

PROCUREMENT STRATEGY - JULY 2006

1 Original Procurement Strategy

The originally conceived procurement model is as shown in Figure 1 below:

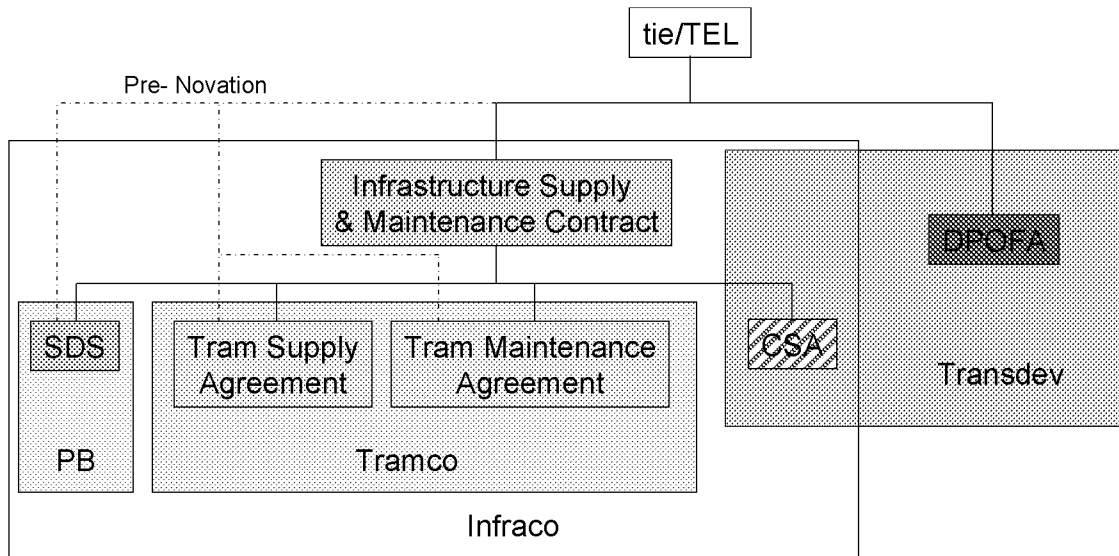


Figure 1

The key characteristics of this model were as follows:

- The Infraco acts as a single point of responsibility for the delivery of the system, including the trams, up until the point of opening for revenue service.
- The contract for System Design Services (SDS) is procured and entered into directly by tie and novated to Infraco at the date of Infraco Contract award.
- The Tram Supply and Tram Maintenance contracts are similarly novated to Infraco.
- The operator's resources are to be provided to the Infraco through the Commissioning Services Agreement (CSA). This "carve out" was not originally conceived drafted in the DPOFA, but the associated scope of work is partly in the of DPOFA and is partly in a side letter between TETL and tie which was entered into at the time that the DPOFA was executed.
- The Tram maintenance contract kicks in at the point at which the shadow running phase starts (approx 3 months prior to passenger carrying service).

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Following the deliberations of the procurement sub-committee, it was identified that further areas of flexibility should be introduced to the procurement strategy. Consequently, the Infraco and Tramco procurement processes have been adapted to allow pursuit of alternative procurement scenarios. This is intended to test under competition how bidders will price different responsibilities and risk allocation.

Two alternative approaches to the procurement of the infrastructure and vehicle supply are presented below, either of which could be combined with the original or two alternative approaches to the procurement of the operations and maintenance services presented below.

Utilities diversions were planned as distinct advance works, ideally with no interface with Infraco. Consequently, at no point was any modification to the ongoing MUDFA procurement approach considered. This package of works will remain as a direct contract between tie and the preferred contractor and is accordingly not considered further in this paper.

