound to that figure in relation to periods of delay beyond those covered by EOT1[26].

11.14 Cyril Sweett has been asked by tie to prepare a report which seeks to assess the potential exposure to additional cost caused by delay, based on an exercise conducted by Acutus. That exercise sought to set out some parameters in relation to an entitlement to extension of time, based on information available to Acutus at the time. It was not based on a detailed forensic analysis of all time related issues that might impact the project to 1 September 2011. Cyril Sweett concluded that the potential range of additional cost would be in the region of between £16.709m and £62.943m.

11.15 On the assumption referred to above, namely that additional cost caused by delay ought to be considered by reference to an end date of 31 March 2011, tie's view is that the appropriate figure to take from Cyril Sweett's analysis would be the upper figure of £62.943m. Of this total, Cyril Sweett's report states that circa £7m is referable to a period after 31 March 2011, and therefore the adjusted figure would be £55.943m.

11.16 Drawing together the foregoing:

tie's assessment £46.974m

[26] tie considers that this weekly figure for Siemens is a high one, and that Siemens would be unlikely to seek a figure as high as this. However, it remains the case that the weekly figure is subject to increase, and this risk is factored into the conclusions reached at paragraph 11.17

Cyril Sweet's assessment	£55.943m
Infraco's figure	£68.700m (may be subject to increase as noted above)

11.17 On the basis of the foregoing, it would be prudent to assume for present purposes that the sum to be allowed for Infraco's entitlement in relation to additional cost caused by delay is £60m. This figure is not a scientific or definitive prediction of the sums which Infraco might recover. That could only be achieved by undertaking a detailed forensic analysis of the issues. It represents a prudent figure to be carried forward into the spreadsheets at Appendix 1 of this report.

Preliminaries

11.18 It appears to be agreed between tie and Infraco that if preliminaries were to be paid on the basis of the effluxion of time to 31 March 2011, that amount that would fall due to Infraco would be £47.276m. Beyond this, there appears to be a dispute in relation to whether a further Incentivisation Milestone of £1.2m falls to be paid. The basis of this dispute is not clear, and for present purposes, it should be assumed that the total figure would be £48.476m. The sum of £35.367 has been certified against this figure, leaving a difference of £13.109m still to be paid by tie to Infraco.

11.19 In relation to MOV4, if Infraco proceed with the Prioritised Works to 1 September 2011, its entitlement to preliminaries flowing therefrom, will be £9.317m. It is recognised that Infraco might not progress with the Prioritised Works on the agreed basis; in that event, its entitlement to recover preliminaries in respect of the Prioritised Works ought to be reduced. However, for present purposes, the prudent approach is to assume that Infraco will be entitled to the full amount.

11.20 Accordingly, the total of Infraco's entitlement on a time based approach to preliminaries would be as follows:

Schedule part 5	£47.276m
Incentivisation Milestone	£1.200m
Prioritised Works Preliminaries	£9.317m
	£54.405m

11.21 If preliminaries fall to be evaluated on a basis commensurate with work done for the period to 31 March 2011, then tie's assessment is that Infraco would be entitled to recover the following:

Fixed preliminaries:	£10,186,000
Time related preliminaries	£11,990,000

£22,176,000

11.22 If preliminaries are to be approached in this way, then Infraco would be entitled to make recovery of its additional cost caused by delay, subject to the usual evidential requirements as referred to above. As referred to above, the approach which has been adopted is that a figure of £60m would be appropriate for present purposes. The overall total on this basis would therefore be £82.176m.

Conclusion

11.23 On the basis of the foregoing, it can be seen that a comparison between a time based approach to preliminaries and additional cost caused by delay, and an "earned value" one can be summarised as follows:

Time based: £54.405m

Additional cost: £82.176m

11.24 For the reasons explained above, these two totals ought to be treated as mutually exclusive alternatives. On balance, it is considered that the better approach, supported by the decision of Lord Dervaird, is the time based one. However, for the purposes of the current exercise, it would be prudent to assume that the potential exposure lies in a range between the two figures.

