

DLA PIPER RUDNICK GRAY CARY

REPORT

SUBJECT: TRAM PROCUREMENT STRATEGY

Introduction

PART I of this paper summarises the legal procurement impacts of the provisional conclusions reached in a meeting of a TEL sub-committee to review the procurement strategy Options 1 to 4 and to discuss the contents of an options summary paper prepared by Alastair Richards and Keith MacMillan. PART II addresses each of the specific topics contained in David Powell's instruction letter of June 15th to DLA Piper.

No substantive discussions or conclusions flowed from the June 7 Meeting in relation to the treatment of the MUDFA contractor. Accordingly, this note does not address any issues relating to those aspects of the ETN procurement strategy.

PART I *Tram Supply Procurement*

In relation to the Tram Supply Procurement, the meeting discussed a number of possible scenarios around Option 1. The following is a summary of the scenarios based on Option 1 (which DLA Piper considers to be the optimal solution) based on the preliminary conclusions reached in the meeting and taking account of applicable procurement law :-

1. The Tram Supply Procurement could proceed with **tie** letting 2 contracts (as planned and currently envisaged), one for Tram Supply and one for Tram Maintenance.
2. The Tram Supply Agreement could be novated by **tie** to the InfraCo, but without the Tram Maintenance Agreement also being novated to the InfraCo.
3. The Tram Maintenance Agreement could be held by **tie** pending a decision to novate the Tram Maintenance Agreement to TETL or to a specifically procured ETN System Operation and Maintenance ("O&M") contractor.

Fundamentally all above steps would be within the ambit of the current OJEU notice relating to the TramCo procurement and would not themselves require any re-advertisement.

The following issues require consideration in response to Minute 02/02 and Minute 03/01 of Meetings 2 and 3 of the Procurement Strategy Sub-Committee.

- A. if **tie**/TEL required an ETN system wide O&M contractor to be put in place from the commencement of passenger carrying operations, a number of practical and procurement law issues arise:
 - the need to be procuring an O&M contractor simultaneously with closing the Tram Supply and InfraCo procurements;
 - a separate O&M contract competition being launched contemporaneously with the competition for the Tram Supply - Tram Supply competition continues in its current form (requiring a combined submission for supply and maintenance) - means the Tram Supply bidders will fear wasted time and expense when they see a separate

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O&M contract procurement covering the same services in terms of vehicle maintenance;

- it may be difficult to stimulate competition if O&M contract bidders see that part of the services for which they are being asked to tender (vehicle maintenance) is currently being sought from the tram supplier. **tie** is under a duty to conduct procurements where the requirements on bidders are proportionate; asking Tram Supplier bidders and O&M bidders to tender for the same scope is not proportionate.
- one party was excluded at the PQQ stage on the basis that it did not have the requisite technical capacity in the field of tram maintenance to allow it to progress. If an O&M contractor is procured separately in our opinion this is likely to give rise to a legal challenge from that party in relation to the tram supply procurement process;
- the timing of any challenge could be very adverse to the project programme, leaving the procurements some months down the line with an InfraCo contractor close to being appointed but with **tie** at a risk of having to recommence the Tram Supply competition.
- the cost and resourcing implications of a further regulated procurement.

B. To avoid legal risk, the procurement of a new system wide O&M contractor would therefore require the Tram Supply Procurement to be re-advertised and re-commenced from the outset and:

- if an entirely new O&M contractor was to assume responsibility for ETN system wide maintenance from the commencement of passenger carrying operations, what practical incentive would there be for the DPOFA contractor to carry out the commissioning operations properly and diligently? The DPOFA contractor may not be the new O&M contractor and if that were to be the case, a difficult interface would exist at a crucial stage of the system's development (commissioning and systems testing);
- A result might be the early termination of the DPOFA (other than at a "no-cost" break point). This would need to be considered and any cost arising would have to be factored into the overall project costs, alongside the cost/benefit analysis of adopting such a strategy.

C. Alternatively: **tie** could consider procuring an ETN system wide O&M contractor at the time of the first re-set under the DPOFA (3 years after the commencement of passenger carrying operations).

We would see this as having the following advantages (subject to commercial acceptability to TETL):-

- no need to re-advertise and re-commence the existing Tram Supply Procurement thereby maintaining market stability;
- no interface in relation to system/vehicle maintenance at the critical system commissioning and testing stage, with the party responsible for performing the commissioning exercise responsible for system and vehicle maintenance for the first

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3 years of in-service operation, so there will be alignment of interest to ensure that the commissioning works are carried out properly;

- TETL could have the initial Tram Maintenance Agreement novated to it, so that the incumbent operator becomes responsible for procuring maintenance, thereby removing an operational interface with InfraCo in terms of fault attribution on the non-availability of a tram
- the parties responsible for actual tram manufacture and actual infrastructure construction perform the task of ironing out technical flaws at beginning of service period;
- on the basis of representations made by TETL, they consider that the operator will be the most appropriate person to manage the provision of vehicle maintenance services by the tram manufacturer, as a subcontractor;
- tram maintenance by the vehicle manufacturer (as subcontractor to the operator) in the first 3 years of the vehicles life should help alleviate concerns that the Tram Supplier and Manufacturer may have over its exposure during the initial warranty period (to be limited to 2 years, other than for finishes and major components);
- there is precedent in other UK tram systems for the operator managing maintenance, but with the tram manufacturer carrying out the vehicle maintenance services as a subcontractor;

Note that if TETL were terminated, the tram maintenance contract would also end and require procurement, unless **tie** retained step in rights.

D. *InfraCo Procurement - Placing the availability/maintenance obligations*

If the ETN O&M contractor takes on wholesale responsibility for system availability (including infrastructure and vehicle maintenance), the question of the management of/responsibility for latent defects in the infrastructure design or construction will need to be carefully thought through. See also PART II Task 4(d) below. The ETN O&M contractor will not accept this risk.