**2. Procurement Prior to System Opening**

**2.1 Separable Maintenance**

Subject to the constraints of procurement regulations, the desire to re-configure the operations and maintenance contracts was a key conclusion of the procurement sub-committee. The basic model by which this can be achieved is shown below:

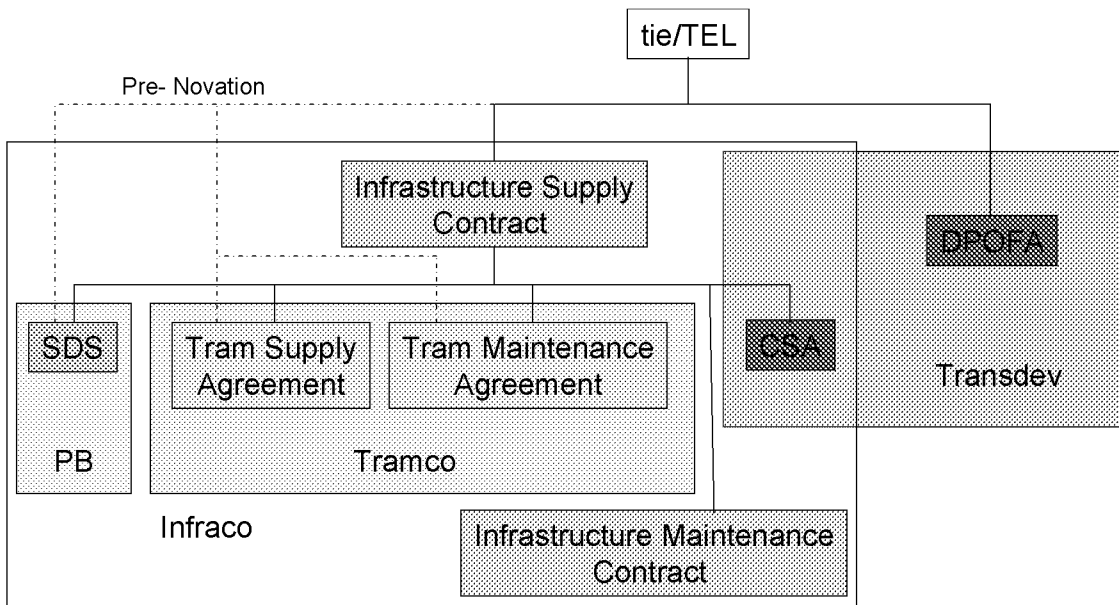


Figure 2

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The key changes to the original strategy are as follows:

- The original Infraco scope of works is let on the same basis as in the original procurement model, however the maintenance component is contained in a distinct and separable subcontract to allow subsequent assignment.
- This model retains a direct relationship with the previous communications to the market and to both the Tramco and Infraco OJEU notices.
- The Infrastructure maintenance contract would, in line with the Tram maintenance contract, commence at the beginning of shadow running i.e. once trams begin to run on the network to prove it under live (but not public) operational conditions.
- Having the Infrastructure maintenance contract let in parallel with the Infraco Supply contract could also be contemplated but is not preferred as this would require a move away from the principles set out in the Infraco OJEU notice.

**2.2 Separable Procurement & No Tramco Novation**

Another, substantially different alternative scenario is to be made possible within the revised procurement strategy, as shown below:

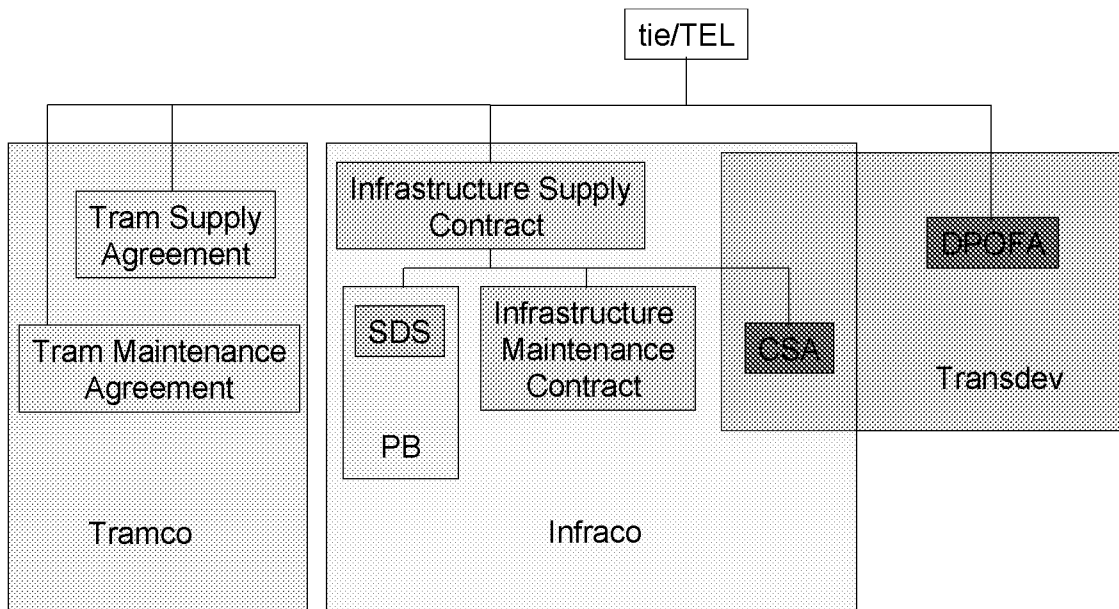


Figure 3

The key features of this approach are as follows:

- Novation of the Tramco contracts is not undertaken.
- The Infraco is no longer has the sole responsibility for the delivery of the system.

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- The main perceived advantage of this scenario is the elimination of the mark-up that Infraco will place on its responsibility for the Tramco contracts, particularly the Tram Supply Agreement.
- This approach is inconsistent with the discussion **tie** has had with the market on standard compliant bid but novation has been presented as the preferred option, not the only approach.
- A third interface (concerning provision of drivers to test and commission trams) between the Operator and the Tram Supplier/Maintainer is created.
- **tie** would have to undertake the system integration between the Infraco and Tramco activities. The key activities associated with this role would be; technical interfacing of various systems, managing system runtime, taking overall programme responsibility as well as the associated commercial issues. The implications of this are set out in Q&A format below.

Q: Can we identify premium in Tramco for novation to Infraco?

A: Dialogue with four Tramco bidders suggests that risk premium associated with novation will be low unless they perceive that they will be vulnerable to abuse by one of their rivals. This risk is more to do with perception and should be manageable through bid process protocols. The Tramco bidders have been asked to identify the value that they place on this risk within their tender submissions due on 5 October 2006.

Q: Can we identify the premium in Infraco for novation of Tramco?

A: The risk is more tangible and larger. There will be a genuine exposure for Infraco in that the liability caps/L.D.s for the Infraco will not be capable of being fully backed off onto Tramco.

The other risk driver would be where there is an "alien" vehicle novated to the Bombardier or Siemens Infracos. Competitive and Partner pressure should substantially mitigate this. Only Bombardier have highlighted this issue. Siemens have previously integrated 3<sup>rd</sup> party vehicles within a complete system and have declared that they would be happy to do so again. This issue does not apply to Amec Spie.

A risk value of £50-60m has previously been speculated, but had no substantiation and is believed to be excessive. Inclusion of this level of contingency would risk a non-competitive bid.

Although this risk is difficult to quantify, the author would suggest that this would be valued by the Infracos at between £5 and 11m on the basis of applying a 10-15% uplift on a contract valued between £50 and £75m. The Infracos will be asked to identify and quantify the risks that they perceive associated with novation in their bids. A possible mitigation to the risk of Tramco insolvency (which is the worst-case event from Infraco's perspective) would be to include appropriate contractual relief. It is proposed to test this during negotiations.

Q: If we don't novate Tramco what is the impact on SDS design contract?

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A: Little, if anything. SDS's role in relation to the tram is limited essentially to performance definition and interface management.

Q: If we don't novate Tramco who undertakes integration with Infraco and at what cost?