12 **Separation - mobilisation payment**

12.1 A further element of the payment to which Infraco may be entitled for work carried out is in respect of the mobilisation payment made to BB and Siemens of £45.2m. That sum has already been paid by tie; the question which arises is whether any element of it can be recovered in the event that the Infraco Contract is brought to an end prematurely, without all of the Infraco Works having been completed. This issue is addressed in detail at Appendix 2 of this report, the conclusions of which are summarised below.

12.2 tie employees who were involved at the time of the formation of the Infraco Contract have indicated that the mobilisation payment was in fact an advance payment to BB and Siemens, paid 50/50, to assist them with cashflow. It is understood that value was taken out of the other elements of the Contract Price and paid to Infraco at the outset of the project in the form of the mobilisation payments.

12.3 On this basis, if the Infraco Works are completed, the advance payment would eventually balance itself out as the Milestones (whose value had been reduced to take account of the mobilisation payments) catch up with the payments which had been made up front. However, if the Infraco Works are not completed, and Infraco's involvement is halted part way through the project, the balancing out of the advance payment will not have been completed in its entirety.

12.4 tie's position is that it was the common understanding of the parties prior to contract formation that an element of the advance or mobilisation payment ought to be returned in the event that the Infraco Works are not completed by Infraco.

12.5 There is some force to the proposition that the parties cannot have intended that the mobilisation payment should operate as a windfall to Infraco in the event the Infraco Contract was brought to a premature end.

12.6 That is supported by the provisions of clauses 88.8 and 90.12 of the Infraco Contract, which suggest that in the event of termination, the payment to which Infraco is entitled will bear some relation or proportionality to work done, or value earned.

12.7 However, if the correct approach to preliminaries and additional cost caused by delay is to adopt the time based approach referred to at section 11 above, then it would be consistent to treat the mobilisation payment as having been triggered by the effluxion of time: once having been triggered in this way, then there would be no mechanism in terms of which the mobilisation payment could be clawed back.

12.8 Even if it is the case that some element of the mobilisation payment falls to be repaid on early termination, the question which then arises is how the extent of any repayment of the mobilisation payment is to be calculated. tie's approach has been to aggregate the Construction Milestones (partially and wholly completed) with an assessment of the value tie Changes, and compare that with the amount actually paid, in order to arrive at a view of how much Infraco has been "overpaid". However, this approach does not provide a true reflection of the recalculation of the mobilisation payment.

12.9 It is possible to arrive at a number of ways of calculating the potential repayment (for example, through a recalculation of the Construction Milestones to divide the £45.2m mobilisation advance between them proportionate to value), but a court is only likely to adopt any one of these approaches if it is satisfied that this was, objectively speaking, what the parties must have intended.

12.10 In the absence of a cogent explanation of the way in which the calculation of any repayment ought to be calculated, the prudent approach for present purposes would be to assume that Infraco will be entitled to retain the full extent of the mobilisation payment. If such a formulation can be determined by tie, then the issue ought to be revisited in order to assess whether it would be reasonable to conclude that tie will be entitled to make some recovery therefor.

13 **Separation - additional consequences**

CAF

13.1 In the event of automatic termination under MOV4, tie will acquire the Trams, the Tram Related Equipment and the Depot Equipment, in return for payment of a sum calculated to reimburse CAF for what it has delivered.

13.2 Clause 3.3.6 of MOV4 provides that this payment will be calculated by reference to:

(a) All the milestones payments in the Tram Supply Agreement, not merely those milestones which have been triggered by the passage of time;

(b) Less a deduction to reflect the difference in value between what CAF has delivered, and what it would have delivered had the Infraco Contract not been terminated.

13.3 This figure is assessed by tie to be £10,330,000. This figure has been included in tie's total cost of another contractor completing the ETN as far as York Place (see section 14 below).

13.4 In addition, certain sums fall to be paid to CAF in relation to delays sustained by them. These figures have been agreed between tie and CAF as follows:

Claims in relation to MUDFA delays	€786,000
Further claims in relation to delay to depot	€5,100,000
Additional claims	€466,000[27]
	€6,352,000

13.5 As referred to at section 9 and footnote 24 above, the sums which have been expressed in Euros have been taken forward into the spreadsheet analysis in sterling, using an exchange rate of £1.00 = €1.139. On this basis, €6,352,000 is equivalent to £5,576,821.

