



Infraco Resolution Strategy

24 July 2009

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1. Background including objectives

1.1. Background

tie Ltd and Bilfinger Berger Siemens CAF (BSC) have a number of contractual and commercial disagreements over the Edinburgh Tram Network Infracore Contract executed in May 2008. This culminated in February 2009 with a visible dispute over commencement of work in Princes Street.

Detailed negotiations and commencement of formal dispute resolution processes resulted in a Supplemental Agreement for Works on Princes Street (which commenced in late March) and formation of a Project Management Panel (PMP) with representatives of tie, TEL, and BSC aiming to resolve such contractual issues / differences.

After three months of activity in Princes Street and on the PMP on a range of key issues, there has not been sufficient progress on unlocking differences to give sufficient certainty of cost, programme and confidence in future progress.

As a consequence, **tie's** CEO, Richard Jeffrey, met with the German Principals of Bilfinger Berger and Siemens (Drs Keysberg and Schneppendahl). The outcome was an agreement to attempt an intensive week of non-binding mediation, facilitated by two external mediators.

The purpose of this mediation was to reach agreement on the specific themes to enable success to be measured against the criteria of:

- Better relationship
- Commitment to progress
- Price for issues to date
- Some certainty about the future
- Information from BSC to support changes notified

1.2. Mediation

The intensive week of mediation commenced on 29 June and concluded on 6 July. The core themes addressed included:

- Clause 4.3 and the role of Schedule Part 4.
- Future On Street Supplemental Agreements
- Base Date Design Information – IFC
- Misalignments
- Value Engineering
- Change items to be valued
- Extension of Time 1
- Extension of Time 2

Progress was made in understanding positions and in closing gaps in some areas, however, there was no significant improvement against the objectives overall to demonstrate an acceptable “breakthrough” for **tie**.

The principals' meeting of 6 July resulted in unsubstantiated restatement of the BSC view that there remained a £80m -£100m issue that was **tie's** problem to address.

tie concluded that this was wholly unacceptable and therefore made recommendations to the **tie** Board and Tram Project Board to progress matters using all necessary contractual mechanisms to increase certainty of cost and programme.

1.3. July 8 Board Meetings

The **tie** Board and Tram Project Board met on the 8 July to consider the options and recommendation and gave full support to the recommendation of Option b)

- a) **Negotiate settlement of all issues with BSC** – 3 months and mediation has not delivered an outcome which is acceptable in terms of certainty on delivery, engagement, programme and costs
- b) **Formal contractual approach** – DRP and other remedies
- c) **Reduce BSC scope** – instruct or by negotiation and re-procure
- d) **End BSC contract** – termination or by negotiation and re-procure

Option b), The Formal Contractual Approach is required to drive out certainty and force the provision of information to **tie**. This is designed to progress all substantive issues through formal DRP process to adjudication – prioritised to the high value, risk and delay items and keeping a focus on the detail.

The approach includes the following:

Instruct BSC to implement changes in the meantime – **tie** does not need to instruct on the obligation to progress the works generally.

Access information by invoking the Audit and Best Value clauses – especially in relation to programme and design management

If appropriate, serve notices of breach of general obligations to mitigate delay, provide information, comply with design review procedure, progress the works, appoint subcontracts and other instances of failure to manage the project for the client where such items are justified.

The advantages and disadvantages of this approach are as noted below:

Pros

- Certainty based upon facts and contract rather than negotiated settlement – decision making more robust against future challenge
- Force the hand of the consortium partners – Siemens and CAF – if replacement of BB in consortium is ever contemplated
- BSC in major/persistent breach if they refuse to continue working

Cons

- Could take many months especially if BSC stick to formal DRP process
- BSC stop work (ie obligation to continue is itself in dispute)
- If BSC don't like the adjudicated answer they go to court rather than continue
- If the answer still presents an unaffordable project we have spent additional £m's in the meantime.

1.4 Summary

Whilst adopting the strategy to use the formal contractual approach and all appropriate contract mechanisms, **tie** will keep channels and communication open at Project Management level to try and resolve any item. **tie** are also seeking to ensure any cash exposure with InfraCo is managed to a minimum if a dispute escalates.