The latent defect liability coverage period requires discussion. As a starting point, if the InfraCo were to be kept on the hook, then the statutory limitation period applicable under Scots Law would be 20 years. Infraco would be likely to attempt to reduce this period and to cap exposure.

PART II

E. *Responses for David Powell's letter of instruction dated June 15th 2006.*

1. *SDS Agreement*

1.1 Key Tenets

- **Contracting Parties** - Parsons Brinckerhoff Limited and **tie**.
- **Contract Effective Date** - 19 September 2005.

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- **Contract Duration** - Until the end of the defects liability period under the Infraco Contract.
- **Overarching Purpose** - to develop a detailed design for Line One, Line Two and other aspects (as required) of the Edinburgh Tram Network, to ensure that this design is "compatible with system integration" and to obtain all Consents (planning, TROs, TTROs etc) necessary for the design, construction, commissioning and opening of the Edinburgh Tram Network.
- **Novation** - it is the current intention of **tie** that PB Limited will, in due course, be novated to the Infraco. PB Limited will, therefore, be required to provide services pre-novation to **tie**, and post-novation to the Infraco.
- **Payment** - predominately paid on the basis of lump sum milestones. There are some provisional sums and, also, a schedule of rates for personnel.
- **Retention** - 3% or a £500k retention bond. PB Limited provided a bond. Bond is released on execution of the Novation Agreement.
- **Cap on liability** - £10m each and every claim (howsoever arising except for pollution or contamination claims where the cap is £10m in aggregate). No overarching cap.
- **Flexible suspension and termination rights** - grounds of termination include breach of a material provision, insolvency, breach of confidentiality provisions, no fault termination (on 60 days' notice), corrupt gifts, continuing force majeure and persistent breach. No compensation is paid on termination. The SDS Provider will be paid for the work it has carried out in accordance with the Agreement up to the date of termination. Demobilisation costs will only be paid where there has been no fault termination or termination following a **tie** default.
- **Robust Change Control Mechanism** - valuation of any change is based on the rates and prices included in the contractual pricing schedules. The SDS Provider must identify any instruction from **tie** that could amount to a **tie** Change within 10 Business Days of such instruction.
- **Standard tie dispute resolution procedure** - escalating through internal mediation (representatives and chief executives), external mediation, adjudication and court. Includes drafting to allow the joinder of disputes.
- **Assignment and novation** - standard **tie** provisions included which allow novation/assignment by **tie** without the consent of the SDS Provider to various entities including CEC, TEL and the Scottish Ministers.
- **Intellectual Property** - **tie** owns the Project IPR and has a licence for the SDS Provider IPR with the ability to grant sub-licences.
- **Insurances** - professional indemnity (£10m), third party liability (£5m) and employer's liability (£10m).
- **Controls on Personnel** - Key Personnel, controls on sub-contracting and removal of employees.

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1.2 *SDS Deliverables*

The scope of services which the SDS Provider is required to perform is very wide and encompasses undertaking "all design and Deliverables necessary to enable the Edinburgh Tram Network to be procured, constructed, tested and commissioned ... and then operated and maintained". Specific deliverables include:

- design of the Edinburgh Tram Network (preliminary and detailed);
- design of utilities diversions (preliminary and detailed) and other activities to support the technical requirements of the MUDFA Works;
- development of requirements specifications into a suite of **tie** requirements/technical specifications (e.g. trams, OLE, fare collection equipment, track formation, tram stops, civil and structural engineering works, depot etc);
- necessary research, surveys and investigations;
- production of a tram service simulation;
- procurement and construction support (development of tender documentation and provision of technical support to **tie**);
- obtaining relevant planning consents and permissions, traffic regulation orders (permanent and temporary) and all other necessary consents;
- management of stakeholder (statutory and non-statutory) issues and assisting in respect of the realisation of the Parliamentary Undertakings;
- operations development support (includes working with the Operator on technical and system integration issues);
- undertaking comparative technology reviews so as to identify the most appropriate ways of delivering the functionality required of the tram system and its components; and
- transport modelling and production of the SDS-JRC Modelling Suite

1.3 *Milestones*

A gateway process has been set up in the SDS Agreement in order to control the progress and payment of the SDS Provider. Phases are as follows:

- Requirements Definition - cap of 50% of payment until Milestone completion;
- System-Wide Preliminary Design Requirements - no payment until Milestone completion;
- Preliminary Design (in respect of Sectors/Sub-Sectors) - cap of 80% of payment until Milestone completion; and

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- Detailed Design (in respect of Sectors/Sub-Sectors) - cap of 80% of payment until Milestone completion.

1.4 Risks

A detailed risk matrix featuring the contractual risks inherent in the SDS Agreement has been separately prepared. Some of the key risks which are mitigated by the drafting in the SDS Agreement are:

- Design liability - this does not remain with **tie** and is novated to the Infraco;
- Programme - early design facilitates benefits to the programme;
- Consents - worked on early so as to mitigate later delays;
- Pricing - greater certainty on pricing as design is available for pricing purposes; and
- Utilities design is carried out early so as the required utilities diversions can be carried out in advance of the Infraco Works.

1.5 tie Deliverables

tie is required to issue the "normal" deliverables as would be expected in relation to the administration of any consultancy agreement. This includes adherence with payment protocols and certification procedure, notices under the Review Procedure, notices under the dispute resolution procedure and protocol for instructing **tie** Changes.