The system integration role sits within Infraco as an integral feature of the original procurement strategy. If the Tramco novation was not to be implemented, this role would pass back to **tie** at this point no longer supported by SDS. **tie** could manage the associated risks by the following routes:

a) **tie** undertakes the role. The resources to undertake this would have to be recruited. Typically, a team of 5-6 relatively skilled engineering/project management personnel would be required, entailing a direct cost of c.a. £1m – 1.5m. **tie's** risk exposure would be significantly increased in this scenario. The key risks to be managed are:

- Technical interfaces
- Programme – **tie** would ultimately become directly responsible for the system opening date
- Organisational interfaces during testing and commissioning
- Commercial disputes/claims between the contractors

b) A 3<sup>rd</sup> party could undertake the management of this risk under contract to **tie**. The value of this contract would be substantially higher (say 50-100%) than managing the risk with in-house resources. There would be an opportunity to transfer some of the risk to the 3<sup>rd</sup> party; however this would be limited given the relatively modest size of the 3<sup>rd</sup> party's contract.

c) Have the O&M contractor undertake the system integration. This currently sits outside the core scope of DPOFA, but Transdev could call on their overseas resources, which would possibly result in a direct cost similar to or above that of utilising a 3<sup>rd</sup> party. If this were to be pursued, the Transdev resource would have to be fully considered. The characteristics of this approach are:

- There would be no question of Transdev's motivation to manage the integration.
- There may be more ability to offset the risk, although inevitably there would be a value above which this would revert to **tie**.
- Work on the ground during testing and commissioning may be smoother.
- The transfer of this set of responsibilities into DPOFA would create a risk of procurement challenge from Infraco bidders, given the likely value of system integration scope and the requirement on bidders to have accepted this role as a condition to prequalification.

In each of these approaches, **tie** would substantially retain the risk as well as incurring the cost of the resources to manage the risk.

### 3 Procurement Model After System Opening

#### 3.1 Original Strategy

The originally conceived contract configuration for the Operations & Maintenance phase of the project is as set out below:

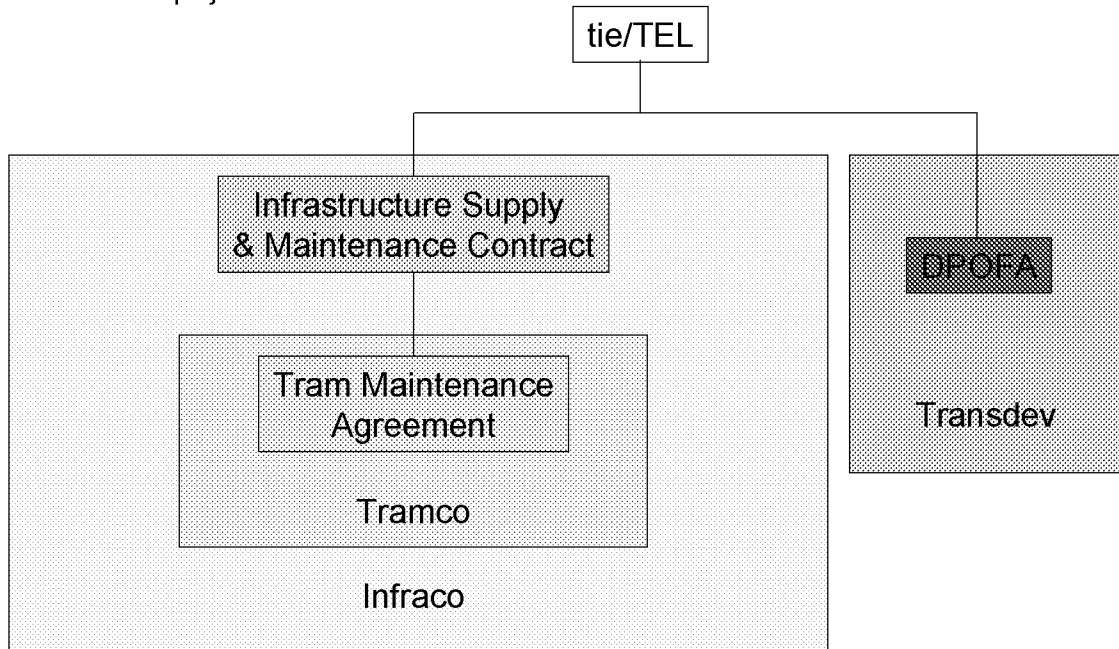


Figure 3

The key characteristics of this approach are as follows:

- The Tramco maintenance contract will attract a mark-up from the Infraco supplier.
- Residual obligations, primarily defects liability, defects rectification and warranties, under the Infraco Supply Contract and Tram Supply agreement will remain effective.
- Interface arrangements between Transdev and Infraco will exist in both the Infraco and DPOF contracts. The framework for these commitments is already contained in DPOFA but requires detailed negotiation and sign-off.
- Under DPOFA, Transdev will undertake housekeeping (predominantly cleaning) of the trams and tramstop infrastructure.

### 3.2 Revised Strategy – Decoupling of Tramco Maintenance

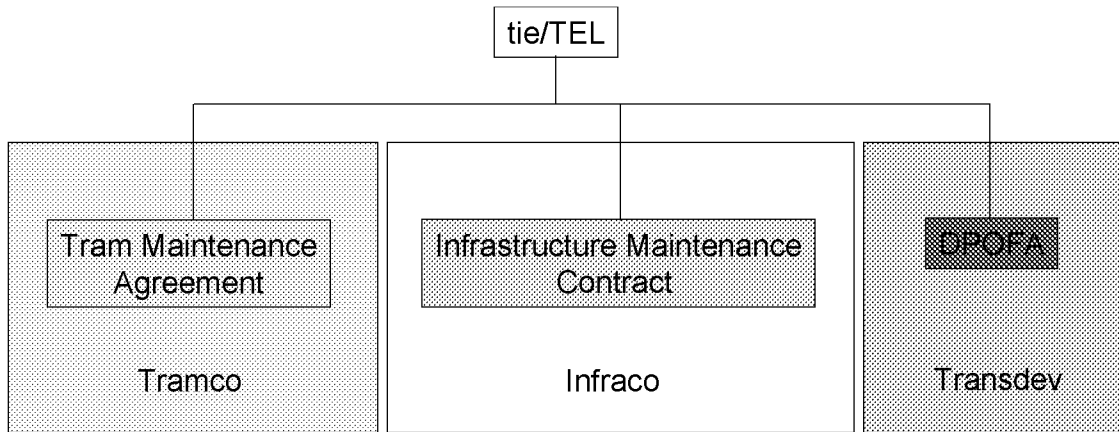


Figure 4

Key characteristics:

- Infraco will continue to owe defect rectification obligations throughout the term of the defects liability period and thereafter for latent defects ~~(by statute)~~, though it should be expected that Infraco will seek to agree a shorter period than the 20 year limitation under Scots law.
- Management of the interfaces between the three contractors will lie with tie/TEL. TEL would need to be resourced to handle the administration of the three operational phase contracts. As an estimate, this could entail three senior staff and associated support say £200,000 to £250,000 per annum.
- This configuration could be implemented at any stage, including at award of the Infraco contract; however it is recommended that the earliest point at which this transfer of responsibility for contract management is considered is at the commencement of passenger carrying service. An alternative point at which this could be considered would be at the first DPOFA re-set (3 years into passenger carrying service). [AS DISCUSSED, THINK THAT THE EARLIEST POINT SHOULD BE THE SATISFACTORY CONCLUSION OF THE RELIABILITY TESTS. IS THERE A TECHNICAL RATIONALE FOR HAVING THIS EARLIER OR LATER?]
- The key advantage of this approach would be the elimination of the Infraco mark-up on the Tram maintenance activity, which is estimated to be in the order of £200k per annum.
- The other potential advantage of this scenario is that tie/TEL have the best possible visibility of the performance of each of the contractors' activities.