[27] This figure was agreed during the Mar Hall mediation. It is understood that subsequently parties have agreed to value this figure on the basis of a schedule of rates, but that the eventual total should not exceed €466k. That figure has therefore been utilised for present purposes.

14 Separation - claims by tie against Infraco

14.1 The intervention of the Mar Hall mediation and the subsequent execution of MOV 4 essentially placed in hiatus a number of claims which tie was intending to bring against Infraco (and *vice versa*). However, as part of the culture change, these claims were effectively shelved in the hope that they would be incorporated into the lump sum price to be paid for the Off Street works on the basis that the Settlement Agreement was entered into.

14.2 However, on the basis that the Settlement Agreement is not entered into and the party's positions then become entrenched, in response to any claims brought by Infraco it is inevitable that tie will look to its own claims as a means of abatement.

14.3 It is likely that a number of claims already exist and that, upon termination or through separation, more claims come to light. However, the following claims have been identified which need to be taken into account when assessing separation costs. Those claims are:

(a) Princes Street defects

(b) Consequential losses/third party claims in relation to Princes Street;

(c) Over payments in relation to the Princes Street Supplemental Agreement

(d) Other defective works

(e) Lost value engineering opportunities

14.4 Each of these potential areas of claim is considered in turn at Appendix 4 of this report.

14.5 In overview, however, save for the claim relating to the Princes Street defects, these various heads of claim effectively either cancel out or negate other heads (and thereby attract a nil value) or else are mentioned here in order to ensure the principles behind the claims are recognised, as opposed to a value being adopted.

14.6 With regard to the claim relating to the defective Works at Princes Street, tie has assessed this claim to be in a broad range of £0.5m to £8m, depending on the extent of remedial work to be carried out. However, it is evident that tie would seek to maximise their recovery in this respect. For the purposes of the current analysis, a figure of £4m has been utilised on the basis of discussions with the Certifier.

15 **Separation - costs of employing another contractor**

15.1 In order to provide a like for like comparison with the Settlement Agreement, tie has produced an assessment of the potential cost associated with engaging another contractor to complete all outstanding work as far as York Place. The risk allocation of this new contract would require to be negotiated and agreed: the cost of proceeding with a new contractor would turn to a significant extent on the risk profile that could be achieved.

15.2 However, tie has conducted an exercise whereby it has concluded that the potential costs of proceeding with a new contractor would be £184.928m.

15.3 tie has also obtained an assessment from Cyril Sweet of this cost, based on market rates, which concludes that the cost of proceeding with another contractor would be £177.937m a margin of difference of around 5%. Accordingly, it would appear to be prudent to utilise the tie figure.

15.4 In addition, if there are any costs associated with putting the project on hold between York Place and Newhaven (for example, making good any work commenced on this section), they will also require to be taken into account. This will include the costs of compliance with the Edinburgh Tram (Line One) Act 2006 and Edinburgh Tram (Line Two) Act 2006 ("the Tram Acts"), and potential issues associated with land acquisition.

15.5 These issues are considered in detail at Appendix 6, but in summary tie's obligations (as the statutory undertaker) under the Tram Acts in relation to reinstating the works to their original position depend very much on the intention behind any proposed hiatus of the works.

15.6 The relevant legislation requires tie to remove all rails and make good the road surfaces to the satisfaction of the local authorities. In addition, tie is required to remove structures and make safe the whole area of the works. This is a requirement of the legislation in circumstances where tie "…*no longer requires*…" the tram facilities built to date.

15.7 This would seem to apply where the decision is taken either to permanently abandon the works or to place them in long term storage (awaiting, say, subsequent funding at another date). If, on the other hand, the hiatus is of shorter term, such as to place the remaining works with another contractor, as there would be no sense of abandonment, then temporary measures (such as placing tarmac over the existing rails) may well be acceptable.

15.8 It may also be the case, in conditions of longer term abandonment, that tie may wish to demolish more substantial structures to avoid any third party liability.

