tie Limited

Paper to	:	**tie Board / Tram Project Board**
Subject	:	**INFRACO OPTIONS ANALYSIS**
Date	:	**11th March 2009**

On 11th February and 19th February, the **tie** Board / Tram Project Board was advised of the difficulties being faced as a result of very poor progress by Infraco and an escalating series of disagreements leading to contractual dispute. The Board requested an analysis of both:

- Strategic commercial options available with a desired outcome of minimising further project delays, resolving commercial disputes within the bounds of the contract, turning around delivery performance and restoring confidence through an agreed programme and updated outturn cost estimate (See detailed paper at Appendix 1)

- Scope and funding options to provide 'safety valves' in respect of affordability if necessary and found to be acceptable by CEC and Ministers (See detailed paper on scope options at Appendix 2)

The following is an executive summary of these deliberations:

Preferred commercial strategy

In an environment where the consortium have refused to carry out work on the project, particularly on Princes Street, until the principal commercial disagreements have been resolved then the best outcome in any case is served by a rigorous and targeted pursuit of matters through the contractual Dispute Resolution Procedure (DRP) which demonstrates our determination to preserve the terms of the contract we have agreed, exposes the failures of Bilfinger to perform to other members of the consortium and helps minimise further delays as we can instruct the commencement of work whilst matters are being pursued through DRP. We have instituted DRP on the matters in dispute in relation to Princes Street.

The DRP process is governed by strict timetables and although it can be targeted a resolution of all significant matters in dispute would take several months during which time it would not be possible to provide stakeholders with the degree of certainty they require on outturn costs and programme. The DRP process and the way in which it will be targeted and progress monitored is the subject of a separate paper to the joint tie Board / Tram Project Board.

A prolonged DRP campaign is however unlikely to be in the interests of either party and our strategy is to use it as means to an end to force a more constructive resolution of issues in accordance with contract and delivery of cost and programme certainty. This would require a significant change in the contractual positions taken by Bilfinger as well as the ongoing quality of their engagement and delivery. It is likely this will require Bilfinger's consortium partners, in particular Siemens who are responsible for performance under the contract on a joint and several basis, to take

CEC00491577_0001

steps to deliver these changes. We can see an outcome where this may require the replacement of Bilfinger as the civils partner in the consortium either by a new partner or by the civils capability of Siemens and/or their subcontractors.

At the time of writing we are already seeing significant progress in this regard as Siemens have proposed the establishment of a constructive 'Framework Management' group to Bilfinger which would work to resolve matters without resort to formal dispute and construction would progress on the ground without delay. Although Bilfinger have not yet formally responded to their partner's proposals it represents clear daylight between the positions of Bilfinger and Siemens. In any case we must keep up pressure of our targeted DRP referrals.

Other commercial options examined and considered sub-optimal were:

- Termination of the Infraco contract – even if we had confident grounds to terminate this would mean losing the hard fought contract we have, the Siemens and CAF capability we are broadly satisfied with and the supply chain Bilfinger have now assembled. This option also presents very significant uncertainties with regard to an acceptable re-procurement timescale and pricing as well as the greatest risk of loss of stakeholder support for the project.

- **tie** step into the civils role – discounted due the additional risks and interfaces we would need to manage – not in accordance with the Business Case.

- Negotiate a settlement of contractual disputes and programme – in essence what Bilfinger want and likely to be a very expensive option indeed. Under the current Bilfinger stance this would involve working on a 'cost plus' basis outwith the contract to be able to make acceptable progress with construction.

Programme and outturn costs consequences of commercial strategy

On programme –

We have reported an <u>unmitigated</u> potential slippage of revenue service into Q2 2012 and that tie considers recovery can be achieved to deliver a date in Summer 2011 – with an outcome within this range. The most important determining factors are that there is no further significant slippage in programme (eg work in Princes St and in other places must progress immediately) and the consortium must engage proactively in implementing recovery solutions.

This is only deliverable if we get reengagement of the consortium (eg through the Siemens proposal for a Framework Management group) in the near future. Any re-procurement (either or the entire consortium or of a new civils partner) or a prolonged DRP engagement would give rise to longer delays.

(To date we have not formally considered the programme (or cost) impacts of a staged opening of Phase 1a eg commencing services from the airport to Gogar or to Haymarket in advance of a full opening.)