### 3.3 Revised Strategy – Integrated Operations & Maintenance Retaining Subcontracts

A model whereby operations & maintenance could be combined is possible within the revised strategy, as shown below:

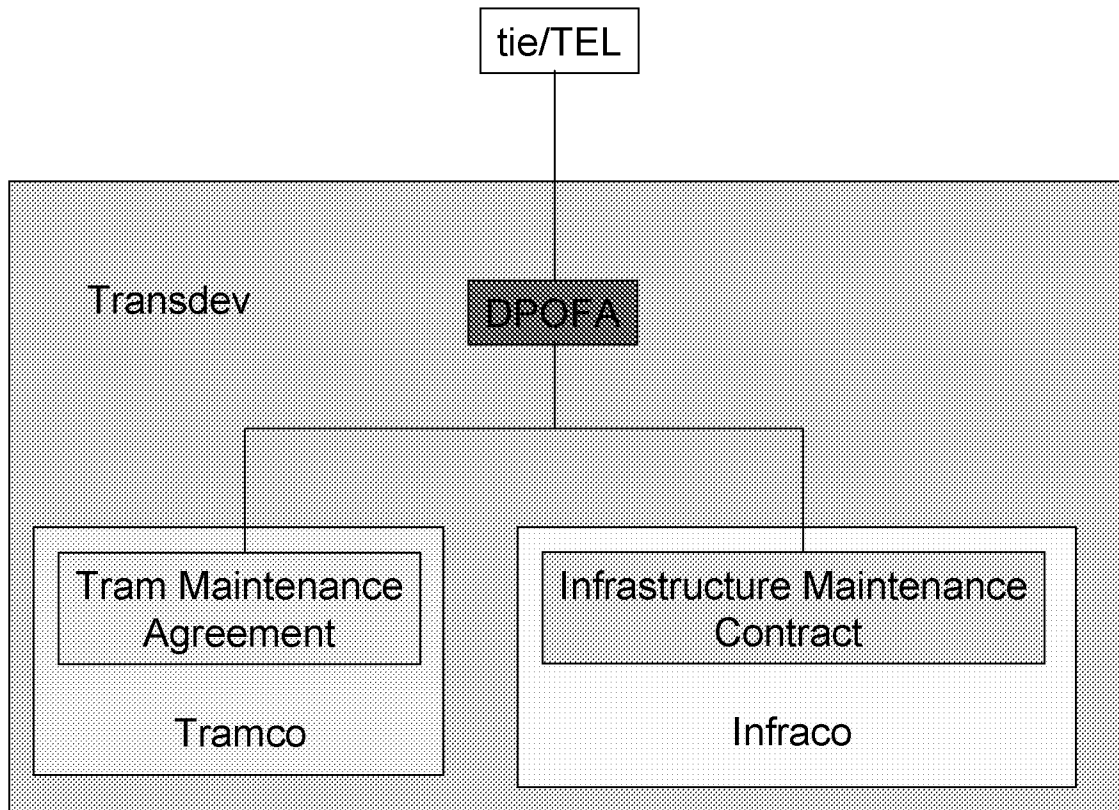


Figure 5

- This model has the advantage of creating a single contractual responsibility to undertake all operations and maintenance activities, thereby significantly reducing tie/TEL's workload and risk exposure at the contractual interfaces.
- However, both the Tramco and Infraco subcontracts would attract a mark up from Transdev requiring negotiation now.
- Transdev would shoulder the burden for resolution of technical and contractual interfaces between the three parties.
- Both Infraco and Tramco would have residual obligations UNDER THE INFRACO CONTRACT AND TRAM SUPPLY CONTRACT RESPECTIVELY which would remain direct to tie.
- As per the previous alternative, this configuration could be introduced at any point, however the earliest point at which this is recommended is that the start of passenger carrying service. Again, the first DPOF re-set point could also be considered. [AS DISCUSSED, THINK THAT THE EARLIEST POINT SHOULD BE THE SATISFACTORY CONCLUSION OF THE RELIABILITY TESTS. IS THERE A TECHNICAL RATIONALE FOR HAVING THIS EARLIER OR LATER? THERE WILL BE A HUGE COMMERCIAL DRIVER IN TERMS OF WHEN TETL WOULD BE "COMFORTABLE" TO TAKE ON THIS RISK. THIS COULD BE A POINT IN TIME WHEN ALL MAJOR DEFECTS ARE LIKELY TO HAVE ARISEN.]



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- Acceptability to bidders would need to be tested but should not be problematic.
- Step-in rights would need to be in place for **tie**, if Transdev were terminated.
- Transdev have stated a wish to undertake both the tram and infrastructure maintenance directly. This could be achieved by the termination of the two maintenance subcontracts, leading to the scenario shown below.

3.4 Revised Strategy – Integrated Operations & Maintenance Without Subcontracts

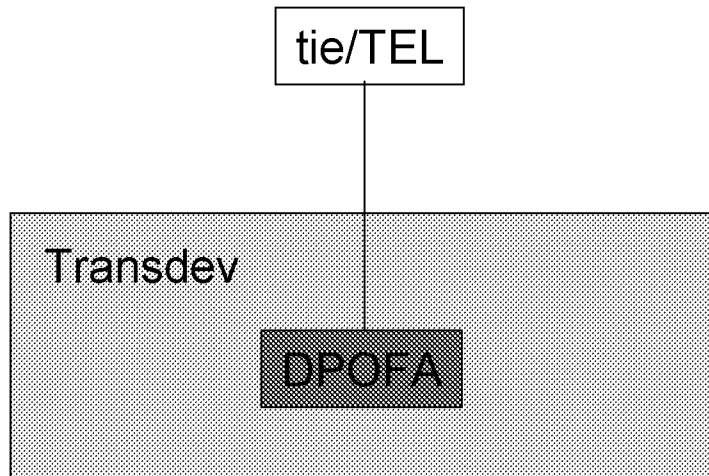


Figure 6