15.9 tie, with CEC, has carried out an exercise to assessment the potential costs of putting on hold the section from York Place to Newhaven: it concludes that this figure would be in the

region of £4,543,000 [*tie to reassess this figure to ascertain whether any further elements ought to be allowed for*]. In the absence of any independent verification of this figure, it has been taken forward to the analysis for present purposes.

16 **Separation - completion of design**

16.1 A further head of cost in the event of automatic termination in terms of MOV4 is that of completing the design. It was envisaged in the HoTs agreement that:

"*The Infraco shall complete the integrated Design from Airport to Newhaven (Phase 1A) to meet the Employer's Requirements.*"

16.2 It is understood from tie that some progress has been made towards completing the design, but that the progress has been slower than had been anticipated, and the design is still not complete.

16.3 In the event of automatic termination, Infraco's obligations in relation to the design would cease. If the project were to be completed by another contractor, the design would require to be completed, with the associated cost implications.

16.4 The cost associated with completing the design will depend on its status. However, tie has estimated (on a conservative basis) that the potential cost of completing it could be in the region of £5 - £10 million.

17 **Separation - costs of putting the project on hold**

17.1 In the event that automatic termination occurs, it may be that instead of proceeding with another contractor, the project is put on hold for the time being. This approach does not produce a true like for like comparison with the consequences of entering into the Settlement Agreement, in that it does not deliver a network as far as York Place.

17.2 This will require all work to be considered, not just that section between York Place and Newhaven referred to above. Similar considerations in relation to the provisions of the Tram Acts will apply.

17.3 tie has assessed the potential cost associated with putting the whole of the project on hold as £11,935,000 [*tie to revisit to ascertain whether any further elements ought to be allowed for*].

17.4 These costs are an alternative to engaging a new contractor. They are cumulative with the other costs referred to in the foregoing sections (work carried out to date, claims, counterclaims, payments to CAF, costs of formal dispute resolution proceedings if no agreement can be reached).

18 **Separation - achieving resolution on payments to be made**

18.1 As referred to above, clause 3.3.4 envisages that the parties will seek to agree "*mutually acceptable terms*" in relation to deal with the consequences of automatic termination pursuant to clause 3.3.3. That will include seeking to agree any payments which should be made.

18.2 If agreement cannot be achieved through discussion, the parties will then require to look to more formal means of resolving any disputes which remain.

18.3 The dispute resolution provisions contained in Schedule Part 9 of the Infraco Contract will survive the automatic termination. This means that any disputes ought to be resolved in accordance with the mechanism set out in that Schedule: broadly, that mechanism consists of internal Infraco/tie discussions, mediation, adjudication and litigation.

18.4 As can be seen from the discussion above in relation to the many heads of claim which remain outstanding, there a number of issues which divide the parties, and where there has been little evidence of consensus. Taking those issues through the DRP process is likely to be lengthy and expensive; unless the parties agree to be bound by the decisions of adjudicators, it is likely that the disputes would end up before the Court of Session.

18.5 An alternative approach might be for the parties to adopt a speedier means of resolution: this might be by way of mediation, or by way of a binding expert determination to sweep up all outstanding issues.

18.6 In the event that matters cannot be resolved in this way, legal and expert costs will be incurred in the event that the disputes are litigated through the courts. A figure of £3m has been utilised in relation to these costs; that figure does not represent a definitive estimate of the potential costs, but has been adopted in order to provide a comparison between this and the other options available to tie/CEC.

18.7 Beyond these legal and expert costs, there would also be internal costs for tie/CEC associated with the dispute resolution proceedings.

19 **No Settlement Agreement – continuing with the Infraco Contract**

Provisions of MOV4

19.1 If the Settlement Agreement is not entered into before 1 July 2011 for any reason other than the funding issues referred to in section 3 above, then the Infraco Contract will remain in place[28]. The Infraco Works should recommence on 2 July 2011, with the Prioritised Works effectively being subsumed into them.

19.2 The Infraco Contract going forward will be subject to two principal amendments introduced by clause 3.4 of MOV4, namely:

(a) Infraco is required to self certify that the civils, systems and trackwork Design is in accordance with the Employer's Requirements. tie will have no right or obligation to review that Design, and Infraco will be released from its obligations under clause 10 of the Infraco Contract (subject to issues in relation to ROGS);

(b) The Planned Sectional Completion Date for Section A is revised to 16 December 2011, and the delineation of Section A is reduced.

