tie **Limited**

Outline Business Case – PUK Comments on Risk Matters

The following observations have been raised by PUK in their review of the 'draft' Outline Business Case for the Tram schemes (August 2004) regarding risk matters. tie responses are shown in blue italics.

7. Section 5 – Whilst this section on risk analysis appears very thorough it is rather repetitive and would be improved by some distillation of the key points. *It is acknowledged that there is some repetition. However, this is intentional to try to emphasise certain messages. We have no intention to distil points within the OBC. However, it is likely that elements will be drawn from the OBC (on risk matters) into the uPFCs and that some refinements will be necessary.* We would like to discuss this section in detail but our principal comments are:

    a. If we understand the point made 5.1 3rd para, the omission of operating and revenue risk analysis from the OBC undermines the case being made. *Noted. We intend to dilute the emphasis on risks pertaining to InfraCo*. The paragraph uses restricted risk transfer to justify the limitation of the analysis *(this was not the intention-we will amend text to clarify)* but then paragraph 5.7.2. cites a range of operational risks which "are transferred to or shared with the private sector" – implying (somewhat questionably) the DPOF contract. *Noted. Intention was to imply a direct and indirect beneficial influence on operating expenditure as a whole and was not to infer that these elements were completely wrapped-up in DPOFA.* In practice the DPOF contract reduces but by no means eliminates the optimism bias in either operating costs or revenue forecasts and these aspects of the business case should be addressed. *Noted. We accept that further work will be required to move to greater certainty on both of these components and will make this point at 5.7.2.*

    b. Given a. above 5.2 requires some refinement. *We will amend 5.1 to broaden.* We will Whilst the majority of risks by number may appear to relate to scheme development, the commercial impact of the ongoing risks over the lifetime of the tram can be far greater and need to be brought into better focus here. *Accepted. We will make this point at the end of 5.2.*

    c. Construction Programme – we would like to see a detailed explanation of the programme assumptions used by the technical advisers. The OBC refers in several places to a 3 yr programme and yet to our knowledge no tram scheme in the UK has been built in this time – Nottingham's smaller system took over 4 yrs and the initial 3 yr programme for Leeds increased to nearly 5 yrs once the demands of the city authorities to limit the impact on activities in the city centre were accounted for – it would be surprising if Edinburgh's were any less demanding. Proceeding with early design and enabling work will help to reduce the construction period but longer durations have a significant affect not only on construction price but on the value of future revenue income to tie and CEC. *Noted. We will obtain the rationale for the 3-year construction period from our Technical Advisors and forward this as an Information Note.*

    d. 5.5.3. - our previous comments stand that whilst endorsing the intent of the analysis undertaken we question the extent to which 44% Optimism Bias has been reduced to 25% at this stage. *Noted. We stand by our estimates derived applying HM Treasury Guidelines and shown the overall robustness of our 'cost estimates plus optimism bias' in the benchmarking in Section 5.10.*

    e. 5.7.1 - we would like to understand the work that has been done to evaluate the costs of utility diversions. This has been an aspect of significant cost escalation elsewhere and was identified for particular attention by the NAO report. We would advocate a substantial risk provision to be made against any estimates for these activities. *Noted. We will obtain the rationale for the utility diversion estimates from our Technical Advisors and forward this as an Information Note.*

f. 5.7.2 – as noted above we believe this section needs some refinement. To our reading the text implies a greater level of certainty than is reflected in the DPOF contract which is subject to future adjustment and covers only the first few years of operation. *Noted. We accept that further work will be required to move to greater certainty on both of these components and will make this point at 5.7.2.* We query the comments on hard FM in the 3rd para as these costs are normally embodied within the PFI price. *Accepted. Will amend to infer there needs to be greater scrutiny of these elements rather than just capital expenditure.*

g. 5.7.3 – see comments above on variability of revenue forecasts but again here care is needed not to over state the certainty inherent in the DPOF contract. *Noted. We accept that further work will be required to move to greater certainty on both of these components and will make this point at 5.7.3.*

h. 5.10.1 – we would like to discuss the proportion of risk proposed to be retained as set out in the table. *These proportions have been defined through discussion with DLA.* The statement in the 4th para is misleading – whilst we will seek to protect tie where ever possible, tie will almost certainly be left with other material risks related to land, utilities, highway works, planning issues and more in the operating period. *Noted. We will expand to refer to those aspects listed to in the first two paragraphs.*

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