- This model would retain the advantages of having the single point of responsibility and may provide substantially better value for money than the alternative shown above in Section 3.3.
- The option would require a new procurement.
- tie/TEL would lose the flexibility of being able to control underperformance of maintenance works.
- This arrangement is also clearly different to the models communicated thus far to the market. There would be a tangible risk of challenge from Ansaldo (unsuccessful applicant for Tramco prequalification) if this model were adopted at the point of passenger carrying service.
- Best time to implement this would be at end of defects liability period [PERIOD OF 3 YEARS?]by means of a procurement in which Transdev compete. Integrated O&M solution is therefore benchmarked. If done prior to that time, value locked into DPOFA will be lost entirely.
- There would be termination costs payable to both maintenance contractors.
- There would be an income potential for Infracore to argue that construction/design defects are in fact the result of deficient maintenance. [COULD SAY THE SAME FOR ANY OPTION WHERE THE INFRASTRUCTURE MAINTENANCE IS ASSIGNED TO THE CONTROL OF ANOTHER.]
- Step-in rights would be required for tie if TETL terminated. [STEP IN TO WHICH CONTRACTS?]

**4 Conclusions & Recommendations**

The revised procurement strategy outlined above creates significantly more flexibility than was inherent in the original approach. Given the communication that has been held thus far with the market, the limitations within which this revised approach can be implemented are set out above.

The revised strategy is consistent with the communications this far with the Tramco bidders and with the Tramco suite of documentation that has been prepared. Accordingly the Tramco ItN was released to the market on the 7<sup>th</sup> July.

The revised strategy has more implications for the Infraco procurement. It is recommended that the Infraco ItN is re-worked to reflect this new approach.

David Powell  
19<sup>th</sup> July 2006