19.3 The exposure of tie/CEC will then include all the elements referred to above in connection with separation[29], *plus* a number of other factors:

1) The costs associated with tie Change in relation to work which has not yet been carried out (see section 8 above);

2) The costs associated with Infraco completing the work to York Place under the Infraco Contract, with the existing risk profile, including any claims which arise in relation to that work;

3) Assuming that the project is only to continue to York Place, Infraco may be entitled to recover the profit that it would have earned in relation to the omitted section from York Place to Newhaven.

Each of these is dealt with in turn below.

Change in relation to work not yet carried out

Agreed INTCs

19.4 As referred to in section 8 above, there are currently a number of INTCs where there is agreement between tie and Infraco in relation to both the principle and quantum of an INTC,

[28] Subject to certain changes introduced by MOV4 dealt with in more detail below
[29] Save that the payment to CAF in return for delivery of trams will not be triggered

but there is a dispute in relation to the extent to which the work in question has been completed. If work continues under the Infraco Contract, it is assumed that Infraco will complete the work, and the full agreed amount will become due to Infraco.

INTCs determined through adjudication

19.5 As referred to at section 8 above, there is a dispute between the parties in relation to the extent to which work which is the subject matter of adjudications has been completed. It is assumed that if work proceeds under the Infraco Contract, that work will eventually be completed by Infraco, and the sums determined at adjudication will therefore fall to be paid in their entirety.

INTCs where there is a dispute on quantum

Infraco value	£12,212,041
tie value	£10,724,485
Difference	£1,937,556

19.6 There is no independent analysis of tie's figures available; in the event of a dispute in relation to this issue, it is likely that factual and expert quantity surveying evidence would be required to determine the correct value. In those circumstances, as explained at section 2 above, a mid point has been taken between the tie and Infraco figures.

INTCs where there is a dispute in principle

Design development/Pricing Assumption No.1

Infraco value:	£18,354,838
tie value:	£3,006,734
Difference	£15,348,104

Misalignment

Infraco value:	£5,913,690
tie value:	£308,403
Difference	£5,605,287

19.7 tie has also produced an alternative figure in each case which evaluates the INTC in question on the assumption that Infraco is correct in principle to assert that there has been a tie Change, but tie takes issue with the quantum of Infraco's figure. This would reduce the

value of Infraco's claim to £9,275,293 in relation to Pricing Assumption No.1, and £4,189,947 in relation to misalignment.

19.8 On the basis of the comments above in relation to the relative prospects of success of the competing arguments, it can be seen that it would be prudent to proceed, for present purposes, on the basis that Infraco will be entitled to make recovery in relation to these INTCs. There is no independent verification of Infraco's alternative assessment on quantum, and accordingly, the prudent approach would be to take a comparison between tie's figures and Infraco's figures, and adopt the mid point between these two figures in the analysis, as referred to at section 2 above.

Clause 22/65

19.9 The issues of principle in relation to this dispute are set out at section 8 above. tie assesses that the value of the work yet to be done which falls within this category is £292k. This is higher than the figure of £93k advanced by Infraco (because Infraco seek to categorise potential changes in terms of clause 80, rather than clause 65).

19.10 For the sake of prudence, tie's higher figure ought to be used in the analysis being carried out for present purposes.

Miscellaneous INTCs

19.11 tie has produced figures in relation to the respective values in relation to this category of INTCs as follows:

Infraco value:	£8,633,000
tie value – if tie correct in principle:	£24,000
tie value – if Infraco correct in principle:	£3,734,000

19.12 For the reasons explained in section 8 above, it would be prudent to proceed, for present purposes, on the basis that Infraco will be entitled to make recovery in relation to these INTCs. There is no independent verification of Infraco's alternative assessment on quantum, and accordingly, the prudent approach would be to take a comparison between tie's figures and Infraco's figures, and adopt the mid point between these two figures in the analysis, as referred to at section 2 above.

