

4. COST SAVINGS

Approach to realising savings

Cost reductions will be achieved in two ways:-

- Negotiated savings in bidders and their supply chain's margins
- Savings achieved through developing and implementing value engineering. These savings are categorised as:-
 - Those proposed by Bidders
 - Those identified by the Project and
 - Those that are common to both Bidders and the Project

Negotiated Savings

The target for negotiated savings on margins is £14m, or higher, equating to a 5% reduction in current Infracore adjusted prices.

The negotiating strategy to realise these savings is:-

1. Creating expectation with bidders that savings on margins are required in order to enable the project to proceed. This will be done on part of the briefings given to bidders prior to return of consolidated proposals in April and will be referenced in the documentation provided to bidders to return their consolidated proposals.
2. Obtain greater clarity on the levels of margins built into bids by:
 - Obtaining detailed build-ups of current bids to identify margins and the proportion of work for major subcontractors work and proportion of work to be undertaken by the system integration consortia partner.
 - Configuring the pricing document for return of Consolidated Proposals to prompt bidders to disclose margins.
 - Obtain copies of consortia agreements to identify workload splits, risk and profit shares.
3. Apply leverage to encourage bidders to give up savings on margins by:
 - Emphasising the close proximity of the bids received i.e. that there is strong competition between bidders.
 - Reminding bidders of the predominance of price on the competition i.e. that they will need to reduce their prices to win.
 - Reminding bidders that savings are required in order to meet the final budget; that the gap with the budget is within reach i.e. bidders must also compete with the budget for the Project to proceed.
4. The stages for margin reductions are:
 - Initial reduction in Consolidated Proposal returns.
 - Further reductions during the negotiation phase.
 - Find reductions prior to nomination of Preferred Bidder.
5. During the negotiation phase set targets for further reductions in price, including identifying targets within bidders major sub-contractor work.

6. For the final reductions, prior to nomination of preferred bidder, undertake a final round of formal bidding on margins to focus bidders minds on offering up savings.
7. Identify the system integrator margin which is likely to be significantly higher than those of other consortia members and focus negotiation on reducing this.
8. Transport Scotland and CEC support negotiations by:
 - Continually reminding bidders of the need to make savings and of the expectation that this will come in part from reductions in margins.
 - Remind bidders of the significant buying power that Transport Scotland have e.g. the EARL, GARL, Borders, High Speed Link, Roads programmes of work, implying that co-operation will win a favourable view with Transport Scotland.
 - The Project liaising with Transport Scotland on the big negotiation messages that are to be reinforced with bidders. Establish regular high level meetings between Transport Scotland senior personnel and regional directors of the consortia members – preferably each consortia member separately to maximise competition between and within consortia members.
9. The consortia members are from large international corporations. It is therefore important to:
 - Create expectations early so that this is communicated up the management hierarchy.
 - Get local personnel 'on our side' so that they strongly argue our position and case within their own organisations.

The above approach will maintain competitive pressure on bidders throughout, maximising the potential to realise the targeted savings on margins.

In addition the same process will be applied to Tramco. The potential reductions are not currently taken into account in the £14m target.

Value Engineering (VE) Savings

Value engineering has been undertaken at a number of stages through the project. Certain savings were identified prior to the finalisation of the Preliminary Design Stage Project Estimate and taken into account in it. Shortly thereafter recognising the need to achieve savings (as noted in the Tram Project Board minutes) the Project implemented a value engineering exercise in early December with a target of identifying £50m of savings.

Building on the work already in hand the process for the development and implementation of VE Savings is:-

1. Identify all potential savings from the Project's Value Engineering initiative and each bidders proposals and categorise into easy, medium and difficult in terms of realisation and implementation.
2. Assess the potential cost saving impact together with the impacts on design, consents, programme and stakeholder approvals.
3. Agree the list of potential savings within the Project and allocate responsibilities for developing and implementing.

4. For those savings ideas that are common to the Project and both bidders agree scope and programme for developing and implementing now e.g. raising the level of depot, trackform solution (agree Project proposals with bidders and gain their input and ideas)
5. Consult stakeholders and gain agreement on potential savings list.
6. Require bidders to submit more developed proposals for value engineering with their consolidated proposals. (These will not be part of the formal evaluation but bidders will be encouraged to submit on the expectation that this will improve their chances)
 - Validate bidders proposals for value engineering proposals within the Consolidated Proposals to Deliverability (construction, planning & approvals)
 - Impact on Programme and cost – is it deliverable?
 - Impact on Maintenance
 - Impact on Operations
7. Before appointing preferred bidder, agree Value Engineering proposals to be taken forward and write into deal and agree the formula for firming up prices for adjustment of the contract price together with contractual mechanism for adjusting price for any remaining Value Engineering proposals that are not fully designed out .
8. Once Preferred Bidder is appointed Preferred Bidder works with designers (SDS and their own) during due diligence period to develop designs incorporating VE proposals.
9. Firm up savings where possible before award of contract.
10. As part of the planning and evaluation of proposals, the project will secure stakeholder and third party agreement and approval to proposals prior to contract close and approval. Change control will be applied when necessary.

Details of the value engineering savings proposed to be taken forward are listed in Appendix ????? These have been agreed within the Project as realistic areas for development.