2. Advice on issues arising in relation to the SDS Agreement (numbering as in letter of instruction)

2.(e) Transfer of detailed design to the Infraco and removal of scope of work from the SDS Agreement

The removal of scope from the SDS Agreement is envisaged in terms of Clause 29 of the SDS Agreement, which can be summarised as follows:

- **tie** may in its absolute discretion require the reduction of the scope of the Services prior to the execution of the Novation Agreement by the SDS Provider.
- If required, the SDS Provider is required within 5 Business Days of any request from **tie**, carry out a valuation of all work in progress subject to any agreed milestone or lump sum payments set out in Schedule 3 (*Pricing Schedule*).
- **tie** will, subject to any clarifications as are in **tie's** opinion (acting properly and reasonably) necessary, certify by notice in writing to the SDS Provider that part of the work in progress which is approved by **tie** and give reasons why any part of the work in progress has not been certified and the value of the sums involved no later than 10 Business Days after the date on which such valuation was received. **tie's** valuation of such work in progress is final and binding.

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- If the scope of the Services is reduced by **tie**, then within 30 Business Days of the date of execution of the Novation Agreement by the SDS Provider, the SDS Provider is required to submit a valid VAT invoice to **tie** for the work in progress certified by **tie** in respect of the services which have been removed from the Services to be performed by the SDS Provider.
- Payment will become due to the SDS Provider on the date of receipt of the valid VAT invoice by **tie** and the final date for payment by **tie** of such valid VAT invoice shall be 30 days from the date of receipt of such valid VAT invoice.

It was previously anticipated by **tie** that any proposals for amendment to the scope of Services would follow the bidders being given an opportunity during the procurement process for the Infraco Contract (and the Tram Supply Contract) to review the design which had been carried out by PB Limited and propose amendments to the scope of the design being produced, which would represent value for money and would not adversely impact upon the Programme. One of the Tram Supply bidders has circulated its comments on design issues which it expects the SDS Provider to have taken account of and design issues which the Infraco should take responsibility for carrying out.

The contractual provisions in the SDS Agreement on bidder due diligence can be summarised as follows:

- The SDS Provider is required to make suitable facilities and resources available upon reasonable notice from the bidders for the Infraco Contract and the Tram Supply Contract to permit and facilitate the ability of these bidders to thoroughly examine, check and satisfy themselves as to the adequacy, correctness and suitability of the Deliverables which have been created by the SDS Provider and which the Infraco and the Tram Supplier will be adopting and making use of respectively in the Infraco Contract and the Tram Supply Contract.
- No additional costs are payable to the SDS Provider in respect of the provision of such suitable facilities and resources or the supply to bidders of any Deliverables as part of the procurement process.
- The SDS Provider is also required to permit the bidders for the Infraco Contract and the Tram Supply Contract to carry out a due diligence exercise on the SDS Agreement (including any commercial terms) prior to the award of the Infraco Contract and the Tram Supply Contract provided that **tie** is to procure that such bidders are required to enter into a confidentiality agreement or other agreement incorporating provisions on confidentiality.
- Within 10 days of any request from **tie**, the SDS Provider is required to provide an Estimate of any changes proposed by the bidders for the Infraco Contract to the scope of the Services or the Deliverables, which have been notified by **tie** to the SDS Provider.

Whilst it was anticipated by **tie** that some detailed design might be removed, at the request of Infraco bidders, from the SDS Provider's scope on the basis of the capabilities of the Infraco bidders (e.g. design in respect of OLE), it was not

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envisaged that all detailed design would be removed from this scope. Instead it was anticipated that a novation of the SDS Agreement to the Infraco would always occur, with the SDS Provider performing a potentially reduced set of services to the Infraco post novation. Primarily, novation ensures that no residual design risk (or other contractual risk) remains with **tie**. Novation also provides a contractual mechanism through which the Infraco can "back off" its design liability to the SDS Provider.

If what is required by **tie** is for all detailed design to be carried out by the Infraco, it would be contractually possible to remove the provision of all detailed design from the scope of the SDS Provider by operation of Clause 29 described above. Another option would be termination of the SDS Agreement by **tie** on the basis of "no fault", if no other Services were required from the SDS Provider.

The removal of such detailed design creates the following issues, which require to be addressed:

- timing of the scope reduction. If the SDS Provider is not carrying out any detailed design, then should the design process be stopped now ?
- is any collateral warranty given to the Infraco in respect of the preliminary design ? Would this be acceptable to the SDS Provider ? Full transfer of the design risk to the Infraco may not be possible.
- what is the impact in terms of the Programme? Does the process for applying for planning consents, Traffic Regulation Orders etc stop ?
- no compensation for loss of profits/earnings is payable to the SDS Provider in terms of a removal of scope or termination, but payment will be made in respect of the work carried out to date. There is likely to, therefore, be a level of abortive costs.
- are services other than detailed design to be truncated ? What about the design of utilities diversions, the development of the SDS/JRC Modelling Suite and the carrying out of surveys?

If all detailed design is removed from PB Limited and the consequence of this is that a novation does not occur, there are public procurement risks in respect of potential claims from SDS bidders who did not want to be novated and Infraco bidders who did not want a designer novated to them. We know of at least one SDS bidder who did not want to be novated.

A technical analysis would need to be carried out by **tie** to assess the risks and benefits of the transfer of the detailed design to the Infraco. However, given the issues raised above, we recommend that a truncation of some of the detailed design rather than removal of all detailed design from the SDS scope is more appropriate. The process for identification of the design which could be carried out by the Infraco should be carried out by the Infraco bidders following issue of the Infraco ITN.

2.(f) Not novating the design to Infraco and keeping the SDS Provider as in-house designers

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Under the terms of the SDS Agreement, it is not a requirement that **tie** must novate the SDS Agreement. Therefore, the SDS Provider could continue as **tie's** in-house designers without there being a need to amend the current SDS Agreement. (Although an amendment may be required to the duty of care and this would need to be checked.)

