

Paper to: TPB Meeting date: 9 August 2007  
Subject: SDS commercial issues resolution  
Agenda item:  
Preparer: Geoff Gilbert

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## Introduction

SDS has submitted a claim for £2.8m representing their purported additional management costs resulting from changes, delayed critical issues resolution and delays to approval of the preliminary design. In addition, there are contract changes to the value of £1.1m, which are either disputed as changes, or where the value is in dispute.

The Project propose to enter into negotiations with SDS to reach a commercial settlement for the claim, and certain historical disputed change items, and seek Board approval for these negotiations.

## Reasons for undertaking a commercial settlement

The successful delivery of the procurement phase of the Project is dependent on design progress and completion, achievement of all approvals and consents and the novation of the SDS contract to Infracore.

SDS claim comprises several heads and although **tie** considers that the majority would be subject to legal knock-out, two major heads of claim remain to be assessed in relation to quantum.

**tie** considers that, as SDS has also breached the conditions of the contract, **tie** has an opportunity to lodge a counter claim in relation to the recovery of general damages. The preparation of this counter claim is likely to take a substantial amount of time and the likely success would be determined by the quality of the record keeping during the currency of the contract. **tie** is unable to provide an estimate of quantum at this time.

As the contract contains a dispute resolution provision it is not within **tie**'s gift to *prevent* SDS from referring this matter (ultimately) to an adjudicator.

Referral of a dispute through the formal procedure at this stage in the contract negotiations is likely to result in considerable damage to **tie**'s reputation (political and commercial).

Further, referral of a dispute through the formal procedure will potentially result in a delay to the placement of the Infracore contract.

Delay in design progress potentially threatens the novation of SDS to Infracore, as bidders lose confidence in the ability of the designer to deliver. The distractions of

a dispute will also delay and disrupt the due diligence process, which is critical to full acceptance of design by the recommended Infraco bidder, which will also delay the Infraco contract award. In the event of a dispute between SDS and **tie**, the Infraco bidders will exclude its resolution and impacts on programme from their deal. It is likely in such circumstances that they would not accept novation until such time that these issues are resolved.

A conventional assessment is likely to be both time consuming and disruptive to the progress of the Project during this critical phase, resulting in distraction in management and delivery time for both SDS and **tie**.

A commercial settlement enables historical commercial issues and changes to be concluded expeditiously and it also create an opportunity to incentivise SDS to complete designs by making part of settlement contingent on achieving key delivery milestones.

### **Heads of claim**

SDS claims to have suffered an increase in costs as a result of:

- I. Changes due to Charrettes with CEC / **tie**
- II. Changes due to additional third party agreements
- III. Changes required by **tie**
- IV. Consents
- V. Changes due to EARL
- VI. Tie's failure to accept and review the preliminary design
- VII. Changes due to third party developer's emerging designs
- VIII. Failure to update the master project programme

However, their entitlement to recompense for these events is contractually less certain due to:

- Terms and conditions set out in the SDS agreement and the extensive obligation on SDS to get "all approvals and consents and manage all the stakeholders".
- The failure of SDS to identify and set out the detailed list of all the critical issues, before end of February 2007.
- The failure of SDS to issue the appropriate notices to **tie** within the specified contract timescales.
- The implications to **tie**, MUDFA / AMIS, Tramco and Infraco of delays to attributable to SDS.
- The fact that the Tram Project suite of contracts are bespoke, one-off contracts and therefore untested, then there is a higher level of uncertainty in the interpretation and resolution of disputes by external third parties than where standard contracts are adopted.
- The fact that SDS did not qualify their bid and contract in respect of the number of design iterations, or assumptions, in respect of stakeholder expectations.

**tie's** counterclaim is based on breach of contract relating to these areas.

The alternative to a commercial settlement is to enter into dispute with SDS and invoke the contractual dispute resolution process. In the arena of dispute resolution, the outcome decided by third parties is less certain, given bespoke and therefore untested nature of SDS contract.

### Summary of Financial Position

SDS Position	
Claim (to 01/06/07)	2.8m
Changes in dispute	1.1m

Total expectation	<u>£3.9m</u>
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<b>tie</b> allowance in cost report	
Allowance for claim	2.2m
Allowance for changes in dispute	0.9m

Total comparable allowance	<u>£3.1m</u>
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Details of the relevant ranges will be presented to a special Board sub-committee (to be arranged).

### Proposed basis for settlement.

It is proposed to negotiate a settlement for the claim and disputed changes and include in the settlement a deferral of payment of significant amounts of the agreed sum contingent on:-

- Design deliverables – delivery of design completions and design assured packages to the agreed dates.
- Delivery of the utilities designs to the agreed programme.

Incentives for SDS to settle at a figure acceptable to **tie** are:

- Improved cash flow from early settlement delivered by:
  - Settlement of claim and
  - Settlement within their current accounting year.
- **tie**'s potential counter-claim for delays to **tie**'s overall programme due to:
  - Delay to commencement of Requirements Definition Phase.
  - Delay to commencement and completion of PD.
  - Delays to utilities designs and impact on MUDFA contract
  - Delays to completion of surveys by SDS
  - Delays to **tie**, MUDFA / AMIS, JRC, Infraco, Tramco and CEC
- Charges to SDS contract in respect of:
  - Relaxation of absolute obligation to obtain approvals.
  - Relaxation of run-time obligation

Both of the above are required to align SDS's contract with that of Infraco.

Using the negotiating levers referred to above, a settlement within the range of £2.5m and £3.1m could be achieved, based on the reactions of SDS at initial

meetings to discuss this approach. This being the range within which SDS are likely to accept without invoking dispute resolution.

**Programme for settlement**

Ideally settlement is required prior to selection of an Infraco bidder for conditional contract award recommendation. This will mitigate some of the Infraco concerns and risks associated with SDS. Therefore, ideally, settlement should be delivered by the end of August 2007. However, if a figure acceptable to **tie** cannot be achieved within this timescale, the backstop date for agreement is the conclusion of Infraco / SDS / facilitated negotiations by 1<sup>st</sup> October 07.

**Decision(s) / support required**

It is recommended that the Board authorises a special sub-committee to review the detailed assumptions contained in the claim and counter claim and, subject to this review, to delegate authority to the Project team to negotiate a commercial settlement with SDS within set parameters.

The Board is asked to authorise this paper and to confirm the principles and objectives set out in this paper.

**Proposed**                      Geoff Gilbert    27 July 2007  
Project Commercial Director

**Recommended**              Matthew Crosse    27 July 2007  
Tram Project Director

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