

EDINBURGH TRAM NETWORK

GOVERNANCE PHASE II

1. BRIEF

We are instructed to provide a Report to comment upon the implementation of Phase II of the Governance arrangements for the Edinburgh Tram Project in preparation for full integration into the public transportation system in the City of Edinburgh. This Report therefore follows the Advice Note which we produced in September 2009 and revisits, where necessary, the main topics identified in that Advice Note. The topics were:

- (a) Interaction with the Edinburgh Tram Acts 2006 (Lines One and Two) ("**Tram Acts**");
- (b) Impact on the InfraCo Contract Suite and ETN Delivery commitments;
- (c) Legislative and Regulatory Framework;
- (d) Other Legal or Contractual Issues.

2. TOPIC A

The Governance arrangements have, we believe, been notified to Scottish Ministers by CEC in alignment with the Tram Acts. The Tram Acts are otherwise neutral to the Phase II governance arrangements, though as a detail, the engagement of ETL or LB as the actual ETN operator would in our view require intimation to Scottish Ministers under the Edinburgh Tram Acts.

3. TOPIC B

3.1 No alteration has been made to **tie**'s status as the client and counterparty to the BSC Consortium under the InfraCo Contract.

3.2 Section 5 in our September Advice Note comprised an analysis of risk concerned with possible intervention by BSC to delay or object to the adjustment of Phase II Governance arrangements. To date, no such interference has in fact occurred but we draw attention to our observations in paragraph 5.2:

*"Our view would be that uninvited critical commentary emanating from BSC about how the TEL-**tie**-CEC axis is likely to affect them should be silenced crisply on the basis that TEL is taking up an exceedingly important role."*

3.3 Despite these misgivings, the assignation of the DPOFA contract from Transdev to ETL passed off without incident and **tie** notified BSC that ETL was the new putative operator for the purposes of the interface provisions in the Infraco Contract. These provisions provide for the InfraCo and the Operator to cooperate effectively and for there to be reciprocal relief/compensation events if either interferes with the other. Depending on who is responsible, **tie** would either indemnify or be indemnified from the consequences of such events.

3.4 ETL therefore currently sits as the counterparty to the **tie** pursuant to the DPOFA contract which contains the services delivery remit for the operational phase of ETN. The assignation

to ETL (as opposed to outright termination) of this central services contract was to avoid a risk that the BSC consortium could obstruct Governance Phase II restructuring by requiring negotiations to accommodate the perception of client-side change to their disadvantage.

- 3.5 Our understanding from **tie** at the time it desired for commercial expediency to end Transdev's involvement in late 2009 was that ETL was owned by LB but was to be transferred into 100% TEL ownership. From a procurement law stand point, TEL ownership of and control over ETL would provide a sustainable argument that ETL is TEL's 'in house' provider. ETL needs to remain single purpose and with no commercial mind of its own to retain this status for TEL to benefit from the public procurement law exemption from requirement for CEC/TEL to competitively procure a replacement for Transdev Edinburgh Tram Limited. ETL being positioned as a TEL (as opposed to LB) 100% subsidiary would defuse any procurement issue (award of a contract for services) which may arise were LB to be appointed as ETN operator, without an advertised competition. It is not a conclusive argument that LB and TEL are effectively sister companies when considering if LB assuming responsibility for ETN operations is creating a contract for services.

4. TOPIC C

4.1 State Aid

We do not alter our view that the Governance Phase II arrangements themselves are neutral. We repeat our advice that the way in which the ETN operator (whether it be ETL or LB) is remunerated will require an analysis which, at its most basic, needs to conclude that the operator of ETN is not being subsidised. Under DPOFA this was not the case since the Operator has no role in setting fares or fares policy and is a revenue collection agent and was appointed under competition (a useful defence to State Aid).

4.2 Transport Act 1985 ("TA85")

In past advice dating back to 2004/5 we have pointed out measures which would assist legal arguments regarding LB's status:

- 4.2.1 amendment of LB's articles to expressly state that it has an objective of transportation integration (and the integration of the ETN) as reflected by CEC statutory duties as transport authority. This has two purposes:
- 4.2.1.1 it reinforces the argument that as ETN operator LB can benefit from exemption from procurement regulations as an "in house" provider; and
 - 4.2.1.2 it removes any potential conflict for LB Board coming about if LB is solely a bus operator, as opposed to a integrated transport system manager, responding to TEL.
- 4.2.2 obtaining of Scottish Ministers consent to Tel acquiring LB pursuant to the TA 85 which would remove any residual risk that CEC were somehow acting *ultra vires* permissible treatment of LB as a transport company.

4.3 Competition Law

We have nothing to add to our advice of 21 September 2009, other than to say (i) that it would be prudent to review any Competition Commission findings and directions (once its

current investigation in the UK bus market are concluded) that may concern LB in particular but also the structure of the Edinburgh bus transport market, (ii) the integration of the ETN with the LB bus operation network will heighten the need for *** that LB is not exposed to challenge for abuse of dominant positions.

4.4 LB Minority Interests

We have advised previously (and this view was endorsed by Nicolas Green Q.C.) that the single economic entity position as regards Chapter I of the Competition Act would be optimised by a pure 100% CEC ownership of LB. However, given that the 9% stake is held by other public authorities, we do not consider that this ownership position materially affects either the Competition law analysis or the ability of CEC to put forward the "in house" provider exemption - on the assumption that LB is Tel's 1005 subsidiary, controlled by TEL and has the adjustments made outlined at 4 above.

TOPIC D

4.5 Asset Leasing

We are not asked to deliver further advice at present.

4.6 Tax

We express no view on tax implications of the Phase II Governance arrangements, other than to observe that the ownership of ETN assets by CEC itself is very important to any leasing structure.

DLA Piper Scotland LLP

16th September 2010