If the SDS Provider is retained as in-house designer to complete the detailed design and it is intended that the Infraco should have no design liability under the terms of the Infraco Contract, then the Infraco is appointed (potentially) as a "build only" contractor. The following issues arise in relation to this:

- if the design is not novated, then it is assumed that the Infraco will not be able to take on the risks associated with system integration;
- the SDS Provider will carry the design risk alone which will mean that in the event of any latent defects/dispute associated with the design, **tie** will not be able to rely on the larger financial covenant (backed by bonds and guarantees) of an Infraco to deal with such latent defects/dispute;
- if a novation does not occur, there are public procurement risks in respect of potential claims from SDS bidders who did not want to be novated and Infraco bidders who did not want a designer novated to them. As mentioned above, we know of at least one SDS bidder who did not want to be novated;
- there would be an element of duplication between the SDS Provider and the intended post-novation role of the TSS Provider, and a decision would need to be taken as to whether both consultants were required; and
- **tie** will be separately managing the SDS Agreement and the Infraco Contract, and this is, therefore, an additional contractual interface for **tie**.

If it is intended that the Infraco assumes the risk of design liability for the design produced by the SDS Provider (as in-house designer) without there being a novation, then there is a risk that this would not be acceptable at all to the Infraco. If it was acceptable, there would potentially be a high cost associated with this. The Infraco would also require a collateral warranty from the SDS Provider.

2.(g) Negotiating strategy to achieve savings on the above

There are contractual provisions to deal with any reduction in scope of the Services to be provided by the SDS Provider, and these have been described above.

If the SDS Provider is not to be novated, then this potentially could result in a reduction in PB's fees. However, it could be difficult to argue the level of any reduction given that the novation was always expressed as being at **tie's** discretion. **tie**, therefore, does not have a strong negotiating position unless it is determined that PB Limited do not want to be novated and would be willing to reduce their fees if they are not to be novated.

2.(h) Changing from Lines One and Two to Phases 1A and 1B and the associated runtimes

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This has been the subject of a **tie** Notice of Change. We have not been involved in advising **tie** in relation to this. The protocol for instructing and agreeing **tie** Changes is set out in Clause 15 of the SDS Agreement. The steps for issuing a **tie** Change can be summarised as follows:

- **tie** issue Notice of Change on the SDS Provider. This Notice of Change should set out the required Change in sufficient detail so as to enable the SDS Provider to respond.
- The SDS Provider has 18 days to respond with the Estimate in respect of the required Change. The Estimate includes the SDS Provider's proposals in relation to any impact on the Services and the Programme, method of delivery, mitigation proposals, impact on costs and any required amendments to the SDS Agreement.
- Changes are valued by **tie** in accordance with the Pricing Schedules in the SDS Agreement where the Change relates to similar work.
- SDS Provider is required to minimise costs, mitigate the impact of the Change and seek competitive quotes (where required by **tie**).
- As soon as reasonably practicable after receipt of the Estimate, the Parties meet to discuss the Estimate. **tie** may modify the Notice of Change and the SDS Provider has 14 days in which to respond.
- If there is a failure to agree the Estimate, this can be referred to the dispute resolution procedure. The SDS Provider may refuse to carry out a Change in limited circumstances (e.g. where the Change would be contrary to Law or not technically feasible).
- After the Estimate is agreed or determined, **tie** may issue a Change Order confirming the Estimate or withdraw the Change.

We anticipate that the Change Order relating to Phases 1A and 1B will impact on the pricing schedules and on the contract programme. We do not believe that a change to the contractual scope or the other provisions of the contract would be required, but advise that this should be fully checked out.

3. *DPOFA - Key tenents, deliverables, milestones and risks*

The review of DPOFA is contained as Appendix 1 to this Report. We have not been able to reduce this summary to two A4 sides, given the scope of DPOFA and the relative importance of its key provisions.

4(a) *Transfer of DPOFA ownership to TEL and TEL June Board Paper*

A separate paper has been provided on this issue: DLA Piper advice dated May 31 2006.

4(b) *Impact of these changes on Tramco and Infraco Contracts*

The proposed revisions and refinements to DPOFA as outlined in the TEL Board Paper have at present no impact on the draft Tram Supply and Maintenance contracts.

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The impacts of the proposed DPOFA revisions on the draft Infraco contract are explained in detail in the response to Task 4(a) above and will also entail the loss of certain termination rights for **tie** under DPOFA. The revisions of relevance to the Infraco contract concern the interface between Infraco and TETL and the mechanism for permitting relief in the event that deficient performance by one party affects the other party's ability to discharge its contractual responsibilities in accordance with the prevailing key performance indicators. The DPOFA also provides (in a side letter) for the Infraco Contract to provide for co-operation and consultation between TETL and Infraco on a variety of commercial, operational and technical matters. The actual drafting for much of this (as foreseen in the DPOFA side letter dated 14 May 2004) is already contained in the draft Infraco Contract and requires detailed client review, instruction and sign off.

4(c) *Is the CSA Contract included in the documentation?*

The CSA is a separate draft contract to be concluded between TETL and Infraco. The draft contract already awaits client's instructions on all key commercial issues and has been reviewed by TEL.