On outturn cost –

In January we presented a revised outturn range of between £528m and £546m, including the Phase 1b cancellation costs of £6m and on the principal assumption of significantly improved engagement of the consortium on all fronts. In the event that engagement has not improved and on several issues has worsened. If we achieve reengagement on delivery and programme in the very near future the outturn costs can still be delivered towards the top end of this range ie within the £545m available funding.

Any significant further delays to construction or any required re-procurement of the consortium or civils partner are likely to mean additional time related costs and price premia taking the outturn costs above the £545m mark.

In the event we didn't prevail in our contractual position with regard to Infraco responsibility for design evolution or the consortium's historical failure to commence work where dynamic management of the programme would have allowed then additional costs above the £545m mark would also result.

In any event the negotiation of a settlement of contractual disputes and programme as Bilfinger are seeking, including the prospect of working on a cost plus basis outwith the core contract provisions, is likely to deliver a very unaffordable outcome.

We are not as of today in a position to determine with adequate certainty the impact of the above uncertainties on outturn costs. The consideration of scope and funding options below must be considered as scenario planning for circumstances where a 'safety valve' of say £30m is required.

Scope options

We have considered further value engineering of design ie delivering the same tram service for less cost and conclude that not only have all significant opportunities been reflected in the design already, the additional cost of delays and approvals risk associated with any material redesign activity would very likely outweigh the cost benefits.

We have considered a number of options for truncation of the Phase 1a scope, in essence delivering a shorter tram line as part of the first phase of construction than Phase 1a as defined. None of these options has been subject to the extent of detailed economic and financial appraisal as presented in the Final Business Case, but nevertheless we are confident that the analysis as sound. The following summarises our findings.

To the West the infrastructure must in all cases extend at least to the depot at Gogar. Truncation of the infrastructure from Gogar to the Airport is highly unlikely to be acceptable to Transport Scotland in light of the strategy to provide rail based connectivity to the Airport via the proposed heavy rail/tram interchange at Gogar.

At the other extremity of Phase 1a delaying the construction of the section from Ocean Terminal to Newhaven until the development of Western Harbour resumes in earnest would help match demand and developers contributions with construction costs. Forecast demand on this section is relatively small and could be met in the interim by enhanced feeder bus services. The delayed capital costs might be £15m but there would be an element of additional costs to enhance the infrastructure at Ocean Terminal to facilitate termination and turn-back in that location.

Truncation at Foot of the Walk (ie delaying construction in Leith Docks) would fulfil the imperative to serve the very significant demand on Leith Walk, removal of bus services on Leith Walk and interchange with bus services at Foot of the Walk but would be a delay in the delivery of the redevelopment enabling benefits of the tram in Leith Docks. Again we believe it would be practicable to meet demand from and to Leith Docks by implementing feeder bus services to the Foot of the Walk terminus until such time as demand dictated the construction of the tram infrastructure. However we would anticipate significant local and central government political opposition to this truncation, a possible move to reduce in Grant support below the £500m commitment and opposition from Forth Ports as a major stakeholder and source of developer contributions underpinning the Councils contribution to the project – albeit the delay of construction would better match the timing of receipts from Forth Ports with the incidence of construction costs.

Truncation at Foot of the Walk would delay capital costs (including reduced vehicle requirements) of around £38m although again the cost of infrastructure enhancements at the new terminus would need to be assessed and space restrictions on-street at Foot of the Walk could dictate a terminus a Bernard St as an alternative.

We have also looked at the option of terminating the first phase of construction at York Place/Picardy place – closely matching Line 2 as was approved by Parliament. However we believe that in addition to the loss/delay of economic benefits from Leith Docks this would mean delaying the section of Phase 1a on Leith Walk which presents the greatest opportunity to carry high volumes of passengers and reduce bus volumes. The delayed capital costs (including reduced vehicle requirements) would be in the region of £70m.

In each case the capital cost savings indicated should be considered order of magnitude and would be subject to loss of profit claims from the Infraco including CAF. We have not as yet considered any impact these truncation options might have on programme.

Funding options

There are various options which may be explored to deliver additional funding for the project which we suggest are debated at the Board, including Council borrowings to be repaid out of the future profits of the integrated TEL tram and bus business and Park & Ride revenues.

Appendices

Appendix 1 – Commercial Options Analysis
Appendix 2 – Scope Options Analysis

Prepared by: Stewart McGarrity
Recommended by: David Mackay
Date: 10th March 2009