2. Summary of Legal / Contractual Mechanisms available

There are a range of legal and contractual tools and mechanisms to be deployed as part of the Formal Contractual Approach as approved in principle by the Board.

They will be used to try and resolve differences, generate progress and increase certainty.

Mechanisms to be used will include:

- Schedule Part 9: Dispute Resolution Process
- Use of Audit powers: Clause 104
- Programme obligations and Progress obligations: Clause 60 & 61
- Change Clause related Instructions to Progress: Clause 80.13 / 80.15
- Termination notifications
- Utilisation of clauses to address securities / financial instruments (On Demand Performance Bonds / Parent Company Guarantees)

Separate advice notes are available on the above topics.

There has been detailed analysis of specific issues and grouping of items into broad themes.

These are detailed in Section 3 of this report.

tie intend to progress targeted Disputes through the Dispute Resolution Process in parallel with accessing relevant information through the use of Audit tools (elements in Clause 104).

3. Key Themes

3.1. The key themes where tie and BSC have material differences are:

3.1.1. Entitlement

- 3.1.1.1. Role / test of Schedule Part 4
- 3.1.1.2. Applicability
- 3.1.1.3. Evaluation

These issues have been tested and considered by DLA and the tie team. A consolidated note is available, with particular focus on notified departures and compensation events.

In addition, specific senior counsel opinion has been sought on a number of specific questions. Further advice is being sought w/c 27.07.09.

3.1.2. Design

- 3.1.2.1. Design Development and completion of design
- 3.1.2.2. Design Liability
- 3.1.2.3. Base Date Design Information (BDDI)
- 3.1.2.4. BDDI to Issued For Construction Drawings (IFC)
- 3.1.2.5. Misalignments

These issues have been considered and various advice notes prepared by DLA. This does link significantly with the Entitlement and Programme Grouping.

3.1.3. Programme

- 3.1.3.1. Extension of Time 1 (**tie** Notice of Change 1) Financial Evaluation
- 3.1.3.2. Extension of Time 2 Analysis and agreement of entitlement and Valuation.

EOT 1 will be looked on as a strong evaluation mechanism for EOT 2 therefore a strong win on EOT 1 helps the financial impact of EOT 2.

3.1.4. On Street Approach / Challenge to Contract Rationale

- 3.1.4.1. Supplemental Agreement based on Princes Street
- 3.1.4.2. "Cost Plus" proposals / changes

BSC are challenging the "workability" of the contract and change / compensation events mechanism. By seeking to move all of the On Street Works to "cost plus" it also strikes at the cost risk balance.

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Key Themes in Dispute Resolution Procedure

Case Number	Description of Case	ENTITLEMENT	DESIGN	PROGRAMME	RATIONALE
		(Schedule Part 4; Compensation Events; Notified Departures; SDS; Infraco Change)	(BDDI; BDDI to IFC; BSC to SDS; Misalignment)	(EoT 1 and EoT 2)	(On Street Challenges)
1	The correct method of calculating Head Office Overheads and Profit, Consortium Preliminaries and other Preliminaries elements in respect of tie Change Order Number 21 in connection with the provision of a contingency west bound bus lane at Princes Street, Edinburgh				
2	Whether Infraco is obliged pursuant to the Infraco Contract and without further instruction, to proceed with carrying out of Works on Princes Street, Edinburgh from 21 February 2009 at the latest				
3	The proper treatment, determination and evaluation where it is alleged by the Infraco that the design of the Infraco Works has changed from the design at the stage of BDDI to IFC (to be joined with DRP 6).				
4	Whether the Infraco is obliged pursuant to the Infraco Contract and without further instruction, to proceed with carrying out of works at the Hilton Hotel car park.				
5	True and proper valuation of tie Change Order 1 in connection with the change from version 28 of the Programme to version 31 of the Programme				
6	What comprises BDDI for the purposes of the Infraco Contract (to be joined with DRP 3)				
7	The correct method of calculating Head Office Overheads and Profit, Consortium Preliminaries and other Preliminaries elements in respect of Estimates submitted by Infraco.				
8	Valuation of Infraco Estimate concerning works at Edinburgh Park Exchange				
9	Infraco are of the opinion that Schedule Part 4 (Pricing) to the Infraco Contract takes priority over the rest of the Infraco Contract and, in particular, the Infraco Contract Conditions				
10	The ability of tie to obtain information from Infraco by way of Audit requests pursuant to Clause 104 of the Infraco Contract				
11	The entitlement of Infraco to additional payment in the event that the Phase 1b Works are not instructed by tie				
12	Infraco have an issue with the Earthworks Outline (Schedule Part 4)				

