

EDINBURGH TRAM PROJECT GOVERNANCE PERFORMANCE AND RESTRUCTURING OPTIONS

INITIAL OVERVIEW – FOR DISCUSSION

STRICTLY CONFIDENTIAL

(1) Situation now

The present structure is:

- CEC is client and principal stakeholder
- TEL is 100% sub responsible for overall delivery and future operational integration
- The TPB is a TEL sub-Comm established to oversee delivery (by tie) and planning for operations
- Tram Project Director reports formally to TPB on progress
- **tie** Board responsible for contractual fulfilment
- TS is principal funder

In summary,

- The governance model reflects inheritance but is working reasonably well, roles and responsibilities are clear, external parties (TS, Audit Scotland) have no major concerns.
- The model is operating as envisaged when planned prior to Financial Close, no TPB committees have been established until recently as all action has been handled directly by TPB.
- The model and the individuals involved have proven capable of swift reaction to events such as 1st October TM difficulties leading to heightened focus on coordination of stakeholders and clarity of responsibilities in a key area.
- Attendance and engagement at regular meetings is generally good.

Areas needing improvement :

- **tie** Board meetings go beyond contractual focus, the calibre of Board and challenge is very good. This is a high quality resource which is somewhat out on a limb.
- Considerable overlap between **tie** Board and TPB interrogation
- **tie** is seen as the player accountable and responsible for all aspects, but this is not aligned to actual responsibilities (CEC in particular have key responsibilities around interface with public, roads and traffic which are attributed to **tie**)
- In general, CEC' s leadership role is not well reflected in the execution of governance
- The TEL role and business model is not yet distinct. TEL is not established as an active company though certain individuals are key to project – DM / NR at stakeholder level, BC / AR at operational level; no plan in place to improve on this.

(2) Current events

If as anticipated NR leaves his role as TEL CEO and Project SRO, and WG leaves his role as tie Executive Chairman, the question is do we seek to replace like for like or restructure ?

A like for like solution will not address the weaknesses above, the structure could benefit from streamlining and it is most unlikely that individuals of the calibre and experience of WG and NR could be attracted to the roles as presently configured. So we should take the opportunity to change and improve, with the benefit of experience to date and with an eye on the future.

Essentially, there is one company too many. TEL was created in 2004 to coalesce the tram project with LB at a time when relationships were poor. To the extent of bringing cohesion, TEL has had a positive effect, not least in bringing the operational skills of BC and AR into play. **tie** has developed and delivered the project over many years, but is separated from future operation.

A better option would be the creation of a single legal entity, wholly-owned by CEC (but at arms length), responsible for delivery and operational integration planning and in due course operational management. This would clarify and streamline responsibilities, ensure a smooth transition from construction to operation and encourage end-to-end accountability (what is delivered now will be the responsibility of broadly the same group of senior people when it is operational).

If we can envisage the end-point, say roughly when trams commence revenue service, the single entity would have fulfilled its delivery responsibility and its responsibility for creating an integrated service model ; the same body carries forward the maintenance management responsibilities and takes up operational management for the integrated system. LB would continue as the bus operating company, with its governance aligned with its new sub-group. The single entity could also pick up a strategic planning role in tandem with CEC.

There are questions about combining delivery and operations, but this should not be a barrier. The linkages between delivery and subsequent operation are extensive. Although the scale of delivery capacity is a variable, dependent on pipeline and workload, this can be managed. Similarly, if there is a wind-down in delivery capacity because the pipeline is dry, the challenge will require to be met whether there is a single-entity or the existing multiple entity model. Clear responsibility within the single entity can be achieved by clear divisional management responsibility and reporting.

(3) Options and proposal

If it is accepted that a single-entity model is the desired outcome, there are three options :

- (A) TEL is the entity and **tie** is merged into TEL
- (B) **tie** is the entity and TEL is merged into **tie**
- (C) A new entity ("Newco") is created and both **tie** and TEL are merged into Newco

There are numerous detailed issues around each option but the main points are as follows :

Option A – TEL

TEL's public profile may not be strong at this stage, but does represent the anticipated future integrated transport company. Merging **tie** into TEL would reinforce the hierarchy of **tie** as project deliverer and TEL as ultimate oversight body.

This structure would retain the TEL name and lose the **tie** name, which on balance is the right way round. There would of course be scope to adapt the TEL name if it was thought appropriate, perhaps in the context of a wider review of the integrated system branding. LB shares would be transferred to TEL in due course, as already made clear in the Final Business Case and in Council reports.

However, there are practical problems in moving **tie's** activities into TEL – all of the major contracts would require to be assigned and we can be sure that certain of the counter-parties would not make that easy ; there are c90 employment contracts which would require to be moved ; there are also leases and various other third party contracts. In the other direction, TEL has two employees / consultants whose rights would be fully protected and respected. TEL has no other contractual liabilities. These challenges could be addressed but there would be complexities and almost certainly difficulty ; there would also be significant legal costs and potential delay. Finally, critical health and safety responsibilities would require to be re-written.

Option (B) - tie

The flipside of the practical difficulty of the TEL model is the relative simplicity of the **tie** model. The downside of the **tie** model is that there would most likely need to be a change of company name from **tie** to TEL in order to preserve the profile of the umbrella organisation, a change which will create presentational challenges to avoid accusations of smoke and mirrors. A new name in the context of a refreshed project branding exercise may help with this.