4(d) *Novation of Tram and InfraCo maintenance contracts to TETL*

A novation of Infraco ETN system maintenance responsibilities to TETL would raise the following issues:

- The intention has been to structure the Infraco's involvement post service commencement as an integrated availability and maintenance delivery responsibility, for a minimum of six years secured by appropriate performance bonding and handover security.
- This was validated by market soundings and viewed as desirable by Transport Scotland, **tie**, its advisers and PUK and the Infraco Contract payment mechanism has been designed by PWC in outline around this approach. A transfer of these responsibilities to TETL as a scope change under DPOFA would require a pricing negotiation with TETL, which would not be subject to competition. This would also create some procurement risk since it (i) was never explicitly envisaged that the incumbent operator would take over complete system availability and maintenance duties (ii) parties who did not express interest on the basis that they wished only a construction contract might challenge this variation to scope.
- If a different party to the Infraco is to be responsible for making the system available and for maintaining it, there would be no logic in including these elements in the infrastructure procurement process. They should be tendered separately on the basis that the responsible O&M party begins its work at the time the system is brought into service by Infraco. This would require the O&M procurement to be commenced so that award of the contract would coincide with the end of Infraco's system testing and commissioning phase.
- The maintenance element of Infraco responsibilities is not currently written as a severable contract for novation to TETL, either at contract award (selection in Task 4(d)) or service commencement ("completion") at Task 4(d). Not having Infraco maintain its constructed system is likely to result in

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tension over whether future routine maintenance activity has caused and/or exacerbated technical defects. Requiring Infraco to act (at **tie's** option) as maintenance sub-contractor to TETL could be provided for in the ITN and would not be prevented by the Infraco OJEU Notice. System maintenance could then be managed by TETL but executed by Infraco.

- Would this configuration be acceptable to TETL and to Infraco bidders?

Note that if TETL were terminated, the system availability and maintenance contract would also terminate unless **tie** retained step in rights.

Novation of Tram Maintenance to TETL

- This issue has been reviewed in PART 1 of this paper.

4(e) *Negotiation strategies*

Revisions to DPOFA

The approach for negotiation of the DPOFA agreement revisions with TETL is outlined in our advice paper of 7 December 2005, 26 January 2006, 15 April and 31 May 2006. To recap, it requires:

- commercial and financial work to be completed on the precise changes TEL wishes to propose to and achieve with TETL. This work entails:
 - the identification of how precisely TEL/**tie** wish to recalibrate the DPOFA payment mechanism and incentive regime
 - the compilation of a set of exact commercial approaches to cost rationalisation within DPOFA
 - constructive engagement with TETL to achieve this within a timeframe which permits the closure of issues prior to ITN issue for Infraco ideally, but certainly prior to Infraco BAFO stage.
 - Negotiation parameters to be set.

Novation of Tram maintenance contract to TETL

- A **tie** decision would be required now to inform Tram maintainers (within the formal tram supply contract competition) that their contract is to be novated to TETL, who would manage their performance for the contract term.
- TETL would need to be informed by **tie** now that their DPOFA scope is to be varied, so as to absorb the management of tram heavy maintenance in addition to tram light maintenance currently within DPOFA scope. This has no significant procurement implications.
- The timing of this contract novation should be prior to the delivery of tram vehicles for testing and commissioning in order to allow the maintainer/operator to bed down.

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- The decision on the novation of this maintenance arrangement to TETL could be taken at first reset interval under DPOFA, three years after service commencement.
- DPOFA would require amendment to permit payment to TETL for tram heavy maintenance.
- **tie** should retain step in rights on DPOFA termination.
- TEL's role, capacity and corporate status will require explanation to bidders.

Novation of Infraco availability/maintenance contract to TETL

- The availability/maintenance responsibilities of Infraco need to be scoped separately for the entire system, alongside appropriate contractual provisions.
- The Infraco ITN would need to instruct Infraco bidders that their availability/maintenance obligation will ultimately be owned and managed by TETL. The novation would need to be completed prior to system testing and commissioning.
- DPOFA will require amendment to permit payment for system maintenance to be made to TETL.
- **tie** should retain step in rights.
- TETL would need to indicate now a reasonable level of acceptance of the Infraco contract provisions.
- TEL's role, capacity and corporate status will require explanation to bidders.

The above analysis does not at present configure any planned novation to TEL regarding TramCo contract, Infraco contract obligations or DPOFA which would require proper consideration as to timing and acceptability to third parties.

**DLA Piper Rudnick Gray Cary Scotland LLP
20 June 2006**

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APPENDIX 1

TO REPORT OF 20 JUNE 2006

**KEY TENETS AND DELIVERABLES IN THE DEVELOPMENT PARTNERING AND
OPERATING FRANCHISE AGREEMENT ("DPOF AGREEMENT")**

Notes

1. The defined terms used in this Note are in Schedule 1 to the DPOF Agreement.
2. DPOFA was structured to provide **tie** with considerable flexibility and protection/rights as regards termination, ETN scope and payment obligations.

| Topic | Key tenets and deliverables |
|--|---|
| <i>Parties, Term, Effective Dates and Phased Introduction of the Lines</i> | |
| <i>Parties to the DPOFA</i> | tie and TETL. |
| <i>Term</i> | <p>15 year contract term (approx 9/10 years of operating if construction is completed in 2009) with option for client to extend for up to 5 years.</p> <p>4 Project Phases:</p> <p>Phase A - Development; Phase B - Infrastructure and Vehicle Procurement; Phase C1 - Construction/Implementation; Phase C2 - Mobilisation and Testing/Commissioning; Phase D - Operations.</p> <p>During Project Phases A, B, C1 and C2, TETL is consulting. During Project Phase D, TETL is the Operator.</p> <p>Project Phase Completion Notices (PPCNs) are issued at the end of Project Phases A, B and C1 to allow the Operator to progress to the next Project Phase.</p> |
| <i>Effective Date</i> | <p>14 May 2004</p> <p>The Operating Appendix (Phase D) comes into effect on the satisfaction of various conditions precedent by the Operator.</p> |
| <i>Project Partnering Approach</i> | The DPOF Agreement embodies partnering principles: working in mutual cooperation, pricing on an open book basis, avoiding unnecessary complaints, disputes and claims, not interfering with the other Party's rights or the performance of the other Party's obligations under the DPOF Agreement, and mitigating losses and liabilities. |
| <i>Management of the Project</i> | A joint team will be the forum for partnering, liaison, co-operation and co-ordination. The Project will be managed on a day-to-day basis by the tie Project Manager and the Operator shall appoint the counterpart Operator Project Manager. |