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Key Themes in Dispute Resolution Procedure

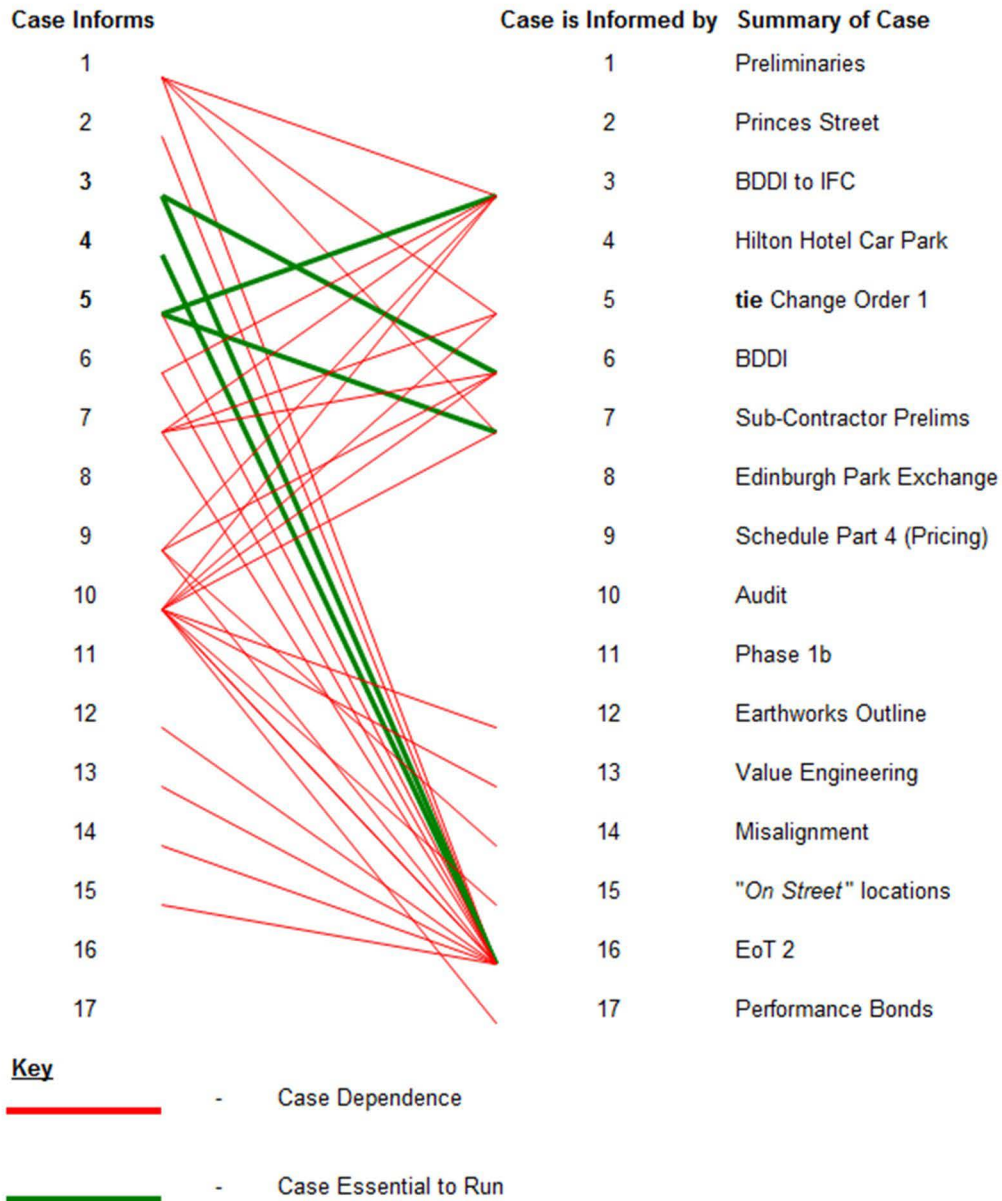
Case Number	Description of Case	ENTITLEMENT	DESIGN	PROGRAMME	RATIONALE
		(Schedule Part 4; Compensation Events; Notified Departures; SDS; Infraco Change)	(BDD; BDDI to IFC; BSC to SDS; Misalignment)	(EoT 1 and EoT 2)	(On Street Challenges)
13	Infraco are not prepared to progress Value Engineering opportunities, in particular Infraco are relying upon paragraph 5.3.3 of Schedule Part 4 (Pricing)				
14	Infraco are of the opinion that they are entitled to payment by tie of all potential consequences of a misalignment between the Infraco Proposals and the SDS Design, in particular the operation of Clauses 4.7 and 4.8 of the Novation Agreement and misalignment arising as a consequence of design prepared by Siemens plc				
14A	Infraco's responsibility / liability for the performance of the SDS Provider				
14B	Infraco's rights/remedies in the event of failure by the SDS Provider in regard to quality of performance				
14C	Infraco's rights/remedies in the event of failure by the SDS Provider in regard to the time for performance				
14D	How entitlement of Infraco to relief and/or extension of time and/or additional payment by way of a Notified Departure is affected by failure of the SDS Provider				
14E	How entitlement of Infraco to relief and/or extension of time and/or additional payment by way of a Compensation Event is affected by failure of the SDS Provider				
15	Treatment of potential changes to "On Street" locations of Infraco Works				
16	True and proper valuation of Infraco's entitlement in connection with proposed revision 2 of the Programme				
17	tie initiating calls under performance securities, including bond granted by Infraco in favour of tie				
18	tie issuing Remediable Termination Notice				