The target for negotiated savings on margins is a minimum of £14m, equating to a 5% reduction in current Infraco adjusted prices to achieve the £517.5m Updated Project Estimate (cautious view).

Responsibilities for developing and implementing Value Engineering savings:-

- Mike Jeffereys supported by Andie Harper – Lead the identification and scoping of savings via the value engineering process already underway. Both the TEL and Transdev stakeholders are represented in the team delivering this process. CEC will be brought into the team once the proposals are more refined and have been fully assessed. They are expected to participate in late February.
- Susan Clark – Leads the implementation of savings proposals and manages the overall savings delivery programme.
- Responsibility for delivering individual savings rests with the project manager for the area of the works within which the relevant saving is implemented. Implementation will be monitored as part of the project management process.

The approach to delivering negotiated and Value Engineered savings is summarised in Appendix ????

Confidence that savings can be achieved

These are the opening prices in what is essentially an ongoing negotiation, a fact which the bidders are conscious of. Bidders generally do not enter negotiations without a negotiation margin built into their figures, as explained in our previous report.

There is latitude to negotiate reductions and achieve value engineering savings. The fact that prices are above the Preliminary Design Stage Project Estimate, figures which were benchmarked against and found to be comparable to the Merseytram contracts reinforces this view.

Both bids are sufficiently robust to form the basis of a strong competition which provides the commercial leverage to negotiate margin reductions.

Bidders are not only competing with each other but competing with the Project Estimate to win the work. This will assist in leveraging reductions in margins.

Both bidders have stated that they see opportunities to value engineer the scheme to reduce costs and both have to a greater or lesser extent put ideas to us. In addition the Project has identified a number of savings proposals from the Value Engineering initiative currently underway. These together with those proposed by the bidders, as endorsed by the Project, amount to £32m after factoring for the level of difficulty in implementation. Of this the "Easy" category savings amount to £22m which is considerably in excess of the £14m necessary to achieve the £517.5m Updated Project Estimate (cautious view) and this is before all proposals are priced.

This reinforces the view that the savings that we are proposing, as a minimum at the cautious level, are deliverable. In addition the experience of The Project Director and the Project Commercial Director is that savings of this magnitude have been achieved previously. For example of one major project that the Project Commercial Director was involved in savings of 14% were achieved between nomination of Preferred Bidder and award of contract through value engineered savings and negotiated reductions in margin.

Negotiations will be led by Mathew Crosse and Geoff Gilbert supported by a team selected from the current Infraco/Tramco evaluation team. Recognising the importance of delivering on the negotiation target the negotiation plan will be developed with the information emerging from the bid clarification and evaluation stages. The Project will take up PUK's offer of negotiation training for the team.

Recognising the importance of this phase of the Project both the Project Director and Commercial Director are committed to staying with the Project at least until award of contract (Critical illness etc excepted).

Avoidance of Post Contract Cost Creep

A number of measures will be applied to maintain costs within the Project Estimate at the post contract stage. These will centre around:-

- Right Design - Fully implementing the de risking principle on which the Procurement Strategy is based so that designs will be completed by SDS (in so far as is required by the Project) and due diligence undertaken by the Preferred Bidder such that they are fully accepted by Infraco as delivering the required performance and as being buildable. This will be completed before award of a contract.
- Right Process and Control - By rigorously applying the project change control procedure to control such that the Tram Project Board is able to decide on any such changes before commitment. This will be supported by:-

- Early warning procedures being applied to identify any issues which may threaten cost and time enabling pre-emptive action to avoid or mitigate where possible.
- Period cost reporting to identify potential cost impacts of potential future changes.
- Clear but limited delegation of authority to control the number of personnel who are able to instruct changes to work on site.
- Ensuring that consents are in place before work commences on site, thus limiting scope for:-
 - Design changes during construction to accommodate consents and
 - Awaiting delivery of consents after Infracore appointment resulting in high levels of standing costs.

Process for Delivery of Savings

Preferred bidder

Final Deal

Award

	Clarification Phase	Evaluation Phase & Negotiation	Facilitated Negotiation	Final Negotiation	Recommendation and Consultation
		Design Due Diligence			
Negotiated Savings	<p>Setting expectations:</p> <ul style="list-style-type: none"> ○ Communicate to bidders that need to make savings (competition with budget) ○ Emphasize that bids are close and that there is everything to play for ○ We expect competitive margins in consolidated proposals 	<p>Negotiate reductions on margins (before nomination of PB will settle margin reductions).</p> <ul style="list-style-type: none"> ○ Take bidders to a second round of competition before nominating preferred bidder 			
Value Engineering Savings	<ul style="list-style-type: none"> ○ Communicate to bidders that required more developed VE proposals and estimated reduction as part of consolidated proposals ○ Schedule all savings opportunities ○ Categorise Opportunities ○ Review and identify savings to assess impact in areas other than cost and assess deliverability against constraints 	<p>Validate Bidders' VE proposals for:</p> <ul style="list-style-type: none"> ○ Deliverability ○ Cost reduction ○ Programme input ○ Maintenance input ○ Impact on operations ○ Impact on performance 		<p>Preferred bidder works with designers to implement all VE savings in detailed designs</p>	