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| <i>Project Development Services</i> | <p>The Operator provides the Project Development Services during Project Phases A, B, C1 and C2 to be provided in accordance with various standards including:</p> <ul style="list-style-type: none"> • Good Industry Practice and Law; • so as not to wilfully detract from the image and reputation of tie, CEC or the Project; • in a manner not likely to be injurious to persons or property; • the Project Development Objectives; and • the Programme. |
| <i>Quality Assurance</i> | <p>During all Phases, the Operator is obliged to have a quality management system in place, overseen by a Quality Manager.</p> |
| <i>Standards of the Transport Services and Project Operations</i> | <p>The Operator is required to provide the Transport Services and the Project Operations in accordance with various standards including:</p> <ul style="list-style-type: none"> • the Operating Method Statements; • Good Industry Practice; • so as not to detract from the image and reputation of CEC or tie; • all applicable Law and Necessary Consents; and • the Environmental Statement. |
| <i>Service Performance and Quality Monitoring</i> | <p>The Operator is required to comply with the provisions of the KPI Regime and the Performance Monitoring Regime. Monthly performance review meetings, Service Quality Reports and Deductions.</p> |
| <i>System Timetable</i> | <p>The Timetable will be agreed 60 days prior to the Planned Service Commencement Date. Amendments only with tie's prior written consent.</p> <p>Detailed provisions cover the organisation of Project Operations to accommodate Special Events (e.g. Hogmanay).</p> |
| <i>Fare Setting and Participation in Integrated Ticketing Scheme</i> | <p>The fares structure for the trams will be set in accordance with the CEC Fares Policy. The Operator is obliged to implement its Service Integration Plan in relation to an integrated ticketing scheme and in the Concessionary Travel Scheme.</p> |

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| <i>Edinburgh Tram Network Integration</i> | The Operator has responsibility for maintaining and implementing its System Integration Plan and its Service Integration Plan. The Service Integration Plan will include arrangements with other local transport providers. |
| <i>Maintenance</i> | The Operator is responsible for light maintenance. Obligation to work together with Infracore to deal with the impact of maintenance on the provision of the Transport Services. |
| <i>Best Value and Benchmarking</i> | The Operator to secure continuous improvement in the performance of the Project Operations. |
| <i>Payment during Project Phases A, B and C1</i> | <p>Payment from tie to the Operator made in respect of the Operator's Core Team (which is a Capped Fee) and in respect of any additional services required from the Operator's Non-Core Staff (at agreed fixed rates). The Services required and the budget for those Services agreed on a quarterly basis. Unless agreed by tie, no payment made by tie in excess of the agreed budget.</p> <p>Within 5 Business Days of certification, the Operator required to issue an invoice for 75% of the certified costs - 25% retention.</p> <p>When the final payment is due and a PPCN issued, the Operator is to issue an invoice to tie for 100% of the retained sums.</p> <p>Fees payable during Project Phases A, B and C1 capped. If the cap is breached because of a delay (not due to the Operator), a budget for further services from the Operator agreed if required by tie.</p> <p>The Parties may agree to suspend provision of the Project Development Services for any period up to a maximum of 12 months.</p> |
| <i>Payment during Project Phase C2</i> | <p>Target Costs payment regime and applications for payment made by the Operator no later than 7 days after the end of each month. These applications will state the actual costs and the Profit Element (agreed in advance and calculated as a % of Target Costs. Certification of the amount claimed will be subject to a budget agreed by the Operator and tie at the beginning of each month.</p> <p>Payments during Project Phase C2 also be subject to a 25% retention.</p> <p>tie only certifies actual costs above the level of the agreed Target Costs to a level of 20% of these actual costs with a cap at 10% of the agreed Target Costs. Operator entitled to a share of 50% of any saving against Target Costs.</p> |

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| <i>Amendments</i> | <p>The Base Case Assumptions are a set of financial assumptions prepared by the Operator.</p> <p>During Project Phases A and B, amendments may be agreed to these agreed Base Case Assumptions to reflect Changes in Law and/or these Base Case Assumptions becoming Inappropriate Base Case Assumptions.</p> <p>Amendments during Project Phases C and/or D dealt with as change.</p> | | | | | | | | | | | | |
| <i>Payment during Project Phase D</i> | <p>Applications for payment will be made in arrears by the Operator for the budgeted Target Operating Costs and the Profit Element for the Reporting Period and following submission of a Service Quality Report to tie. There are 13 Reporting Periods in each year.</p> <p>Application for payment to include any performance deductions calculated by the Operator in accordance with the KPI Regime.</p> <p>Detailed provisions of the operation of the KPI Regime to be further developed after appointment of the Operator but contains all headline KPIs.</p> | | | | | | | | | | | | |
| | <p>Aggregated deductions of 30% or more during any Reporting Period result in a Major KPI Breach Notice requesting the Operator to deliver a KPI Rectification Plan setting out detailed measures to remedy. Unless cured this process continues on an increasing deduction basis, and if a second Major KPI Breach Notice is served: Operator Default.</p> <p>DPOFA currently contains a "pain/gain" share mechanism to share the excess/deficit of actual Operating Costs and actual Operating Revenues.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">Excess Target Revenues</td> <td style="width: 20%; text-align: center;">70% tie</td> <td style="width: 30%; text-align: center;">30% Operator</td> </tr> <tr> <td>Deficit Target Revenues</td> <td style="text-align: center;">70% tie</td> <td style="text-align: center;">30% Operator</td> </tr> <tr> <td>Excess Target Operating Costs</td> <td style="text-align: center;">50% tie</td> <td style="text-align: center;">50% Operator</td> </tr> <tr> <td>Deficit Target Operating Costs</td> <td style="text-align: center;">20% tie</td> <td style="text-align: center;">80% Operator</td> </tr> </table> <p>The Vision Achievement Incentive recognises sustained (three year) performance.</p> | Excess Target Revenues | 70% tie | 30% Operator | Deficit Target Revenues | 70% tie | 30% Operator | Excess Target Operating Costs | 50% tie | 50% Operator | Deficit Target Operating Costs | 20% tie | 80% Operator |
| Excess Target Revenues | 70% tie | 30% Operator | | | | | | | | | | | |
| Deficit Target Revenues | 70% tie | 30% Operator | | | | | | | | | | | |
| Excess Target Operating Costs | 50% tie | 50% Operator | | | | | | | | | | | |
| Deficit Target Operating Costs | 20% tie | 80% Operator | | | | | | | | | | | |