4. Analysis of Individual items – Readiness to Run

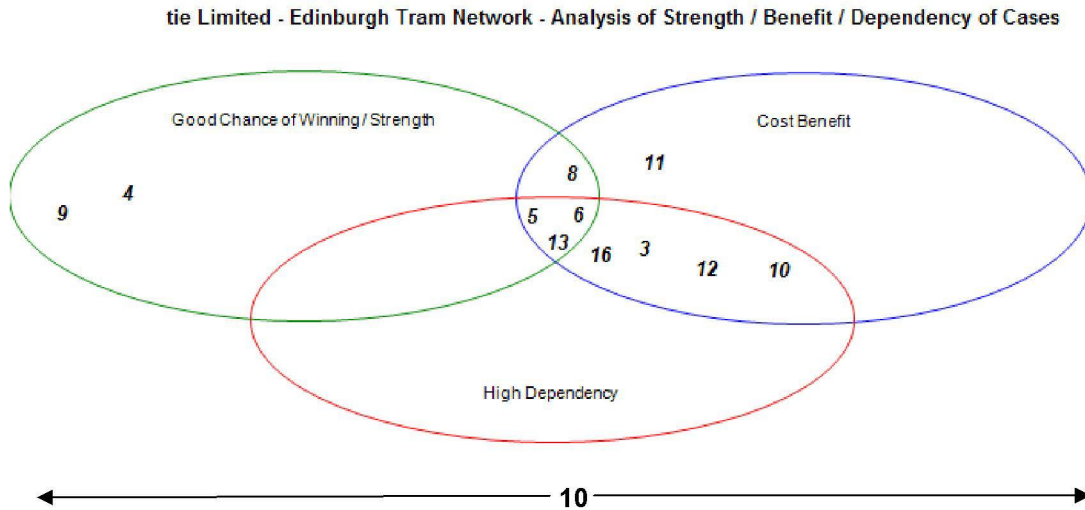
An analysis of “Readiness to Run” has been undertaken for a range of cases / issues. It addresses the likely / actual dispute or disagreement, frames the legal arguments, identifies further factual, technical or financial information or action provided as necessary, and links this to other relevant items.

This individual issue analysis forms the basis of cases to be taken through DRP to a conclusion, once the selection criteria in section 5m the review / challenge has taken place.