Option (C) – Newco

This option would incur the practical difficulties noted above, offers no obvious advantages and therefore holds little attraction.

A variant would be to introduce Newco as a new holding company for **tie** and TEL, or indeed to install **tie** as a subsidiary of TEL. However, these structures would sustain the complications of the multiple entity model and are not considered further.

Proposal

This paper argues that the single-entity model is right and that the most efficient means of getting there is to use **tie** as the single entity. The resulting model would emerge as follows :

Corporate and governance

- Retain **tie** as the entity responsible for delivery and all current contractual obligations, but add TEL's responsibilities to **tie**.
- TPB to be re-constituted as sub-committee of **tie**, not TEL ; OR better still the **tie** Board replaces TPB as primary project oversight body
- TEL is moved outwith project governance structure and retained as a shell
- **tie** Limited is renamed either Transport Edinburgh Limited or a new name – in the balance of this paper this entity is called “New TEL” for simplicity (not a proposal)
- LB is brought into the ownership of the single entity as anticipated

People proposal (assuming WG and NR depart)

- tie Board retained as New TEL Board subject to changes to NXDs already under discussion
- DM is non-executive Chairman of New TEL, retaining Chairmanship of TEL (very low activity if any)
- New TEL Board to be attended by CEC Director of City Development, Head of Transport (who is also Tram Monitoring Officer) and Director of Finance. These individuals are not New TEL Directors so that separation of CEC stakeholder interests is maintained
- Member responsible for Transport retains New TEL Board seat, but other Elected Members resign ; communication channels to the Party leaders and the Transport spokespeople needs further discussion, but in principle can be achieved by regular contact with New TEL Chairman and senior Council officials. This would feed into the existing Tram Sub-Committee of the council's Transport, Infrastructure and Environment Committee.
- New TEL Board meetings may be heavily populated, but no more than now and probably inevitable given breadth of project and range of stakeholder interests; duplication of meetings has been eliminated and costs lowered
- Traffic Management Peer Review Group maintained, but now as a New TEL sub-committee, chaired by MP
- New Communications sub-committee established to ensure proper governance and coordination of this activity ; the proposed Tram Communications Tsar could Chair this Committee.
- TPD (Steven) reports to New TEL Board as for now with TPB
- BC and AR formally contracted to New TEL

A further important decision relates to the possible recruitment of a New TEL CEO, who – on this model - will be overall responsible for construction delivery, preparation for operations and then operational management (including LB). This individual would also take on the public profile role and act as project SRO.

In due course :

- New TEL recruits / contracts resource to handle operational planning and then operations
- Transdev arrangements codified
- New TEL project delivery team migrate to new projects or leave (as under the existing structure, but in the context of a continuing company rather than a one-project company with no follow up work)
- New TEL Board membership evolves to take account of operational responsibilities including bus company subsidiary
- New TEL Board takes decisions, subject to ratification and control by CEC, on deploying cash flows on new projects
- New TEL supports strategy development – interface with CEC departments to be clarified

(4) Result

- Streamlined governance structure, lower cost, minimal duplication and disruption to project progress without diluting control
- Enables CEC through New TEL to take a longer term view of project development in Edinburgh City-Region, utilising a proven resource

- Provides some continuity for New TEL's people where there is a continuing role (a key responsibility of the New TEL Board) and simultaneously optimising continuity and retention of corporate knowledge
- Deploys collective and individual skills of New TEL NXDs more effectively ; and

(5) Other matters requiring consideration

This paper is an outline proposal and a number of the issues above will require further careful consideration. In addition, there are several aspects which have been assessed in arriving at the current governance model and which would need to be re-evaluated :

- Operating Agreements between **tie** / TEL and CEC – these are in-the-family agreements which should be capable of straightforward revision
- **tie's** contractual arrangements (Infraco, MUDFA, DPOFA) – ensure no unintended implications and none are anticipated
- Transfer of LB majority shareholding to New TEL in due course rather than TEL (“Scottish Ministers” approval process, impact on minority shareholders, TA 1985 considerations, LB Board changes) – preliminary view is that there should be no change to previous advice or challenges
- Re-alignment of Health & Safety responsibilities – should create no new issues, structure is in place and **tie** responsibilities would need minimal change as New TEL
- Competition law and State Aid position when integrated services commence – preliminary view is that there should be no new concerns compared to existing TEL model
- Tax planning – this will need to be refreshed to ensure that the VAT and Corporation Tax planning continues to be effective but benefits should still be available
- Articles of Association of **tie** and TEL may need to be adapted, but this should be straight-forward
- CEC approval processes governing the changes should be analysed and documented in advance of implementing changes – the objectives of the proposal are to improve efficiency and cost-effectiveness and hence should be deliverable.
- Current governance arrangements are being reviewed by **tie's** internal auditors and their advice and findings may be helpful

Given the work that has already been done, the work to cover the above matters should not be a lengthy process, probably a few weeks rather than months. It is believed that the single-entity model build around **tie** Limited, as renamed, offers the most effective means of streamlining the governance model to meet the challenges ahead. It is also likely to be the structure which will most readily lend itself to the recruitment of high quality senior management including a CEO.

On balance, therefore, it is not anticipated that these matters would create any barrier to the streamlining proposed.

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