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| <i>Cost and Revenue Adjustment</i> | <p>The Target Operating Costs and Target Revenue may only be adjusted in limited circumstances:</p> <ul style="list-style-type: none"> • Qualifying Changes in Law; • Permanent Roads Changes; • Long Term Roads Changes; • tie Change or Operator Change; and • Reset. <p>Joint Revenue Committee sets the Target Revenue during Project Phase B.</p> <p>TETL is entitled to nominate a revenue consultant to join the Joint Revenue Committee. Parties not entitled to raise a Dispute with regard to the agreed JRC estimates of revenue.</p> |
| <i>Reset</i> | <p>"Reset" occurs every 3 years during Project Phase D: a review of the operating costs, revenues, performance by the Operator, customer satisfaction surveys, Annual Service Report and Best Value Improvement Plans.</p> <p>Following review, the Parties may agree to revise the Payment Mechanism, Target Operating Costs, Target Revenues.</p> <p>If the Parties are unable to agree revisions to the Payment Mechanism etc, either Party may go to the Dispute Resolution Procedure. tie retains the right to terminate.</p> |
| <i>Indemnity</i> | <p>The Operator is required to indemnify tie with regard to any actions, claims, losses etc. which arise out of or as a consequence of breach of the DPOF Agreement, non-performance or delay in performance, or breach of any statutory duty by the Operator. No reciprocal indemnity from tie.</p> |
| <i>Liability and Sole Remedy</i> | <p>Termination rights of either Party are only those rights set out in the DPOF Agreement (other than for fraud or fraudulent misrepresentation).</p> <p>There is no limitation on liability of the Operator for any breach of the DPOFA.</p> |
| <i>Performance Bond</i> | <p>During Project Phase D, the Operator is obliged to take out and maintain a "on demand" performance bond. The amount is to be confirmed; anticipated to be equivalent to about 6 months' operating costs (about £4-5m).</p> |

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| <i>Required Insurances</i> | The Operator is required to take out 3 types of insurance: professional indemnity insurance (£10m cover during Project Phases A, B and C with a 12 year "run off" period); employer's liability insurance (£10m cover during all Project Phases); and third party liability insurances (£5m during Project Phases A, B and C1 and £100m during Project Phases C2 and D). Annual review by tie . Uninsurable risk is dealt with by consensual approach. If uninsurable risk means unlawful to operate, termination occurs after six months. |
| <i>Relief Events</i> | "Relief Events" include: <ul style="list-style-type: none"> • fire, explosion, lightning, flood etc.; • failure by statutory undertakers to carry out works or provide services; • accidental loss or damage to a material part of the System; • any failure or shortage of power or fuel; • any blockade or embargo; • strikes affecting the public transport industry in Scotland; or • CEC or a Roads Authority closing roads or restricting use of roads. |
| | The occurrence of a Relief Event may entitle the Operator to an extension of time and/or relief from termination for Operator Default. Obligation to mitigate the effects of any Relief Event No relief if information is provided late and the KPI Regime will be in operation. |
| <i>Roads Changes</i> | There are 3 types of Relevant Roads Change: <ul style="list-style-type: none"> • Permanent Roads Changes treated as tie Changes; • Long-Term Roads Changes which persist for more than 3 months but are not permanent, not treated as tie Changes but may result in amendments to the Operating Output Specification, a recalibration of the KPI Regime and/or adjustments to the Target Operating Costs/Costs but not Target Revenue; and • Temporary Roads Changes which persist for less than 3 months, not treated as tie Changes but may result in amendments to the Timetable and/or amendments to the KPI Regime. <p>These must affect the passage of Trams and directly result in inability of the Operator to meet the Operating Output Specification.</p> |

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| <i>Qualifying Changes in Law</i> | <p>Qualifying Changes in Law are Changes in Law which:</p> <ul style="list-style-type: none"> • come into effect during Project Phases C or D; • involve additional Operating Cost and/or necessitate amendment; and • were not reasonably foreseeable prior to the end of Project Phase B. <p>Once any mitigation/adjustments are agreed, the Qualifying Change in Law treated as a tie Change subject to the Operator's right to refuse to carry out the Change in specified circumstances, for example, if Change not technically feasible or illegal.</p> |
| <i>tie Changes Operator Changes</i> | <p>Parties may propose changes by serving Notice of Change. This Notice will set out details of the Change and require the Operator to provide an estimate with various information including whether relief from compliance of any obligations is required, impact on the Project Operations, impact on costs and revenues, whether any additional Necessary Consents are required.</p> <p>If tie does not confirm the Estimate within 30 days of the contents of the Estimate being agreed, tie Notice of Change is deemed to be withdrawn.</p> <p>If the Change is expected to exceed £10,000, tie may require the Operator to seek competitive tenders.</p> |
| <i>Performance and Financial Adjustments</i> | <p>In the event of a tie Change, Qualifying Roads Change or Permanent Roads Change, amendments will be agreed so that the Operator will be placed in a No Better No Worse position.</p> |
| | <p>The agreed Profit Element will only be subject to change in the case of a tie Change which involves Network Expansion or a material alteration in the scope of the Project Operations such that it is reasonable to project a change in excess of 25% in either annual Operating Costs or annual Operating Revenues. The practical effect: if a change increases or decreases the Project Operations, the Profit Element will not be adjusted unless the Change is outside the stated parameter.</p> <p>However, during Project Phases A or B, if there is a truncation of Line 1 and/or Line 2, the Profit Element will be reduced on a pro-rated basis.</p> |
| <i>Network Expansions</i> | <p>tie may propose Network Expansions to the Operator and, if required, the Operator will carry out the required development services in relation to any such Network Expansions subject to agreement on fees.</p> |