The dependence of independence of individual cases is shown in the diagram below:



5. Selection of Method and Timing of Approach to each Issue



The **tie** team, supported by DLA have used the systematic analysis on the specific contractual issues and then selected an order of priority items based on qualification and quantification analysis:

- Likelihood of winning/strength of argument
- Financial Impact (Costs/Programme benefits)
- Degree of dependency/precedence of other disputes

This has resulted in the following recommended grouping for action.

Tranche 1 (Week commencing 3 August 2009)

5 – EOT 1 (the Notice of Change 1)

4 – Hilton Car Park

Tranche 2 (Week commencing 10 August 2009)

3 – BDDI Definition (if necessary)

6a – BDD1 – IFC (2 examples)
Gogarburn Bridge

6b – Carricknowe Bridge

Tranche 3 (Week commencing 24 August 2009)

6c – BDDI – IFC (Section 7 Earthworks)

13 – Value Engineering (esp design to cost)

Tranche 4 (Week commencing 14 September 2009)

16 – EOT 2 (Time first)

14 – Misalignments

11 – 1b – Schedule Part 38 payment

Issue 10 (Audit) would be used as a supplementary tool:- conjunction with specific DRPs to further expand evidence/facts for BSC.

A “Challenge Team” will include “hardened” forensic characters as McGrigors (Brandon Nolan etc), G Bissett, D Mackay, R Jeffrey, J McEwan (if before August) and CEC representatives such as M Poulton or G Lindsay and possibly A Morgan (PWC) or W Gillan (Peer Review Group)

6. Analysis of BSC Strategy

BSC have consistently tried to expound a strategy which aims to:

1. Keep it simple (work at high level / global) and use the protection / assumptions of Schedule Part 4.
2. Argue that the Contract is too complex / doesn't work and therefore must be changed for our benefit (e.g. On Street Supplemental Agreement).
3. Argue that the Contract prevents them from starting any items which they consider are changes until they are agreed.
4. Argue exclusive access to the works is required and any impact on that needs to be addressed before they can mitigate.
5. Resist information provision on differences (e.g. Design Development / Design Changes) because it is "not available" or "too difficult" or "tie should have it already".

Generally they seek to wrap up differences to a global financial settlement "simplify" contractual processes that they contracted to supply.

They believe the major time / cost liability and risk is not (cannot afford to be) theirs, so are seeking relief / extension of time to cover all types and sizes of difference, especially resisting issues associated with the novated design responsibilities and mobilisation.

They have only shown a willingness to move at all in negotiations at the final stages, generally strongly controlled / influenced from the German parent companies.

Notably, Siemens have behaved more constructively and flexible on some issues.

CAF have not been actively involved in any of the disputed issues.

It is considered unlikely that BSC will fight a "case of attribution" through 6 months of DRP. tie expect to provoke a reaction / resolution in earlier course.

6. Programme to Execute

The DRP timing and schedule is being amplified based on section 5 and refinements with DLA.

Internal review and challenge is being arranged for w/c 27.07.09 and will operate on a phased basis as issues / groupings are ready and aligned above.

7. Project Programme and Financials

- 7.1. A summary paper has been prepared with Graeme Bissett, Gregor Roberts and Steven Bell. This will be inserted here.
- 7.2. The Programme assumption for the purposes of this analysis anticipates Open For Revenue Service at the end of February 2012.

8. Residual Risk Analysis

8.1.

9. Governance of Process

- 9.1. The Resolution approach is as originally set out and supported at the tie Board and Tram Project Board on 8 July.

Updated proposals will be presented on 29 July, detailing the Resolution Strategy, programme, and early targeted contract mechanisms to move forward.

Based on Broad acceptance of this approach, it is proposed that a weekly review of issues and decisions required are undertaken by the Financial, Commercial and Legal (FCL) committee of the TPB with authority delegated to that committee to enable nimble decision making between formal Board meetings.

Initial liaison with the CEC Head of Transport (and TMO) and CEC Head of Legal Services has confirmed their attendance at such weekly committee meetings.

A separate paper proposing this arrangement will be presented to the Tram Project Board on 29 July.