

**Edinburgh TRAM Project
(Commercial In Confidence)**

tie Limited

Paper to : **Tram Project Board**
Subject : **SDS Commercial Settlement On Claim and Historical Changes**
Date : **5 September 2007**

1.0 Introduction

- 1.1 The paper dated 15 August 2007 seeking authority to negotiate a draft settlement with SDS was endorsed such that negotiations should be progressed and any conclusions brought back to the Board for ratification.
- 1.2 Subsequently negotiations were progressed on a without prejudice basis resulting in a draft settlement proposal being put to SDS. In summary the resultant settlement of £2.5m in respect of:-
- Their prolongation and disruption claim,
 - certain historical unresolved changes and
 - unbudgeted changes required to out of value engineering
- represents a saving of £650,000 on the budget. In addition payment of £2m of the claim is deferred until delivery of the final items for each of the three critical design workstages – MUDFA designs, Design Completion Notifications and Design Assurance packages. The first payment of £0.5m is not due until the end of October, by which time any further issues with performance will have come to light.
- 1.3 It should be noted that SDS's performance in respect of the main scheme has improved over the last three and the deteriorating performance on the MUDFA design delivery has stabilised, but more improvement is required. Clearly the Project will need to closely manage SDS to maintain and further improve progress and there is nothing to suggest that this cannot be achieved. Settlement of the claim will assist in this by avoiding diverting SDS's attention from the main job in hand.
- 1.4 Concurrently options to address any ongoing underperformance were also to be considered.

2.0 Background

- 2.1 SDS submitted a claim totalling £2.8m, in addition there remained £1.1m of historical changes which remained unresolved, a total of £3.9m.
- 2.2 Our view in respect of the claim and twenty historical changes is:-
- There is a justifiable claim £1.2m to £1.8m for a 3 month delay due failures to deal with Preliminary Design expeditiously (2 months) and in respect of Critical Issues resolution (1month) delays.
 - Historical changes - £0.5m to £0.97m
- A total of £1.75m to £2.77m.

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- 2.2 **tie** have identified a potential counterclaim in respect of the impact of delays by SDS prior to the commencement of Detailed Design. As noted in previous papers the potential value of the counterclaim is up to £15m. This consists of
- Costs incurred project overhead costs incurred at the time of the delay
 - Costs in delaying the MUDFA programme due to SDS failures and
 - Future costs – the impact of delay caused by SDS on Infraco and Tramco price levels
- Items 1 and 2 are historic costs incurred of approximately £5m. The balance, future costs are a little more speculative.
- However, to date only an outline claim has been developed for the purposes of reducing the value of their claim and expectations in respect of disputed historical changes.
- 2.3 The options for either party to resolve the claim and counter claim are:-
- Follow the stepped contract dispute resolution process of resolution of the claim and **tie** counterclaim between principals, adjudication and finally if unresolved by the former, litigation.
 - A negotiated settlement
- 2.4 The reasons for pursuing a negotiated settlement rather than engaging in a contractual dispute escalation are:-
- To minimise the risks to the Infraco procurement. Novation of SDS to Infraco is a key element of the procurement strategy. Whilst SDS must, under their contract, accept novation Infraco is able to reject or qualify novation. Ongoing or escalating dispute with SDS will become evident to the Infraco in the due diligence process and is likely to provide Infraco with a reason for materially qualifying the novation. The likely qualification would at best be that the unresolved dispute remains with **tie** to settle or dispute. Whilst we are seeking to finalise a deal with Infraco such a situation would not help maintain the Infraco risk transfer objectives.
 - Minimise the impact on the design workstream – currently the most critical workstream for the Project
 - To avoid the cost of pursuing a formal claim and drain on **tie**'s commercial and engineering managerial time at this critical time in the programme.
 - We have no certainty of winning and would be difficult to sustain in formal proceedings. Whilst the delays to the design process on which the counterclaim threat is based can be evidenced as fact the causes of the delays (excluding MUDFA deficiencies) are largely based on anecdotal evidence and interpolation from events at the time. This is particularly the case for the events pre August 2006. The contracts do not appear to have been managed effectively by either party prior to this date. A significant proportion of the additional cost, circa £10m, relates to additional Infraco and Tramco inflation costs due to delay. This is a future potential loss and speculative rather than not an accrued loss at this point in time. Demonstrating this to any required evidential level could prove difficult, particularly in the light of market price changes. In addition the contract terms arguably time out any counterclaim, given the length of time that has elapsed since these certainly prejudicial events arose. However, to win the commission PB sold themselves as an organisation with world class capabilities in light rail design. Whilst perhaps not a contractually enforceable position their delivery of world class management would have avoided many of the difficulties created and encountered by them. This point is reinforced by the progress made under Steve Reynold's direction