Cost of completing outstanding work to York Place

19.13 It is understood from tie that the costs associated with completing the work to York Place on the basis of the Infraco Contract (as amended by MOV4) are projected to be £182,706,712.

19.14 This figure is made up as follows:

Offstreet airport to Haymarket	
	£m
BB work to be carried out	47.264
BB preliminaries	10.450
BB changes as yet unidentified	8.000
BB risk issues	4.060
BB – value engineering not realised	9.104
Siemens – work to be carried out	53.270
Siemens – preliminaries	10.654
	142.802
Onstreet – Haymarket to York Place	
Work to be carried out (incl. preliminaries)	22.500
Other	
SDS	2.003
CAF	10.330
Maintenance/spares	5.071
Overall total	£182.706m

19.15 The figures referred to above include the following:

19.15.1 £8m in relation to change: it is understood from tie that this relates to changes which have not yet been identified; in other words, there is no double counting between this figure and those referred to above in connection with INTCs in relation to work yet to be carried out. By its very nature, the figure for as yet unidentified changes can be no more than an allowance: it is not possible to predict with any degree of certainty what this figure might be.

19.15.2 £4m in relation to risk issues: this is understood to consist of £2.5m in relation to ground risk, with the remainder being a general allowance of 5% in relation to miscellaneous risk.

19.15.3 £9m in relation to value engineering: it is understood that the figure of £47.264m for work to be carried out includes a significant element of value engineering savings. tie's approach has been to assume that Infraco will not realise this value engineering, and it ought therefore to be factored back in to the figures.

19.15.4 £20m in relation to preliminaries: if the project continues under the Infraco Contract, that work will broadly speaking be carried out in the period after 1 September 2011. During that period, Infraco will no longer be recovering preliminaries in terms of Schedule part 5 (those preliminaries cease in mid July 2011) or MOV4. Accordingly, Infraco will be entitled to make a recovery for their continued presence on site (to the extent that it is not caused by their own culpable delay). The allowances for preliminaries seek to recognise this continued presence on site.

19.16 The figures referred to above should be treated as allowances, rather than definitive predictions of what Infraco's entitlement might be in the event that the project continues.

Omission of work from York Place to Newhaven

19.17 In order to provide a proper comparison with the Settlement Agreement, consideration has been given to the omission of certain work from the scope of the Infraco Contract, specifically from York Place to Newhaven[30].

19.18 The detailed analysis in relation to this issue is contained within Appendix 5 of this report. In summary, however, tie is entitled to instruct a tie Change which omitted elements of the Infraco Works. This extent to which this entitlement may be exercised is a question of degree: there are arguments which would support the proposition that it would extend to omitting the section from York Place to Newhaven.

19.19 In this event, it is likely that Infraco would be entitled to recover the profit that it would have made on the work omitted, whether through the operation of the valuation mechanism in the Infraco Contract, or as damages for breach of contract.

19.20 If the instruction to omit the work from York Place is a lawful one within the meaning of the Infraco Contract, in common with any other tie Change, it will require to be valued in accordance with the provisions of the Infraco Contract.

19.21 If it is held that the instruction to omit constitutes a breach of contract, then Infraco would be entitled to recover damages calculated to put it in the position that it would have been in had

[30] Subject to the comments made in this report in relation to powers of omission, it ought to be possible for instructions to be issued to omit any specific section of work – York Place to Newhaven has been used in order to provide parity with the Settlement Agreement

the breach not occurred: in other words, damages to restore to it the profit that it would have made had the work not been omitted.

19.22 On the basis of the foregoing, it is likely that Infraco would be entitled to recover any element of profit on the work that had been omitted, as well as the direct costs of demobilising.

19.23 tie has assessed the potential loss of profit and overheads that might be sustained by Infraco as £1.938m. By its nature, this figure can only be a very broad brush estimate of the way in which Infraco might formulate its claim.

Legal and other costs

19.24 As referred to above, at the end of section 18, legal and expert costs will be incurred in the event that the disputes are litigated through the courts.

19.25 The figure for these costs is likely to be higher if the work proceeds under the Infraco Contract, than if separation occurs. A figure of £4m has been utilised in relation to these costs; as before, that figure does not represent a definitive estimate of the potential costs, but has been adopted in order to provide a comparison between this and the other options available to tie/CEC.