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| <i>Termination during Phases A and B</i> | <p>Termination rights available to tie:</p> <ul style="list-style-type: none"> • termination in whole, if no Line has reached Project Phase C2 or D at the time of termination; • termination in part, in respect of any Line which has not reached Project Phase C2 or D at the time of termination; • during Project Phase A or B, termination in whole or in part where the Project is not affordable or there are risks which would not be prudent for tie to retain (overlaps with overarching "no fault" termination provisions). • failure to agree target costs/revenues in respect of Terminated Lines, Network Expansions, or any other Lines, then tie may terminate the DPOF Agreement; • delay in Planned Service Commencement Date and there is no reasonable opportunity of commencement of operations within 6 months of the planned date. |
| <i>Termination on tie Default</i> | <p>A tie Default means:</p> <ul style="list-style-type: none"> • an expropriation of a material part of the System and/or shares in the Operator by tie or any Relevant Authority; • failure by tie to make payment of £200k due under the DPOF Agreement; • breach by tie of its obligations which substantially frustrates or renders it impossible for the Operator to perform its obligations; • a breach by tie of the assignment provisions. |
| <i>Persistent Breach</i> | <p>If the Operator has breached any of its obligations more than once, tie may serve a Persistent Breach Notice.</p> |

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| <i>Termination on Operator Default</i> | <p>"Operator Default" means:</p> <ul style="list-style-type: none"> • breach by the Operator of any of its material obligations; • Insolvency; • breach of the assignation provisions; • abandonment; • failure to achieve service commencement within three months of planned opening; • if the Operating Costs exceed the Target Operating Costs in 6 Reporting Periods out of any rolling period of 12 months (except in the first 3 years of operation). |
| <i>Termination on Force Majeure</i> | <p>"Force Majeure Event" means:</p> <ul style="list-style-type: none"> • war, civil war, armed conflict or terrorism; • nuclear, chemical or biological contamination (unless caused by the Operator); or • pressure waves caused by devices travelling at supersonic speeds. <p>Relief, entitlement, mitigation responsibility and termination if prolonged.</p> |
| <i>Termination for Corrupt Gifts and Fraud</i> | <p>tie may terminate for a Prohibited Act by Operator or its affiliates.</p> |
| <i>Voluntary Termination by tie</i> | <p>tie may terminate for:</p> <ul style="list-style-type: none"> • failure of the Operator to sustain its service integration arrangements; • Operating Deficit (costs exceeding revenues) in 6 Reporting Periods out of any rolling period of 12 months (except in the first 3 years of operation); and • failure to agree adjustments to the Target Operating Costs and Target Revenues at reset. |

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| <i>Compensation on Termination</i> | <p>No compensation on termination will be payable to the Operator on termination for any reason. However, the following liabilities/payments may arise:</p> <ul style="list-style-type: none"> • any antecedent liability of tie that arose prior to the Termination; • any liability arising because of breach by tie of its obligations on termination or tie default or voluntary termination; • entitlement of the Operator to a Vision Achievement Incentive Payment; and • payment of demobilisation costs demonstrably and reasonably incurred in respect of termination arising out of failure to agree Network Expansions, occurrence of Uninsurable risks. |
| <i>Transition on Termination or Expiry</i> | <p>The Operator is required to provide to tie following expiry or termination a Handback package:</p> <ul style="list-style-type: none"> • employee details; • list of contracts, permits, licences, consents etc. • list of computer systems and software; and • insurance details. <p>The Operator to co-operate and liaise with tie and any Successor Operator.</p> |
| <i>Transfer of Personnel</i> | <p>TUPE obligations on the Operator on termination or expiry of the DPOF Agreement.</p> |
| <i>Dispute Resolution Procedure</i> | <p>There are two different types of DRP:</p> <ul style="list-style-type: none"> • referral to Chief Executives then court for Disputes arising during Project Phases A and B; and • referral to Chief Executives, mediation, adjudication and then court for all other Disputes. <p>Disputes need to be raised within 3 months of the occurrence of the event leading to the Dispute.</p> <p>A right to pursue a Dispute will be waived if there is a failure to observe a time limit within the DRP.</p> <p>Joinder of a Dispute under the DPOF Agreement with a dispute under the Infrastructure Delivery Agreement.</p> |

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| <i>Assignment and Changes in Control</i> | <p>The Operator may not assign any of its interests, rights or obligations or sub-contract any of its obligations without the prior written consent of tie.</p> <p>tie may not assign or novate without the prior written consent of the Operator except to certain stipulated public bodies, including TETL.</p> <p>No change of control of the Operator (or its parent company) without tie's written approval for 3 years following the Service Commencement Date.</p> |
| <i>"Boilerplate"</i> | The DPOF Agreement contains standard "boilerplate" provisions. |