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since January in bringing issues to a head and participating in their resolution.

- To recognise and settle quickly around the valid elements of the SDS claim whilst using the levers of a counterclaim to reduce the settlement figure.

2.5 On balance and based on the reasons set out above the effort required to formally develop and pursue a detailed counterclaim was not considered worthwhile. Hence the negotiated settlement approach should be explored.

3.0 Negotiations

3.1 Negotiations were undertaken in on SDS's figure of £3.9m. Both parties were not able to agree an acceptable figure based on the scope (claim plus twenty historic variations) of the negotiations outlined above. In order to find a basis for an acceptable compromise three further items were introduced into the negotiations:-

- The redesign of the Depot to take account of VE opportunities (SDS value £180k)
- Redesign of the alignment to take account of the omission of the EARL bridge at Ingliston (SDS value £125k)
- Provision of full technical support for MUDFA (SDS value estimated at £200k)
- **tie's** view of the price for these items is £330k (best case)

3.2 Taking these items into account the Parties view of the positions is:-

- **tie** – £2.2m, best case and £3.5m worst case.
- SDS - £4.5m (Representing their likely realistic expectation of between £3.4m and £2.5m as gleaned from their approach to negotiations)

Further details of the parties positions are shown in Appendix A.

3.3 A series of negotiation meetings were held on a without prejudice basis resulting in a draft settlement at £2.5m, including the three further items. This is at the lower end of **tie's** best/worst case settlement range.

4.0 The Draft Settlement Proposal

4.1 Details of the draft settlement are £2.5m for settlement of SDS's claim and any issues arising from their heads of claim up to 17th August 2007, settlement of the historical changes and settlement of the three additional issues introduced.

4.2 To incentivise SDS to deliver the key design outputs for Phase 1a payment is staged as follows:-

- £500k in the October 07 Valuation.
- £500K on satisfactory completion of the last utilities design for Phase 1a – estimated – December 07
- £500k on satisfactory delivery of the last design completion notification for Phase 1a – July 08
- £1,000K on satisfactory delivery of the last design assurance package for Phase 1a – September 08

4.3 This proposal has been confirmed to SDS but is subject to SDS (PB) Board approval and agreement of the formal legal settlement. Successful conclusion of this settlement is to be ratified by the Tram Project Board Procurement Sub Committee in late September 07.

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- 4.4 It should be noted that this draft settlement is specific to the SDS claim and the historic changes referred to in 1.2 above. It is not a once and for all settlement that closes off claims by **tie** for all other issues and any potential future performance failures.
- 4.5 Accordingly the settlement does not include:-
- Any settlement of the issues forming **tie**'s counterclaim. **tie** can return to this in the future in the negotiation of a defence of any future claims by SDS. A letter has been sent rejecting SDS's rebuttal of the heads of counterclaim set out in a without prejudice letter issued by them during the course of negotiations.
 - Any settlement of **tie**'s claims in respect of failures to deliver adequate and timely designs for the MUDFA programme. It is proposed that these are dealt with as part of the SDS final account. To establish the entitlement the relevant contractual notices will be issued.
 - Any compromise of **tie**'s position in respect of any potential future failure to deliver.
- 4.6 On conclusion of this settlement the **tie** chairman should write to the PB setting out **tie**'s frustration and concern that the management they have deployed and their approach generally has not lived up to the world class brand that they sold to **tie** and the residual worry that this will re occur, despite recent improvement. This should be followed up with a visit to the head of PB world in the US to reinforce this point. This lays down an informal marker should the position deteriorate again in the future.