19.26 Beyond these legal and expert costs, there would also be internal costs for tie/CEC associated with the dispute resolution proceedings.

20 **No Settlement Agreement – termination**

20.1 For the reasons explained in section 3 above, if the Settlement Agreement is not entered into for reasons other than those associated with funding, the Infraco Contract remains in place (as amended by MOV4), with the Infraco Works recommencing on 2 July 2011.

20.2 In that situation, it might be open to tie to seek to terminate the Infraco Contract on grounds of Infraco Default. The challenges associated with this approach were addressed in the Report for tie Limited on Certain Issues Concerning the Edinburgh Tram Project produced by McGrigors LLP on 14 December 2010.

20.3 In summary[31], for tie to be entitled to terminate on the grounds of Infraco Default:

(a) tie must establish that an Infraco Default has occurred;

(b) That Infraco Default must be the subject matter of a Remediable Termination Notice which has been validly and competently formulated;

(c) tie's determination of whether a submitted rectification plan is acceptable must have been exercised in accordance with the Infraco Contract.

Failure to meet any one of these tests will mean that a purported termination will constitute a wrongful repudiation of the Infraco Contract.

20.4 Establishing that an Infraco Default has occurred requires detailed forensic analysis; the issue will be subject to intense scrutiny in the context of any ensuing dispute, which is ultimately likely to be ventilated before the courts. The key default is Infraco Default (a), which involves proving not only a breach of the Infraco Contract, but also that the breach has materially and adversely affected the carrying out and/or completion of the Infraco Works.

20.5 The exercise referred to in the foregoing paragraph includes the compilation, review and analysis of all relevant written material as well as witness evidence. Expert input is also required in relation to technical and planning issues. That exercise was commenced by tie in late 2010, but was suspended following the discussions at Mar Hall.

20.6 Remediable Termination Notices were issued by tie in 2010 (prior to the exercise referred to above having been undertaken). It would be unsafe to rely on those notices:

(a) Without the benefit of the outcomes of the forensic exercise referred to above; and

[31] See Executive Summary at section 1 of that report, and the decision tree at page 47 of that report (also reproduced at Appendix 7 to this report).

(b) Because there is a material risk associated with the formulation of the Remediable Termination Notices (based on the sample which has been considered by McGrigors and Richard Keen QC[32]).

20.7 Infraco is entitled to issue a rectification plan following the service of a Remediable Termination Notice. tie is required to exercise good faith in considering any such rectification plan. Good faith requires an absence of dishonesty, fraud, irresponsibility or malice. The issue should not be pre-judged. The decision should be tie's alone, and not imposed by a third party. A decision to reject a rectification plan does not require to be justified as being fair or reasonable.

20.8 The Infraco Contract does not expressly provide for any time limit for the service of a termination notice following the rejection of a rectification plan. However, the elapse of time might affect tie's entitlement to rely on a Remediable Termination Notice, for example through the doctrine of personal bar, or in terms of whether the decision to terminate could be said to have been exercised fairly and reasonably in all the circumstances.

20.9 If tie terminates the Infraco Contract, it is entitled to enter upon the Infraco Works and expel Infraco. That is likely to provoke a legal challenge, the ultimate outcome of which may be measured in years. During that intervening period, it is unlikely that work could continue on the project – either by Infraco or by another contractor – other than with the co-operation of Infraco.

20.10 If tie is ultimately *successful* in the legal proceedings referred to in the foregoing paragraph, then:

(a) The Infraco Contract will have been brought to an end;

(b) Infraco will have no further liability, unless tie proceeds to complete the tram project with another contractor on the basis of the same scope of works that was let to Infraco. In these circumstances, tie would be entitled to recover the additional, or "extra over", cost of completing the project, subject to the cap on liability.

(c) In these circumstances, Infraco's entitlement to make recovery would be similar to those of separation, as dealt with at section 5 above.

(d) It is likely that there would be an element of irrecoverable legal and internal costs associated with the period of litigation.

