

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

Paper to : **Tram Project Board**
Subject : **SDS Novation Issue**
Date : **18th September 2006**

1.0 Introduction

1.1 This paper sets out the current issues in respect of the SDS Novation and the status of their detailed design and the Project's recommendations to resolve these issues.

2.0 Background

2.1 The original OBC Procurement Strategy was based on SDS undertaking the design of the works under their contract with **tie**, largely completing this before award of the InfraCo contract and then the SDS design agreement being novated to the successful InfraCo bidder.

2.2 In this way the detailed designs, ~~warranted~~ checked and validated by TSS as delivering the Tram system functionality, are completed before conclusion of negotiations with the preferred InfraCo bidder. This would enable **tie** to negotiate a price with the preferred InfraCo bidder with minimal risk provision or exclusion in respect of the design meeting the functionality specified by **tie**. This novation was therefore a major component to the transfer of design.

2.3 This overlap of detailed design works and preferred bidder negotiations also reduces the overall delivery programme since the InfraCo contractor will already have a detailed design at award of contract.

3.0 SDS Design and Novation Issues

3.1 SDS are uncomfortable with the novation given a clause in their design contract which provides the Employer (either **tie** or the InfraCo contractor after novation) absolute discretion to decide whether the design deliverables are complete. SDS are concerned that an InfraCo may apply this clause unreasonably to avoid payment of monies due.

3.2 During pre tender consultations with InfraCo bidders they have intimated that they may not wish to use SDS to do all of the design, and in particular the system design (namely system integration) and those elements of the work that SDS would produce performance specifications for e.g. communications systems.

4.0 Implications Of these Issues

Novation

- 4.1 If, in an extreme circumstances, SDS were to refuse to novate their agreement to InfraCo the position would be:-
- Risk transfer is still effected by virtue of the contract between InfraCo and **tie** and SDS remain liable to **tie** for their designs meeting the functionality requirements, to the extent that they are relied upon by InfraCo.
 - In the absence of the novated SDS agreement the InfraCo will either
 - include risk premiums around the performance of their design
 - or
 - seek to exclude design liability, to a greater or lesser extent.
 - If the first of these scenarios transpires the delivery programme will be extended due to InfraCo needing to engage another designer to undertake detailed design work or validate the designs 'gifted' to InfraCo during the bid process, which they would only commence after award.
- 4.2 The above is shown graphically in the diagrams in Appendix A.

Extent Of Detailed Design Undertaken by SDS

- 4.3 As the InfraCo are taking the risk on designs they will have a view on which organisation is best placed to deliver each element of the detailed design and thereby mitigate their risks.
- 4.4 If InfraCo's views are ignored then **tie** will effectively be paying for work by SDS which is of no real value.
- 4.5 There is also the subsidiary but related issue that given the now compressed timescales the sequence of detailed design delivery by SDS needs to be prioritised on the basis of the elements that are risk and price critical to InfraCo.

5.0 Legal Position

- 5.1 DLA have advised on the legal position in respect of SDS's contract on these issues.

Novation

- 5.1 Legal position is that:-
- SDS's obligation to novate is absolute
 - **tie** holds a £500,000 on demand retention bond until such time as the novation is effected.
 - Failure to novate would trigger a termination event and give **tie** the right to recover losses (excluding consequential losses) up to the £10m cap per event.
 - **tie** also holds a parent company guarantee with Parsons Brinkerhoff Group, this would also be triggered in the event of SDS refusing to novate.

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Extent Of Detailed Design Undertaken by SDS

- 5.2 The legal position is that:-
- Under the novation arrangements **tie** may omit scope from the services to be novated to InfraCo.
 - it is intended that InfraCo tenders are being sought on the basis of a mandatory novation of SDS.
 - There are no significant procurement compliance risks if InfraCo refuses to accept a novation of the SDS design agreement or if SDS refuses to accept novation of their agreement to InfraCo and **tie** consequently retains design responsibility. The OJEU Notices are sufficiently flexible to defend this.

6.0 Proposed Mitigations

Novation

- 6.1 SDS's concern on the absolute discretion of the InfraCo deciding whether deliverables are complete is not unreasonable, provided that InfraCo is left with sufficient levers to protect its commercial position (otherwise they will argue for lower caps and possibly exclusions of liability). Therefore it is proposed that the project negotiates with SDS to relax this aspect of the current contract, possibly making any disputes on this issue the subject of dispute resolution. Legal advice is currently being provided on a range of options in this respect.
- 6.2 The Project will use the strong obligations on novation contained within the SDS contract as a negotiating lever to ensure that InfraCo's reasonable commercial position is maintained.
- 6.3 To gain comfort that that the principle of novation of SDS is accepted by InfraCo the Project will consult with InfraCo bidders to:-
- gain firm commitment on the principle of the novation of SDS and any issues and concerns that they may have.
 - Explore a reasonable compromise position
- 6.4 This consultation will be undertaken during the early early stages of the bid period (i.e. early October).
- 6.5 However, to maintain delivery pressure on SDS there will be no negotiation of this issue until nearer the end of the bid period – say mid December. This negotiation needs to be concluded before the return of InfraCo bids and commencement of negotiations. After this point bidders may feel more confident in taking opportunistic stances to minimise risk transfer.

Extent of Detailed Design Undertaken by SDS

- 6.6 To avoid unnecessary expenditure on detailed design that the InfraCo bidders will not use the Project will settle a common position with them to identify the extent of detailed design work they see as benefiting the tendering and negotiation process. The Project will then vary SDS's contract to reflect this.

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Prioritisation of Design work by SDS

6.7 By negotiation and agreement SDS's detailed design effort will be prioritised to minimise the bidder risk price and performance allowances or risk transfer exclusions.

7.0 Other Factors

7.1 SDS are also engaged to provide the design for the MUDFA contract. This work is critical to derisking the delivery of the InfraCo works by completing it prior to commencement of the InfraCo works. It is therefore critical that:-

- a) there is ~~not conflict of interest~~ competing priorities between their work for InfraCo (once novated) and their work for **tie** and
- b) That during the forthcoming intensive design period for completion of preliminary design and delivery of detailed design. [something missing?]

7.2 To address these issues SDS will be required to provide an entirely separate stand alone team to deliver the designs for all utility diversions including MUDFA. SDS will remain contracted to **tie** for the services that this team provide.

8.0 Consultation

8.1 The following will have been consulted on this recommendation prior to the Board meeting:-

- Damian Sharp – Transport Scotland
- James Papps – PUK
- David Connolly – CEC
- Graeme Bissett - **tie**

The paper will be updated and circulated to Board members should any significant changes be made following their review

8.2 It is noted that this paper was not reviewed by the DPD Sub Committee.

9.0 Recommendation

9.1 It is recommended that the Board approve the approach to dealing with this issue as set out above in paragraphs 6 and 7.

Proposed	Geoff Gilbert Project Commercial Director	Date:- 19/9/06
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Recommended	Andie Harper Project Director	Date:- 19/9/06
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Approved Tram Project Board	Date:-
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