5.0 Benefits of Proposed Settlement

- 5.1 The benefits of the draft settlement are:
- Minimises the opportunity for Infracore to pass SDS performance risk back to **tie**.
 - Recognises and recompenses SDS for the valid elements of their claim.
 - Settles price for outstanding SDS historical charges once and for all.
 - Includes payment in respect of the unbudgeted (but valid changes) in respect of the implementation of the Value Engineering changes at the Depot and the EARL bridge (**tie** value of these changes £230K).
 - Settlement represents a £2.0m reduction in SDS's expectation of £4.5m and a £0.65m saving against the current budget as shown below:-

	SDS Expectation (£m)	Settlement (£m)	Difference (£m)
Historical Changes	1.13	0.55	0.58
3 Additional items (VE and MUDFA support)	0.51	0.33	0.18
Claim	2.86	1.62	1.24
Totals	4.50	2.50	2.00
Budget	-	3.15	-
Saving on Budget	-	0.65	-

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- Provides incentivisation for SDS to deliver to the current programme by deferring payment of substantial sums to the completion of key designs stages. This:
 - Incentivisation aligns with the procurement and construction programme.
 - Keeps open the set-off of any **tie** claims for damage from any potential future failure in performance against the settlement sums.
- Avoids disruption and distraction to the project at this critical time.

6.0 Mitigation of future failure by SDS

- 6.1 SDS's performance in respect of both MUDFA designs and the main Project designs have improved over the last three months. Slippage has stabilised as is demonstrated in the Tram Project Board Progress Report.
- 6.2 Whilst SDS claim that their difficulties in delivering the design to programme are now over with the resolution of Critical Issues, there remains the possibility of future failure. Any such significant future failure would result in delay to the procurement programme and subsequent construction programme together with significant additional cost.
- 6.3 To mitigate against potential future failure the following are proposed:-
- Intensive monitoring of SDS's delivery programme on a weekly basis to identify any slippages. This will provide the earliest opportunity to resolve the issues causing any such delay. Any issues in respect of performance will be addressed by director level oversight committee with representatives from **tie** and SDS.
 - Where delay is identified we promptly issue the appropriate formal notices in accordance with the contract (this may include persistent breach notices)
 - Moratorium on changes to the design along the alignment, unless part of the Value Engineering programme.
 - No further optioneering of the design along the alignment.
 - Put the design of structures that are subject to realisation of Value Engineering opportunity on hold pending the development of alternative structures with Infraco bidders.
 - Implementation of the planned due diligence by Infraco to identify any deficiencies in the SDS design at an early stage.
 - SDS to provide a list of personnel committed to the completion of the Edinburgh Tram Project who will not be diverted except with the express written permission of **tie**.
 - If future failure in performance arises set off **tie**'s costs against the deferred payment entitlements under the settlement agreement set out above.

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7.0 Recommendation

- 7.1 It is recommended that the Board:-
- Authorise the draft settlement, subject to SDS confirmation from their board and the agreement of the formal legal settlement and
 - Endorse the proposed actions to mitigate future delays.
- 7.2 The final settlement will be presented to the Tram Project Board Sub Committee for confirmation before final agreement and implementation.

Prepared by: Geoff Gilbert, Project Commercial Director

Recommended by: Matthew Crosse, Project Director

Date: 5 September 2007

Approved Date:-
David Mackay on behalf of the Tram Project Board