[32] See Appendix 2 to the McGrigors report of 14 December 2010

20.11 If tie is ultimately *unsuccessful* in the legal proceedings referred to above, then the potential exposure for tie is significantly greater. The option of electing whether or not the Infraco Contract should be treated as continuing will lie with Infraco. Infraco can choose to treat the "wrongful" termination as a tie Default and terminate itself, but it is not obliged to do so.

20.12 If Infraco elects to treat the "wrongful" termination as a tie Default and terminates, then Infraco will not only be entitled to payment for work actually carried out, but will also be entitled to payment for loss of profit at 10% on civils and 17% on track and systems. The Infraco Contract expresses this payment for loss of profit to be "*calculated with reference to demobilisation costs*". The meaning of this provision is uncertain, but there is a risk that tie's exposure to Infraco would not be restricted to lost profit on the costs of demobilisation.

20.13 If Infraco elects to treat the Infraco Contract as continuing at the conclusion of the legal proceedings, then the parties would be locked into that contract. Infraco would be entitled to insist on being allowed to complete the Infraco Contract. Infraco would be entitled to be paid for work already carried out. The underlying disputes between the parties would remain to be resolved (for example, in relation to Pricing Assumption No.1). Work would not have proceeded during the intervening period; the issue of any consents or approvals which had expired during that period would require to be addressed by tie.

20.14 In addition, the intervening period of delay, and its associated cost, would be tie's responsibility. It is impossible to assess with any degree of certainty what tie/CEC's exposure in this respect might be: it will turn to a significant extent on the length of time that any proceedings take to resolve. It will also depend on the way in which Infraco's site establishment is treated during the intervening period: it may be that agreement can be reached in relation to the extent to which Infraco demobilise. If such an agreement cannot be reached, the exposure to Infraco would potentially be higher.

20.15 An alternative approach would be to seek a ruling (through the DRP and/or the courts) that certain key breaches constitute Infraco Default, and if successful, use this as a basis for a Remediable Termination Notice. It is likely that tie would be entitled to require Infraco to continue with the Infraco Works in the interim, although careful consideration would require to be given to the framing of the referral in this respect. The same degree of forensic analysis would be required as referred to above.

20.16 A summary of the possible outcomes of the termination approach is set out in the decision tree at Appendix 7 of this report (and was also at Appendix 4 of the McGrigors report of 14 December 2010).

20.17 As referred to above, at the end of sections 18 and 19, legal and expert costs will be incurred in the event that the disputes are litigated through the courts.

20.18 The figure for these costs is likely to be higher if the disputes to be litigated include the question of termination. A figure of £7m has been utilised in relation to these costs; as before, that figure does not represent a definitive estimate of the potential costs, but has been adopted in order to provide a comparison between this and the other options available to tie/CEC. In the event that tie are successful in any argument in relation to termination, they are likely to be entitled to recover some of their legal costs in relation to the termination dispute, although the costs in relation to the underlying disputes in relation to entitlement will be dealt with according to success in relation to those disputes. Accordingly, a figure of £4m has been utilised in relation to this option.

20.19 Beyond these legal and expert costs, there would also be internal costs for tie/CEC associated with the dispute resolution proceedings.

21 Conclusions

21.1 Reference is made to the spreadsheets at Appendix 1 of this report which pull together the various building blocks identified in this report in relation to each of the options under consideration.

21.2 As explained in section 2 of this report, the figures set out there do not represent a definitive view in relation to the prospects of success in relation to each of head of claim; rather they represent what would amount to a prudent allowance to be made in relation to the various claims for the purposes of comparing the various options.

21.3 The spreadsheets show the range between Infraco's position (so far as that position is known – see comments at section 2 in relation to this issue) and tie's position, together with an indication of the values referred to in this report as the prudent values to be taken for the purposes of carrying out a comparison of the consequences of adopting the various options that have been identified.

McGrigors LLP
29 June 2011

APPENDICES

Appendix 1 - spreadsheets

Appendix 2 - mobilisation

Appendix 3 - Pricing Assumption No.1

Appendix 4 - claims by tie

Appendix 5 - loss of profit

Appendix 6 - putting project on hold

Appendix 7 - decision tree on termination taken from report of 14.12.10

Appendix 8 - glossary of terms