Background

This purpose of this document is to brief the new Council Chief Executive on the project.

Investment in trams and other public transport initiatives is part of the City of Edinburgh's transport strategy. Over the next ten years, the Capital's population is expected to increase significantly and the existing road infrastructure is not equipped to handle this level of growth in population (and associated demand for transport) without a fundamental change in our approach to public transport provision.

Much of the planned growth outlined above is likely to be in the North and West of the city and the initial tram route(s) were developed with this in mind. The Council examined tram projects all over Europe and found that trams are the most effective form of public transport that reliably stimulates movement away from private car usage. The Edinburgh tram will have a passenger carrying capacity of around 250, which is four times that of a bus. The ride quality and smoothness of acceleration and braking will genuinely deliver a fast, safe transit across the city.

A new company Transport Edinburgh Limited (TEL) has been formed which will be responsible for managing the operation of both Lothian Buses and the Edinburgh trams. This will mean that most public transport users in Edinburgh should benefit from an integrated approach to route planning, through ticketing and timetabling etc.

The planned tram route goes from Airport to Newhaven, via the Gyle, Murrayfield, Haymarket Princes Street, St Andrew Square, Leith Walk and Ocean Terminal.

There are many benefits of implementing the ETN, but a short summary includes:

- Tram encourage public transport journeys and carry more people;
- Tram helps retail and attracts investment; and
- Tram improve accessibility and the environment.

Project delivery

City of Edinburgh Council is the promoter of the ETN and has committed £45m to fund the project. Transport Scotland is the major funder of the project providing £500m. Any costs in excess of £500m are the responsibility of the Council. TEL and tie Ltd are the wholly owned Council companies responsible for delivering the tram infrastructure.

The Business Case for the Phase 1a of the ETN was approved by Council in December 2007. In October 2007, the procurement reached preferred bidder stage. The Infrastructure delivery contract (Infraco Contract) was awarded to a consortium of Bilfinger Berger (Civils infrastructure works), Siemens (Systems infrastructure works) and CAF (tram supply). The contract with the consortium was signed in May 2008 after a lengthy period of difficult negotiations. tie Ltd negotiated the contract on behalf of the Council and tie Ltd is the contract signatory with the BSC consortium with the Council providing a financial guarantee.

At the time of the award of the contract to BSC, significant parts of the design for the ETN were incomplete. This meant that the contract could not be a "fixed price" contract as the exact scope was not then determined.

To build the ETN, significant amounts of pipe and cabling also required to be moved. This was carried out under contract with Carrillion. Unfortunately, for a number of reasons, including a scope increase of 78%, the target completion date of September 2008 was not achieved and this has been a significant cause of delay to BSC's construction programme.

Over the period from contract signing in May 2008, it became increasingly clear that the project was not progressing smoothly and this was illustrated by unsubstantiated demands of significant sums of additional money by BSC. From autumn 2008 relationships between the contracting parties deteriorated. During this period, tie Ltd sought to operate the contract in as firm a manner whilst seeking to maintain a working relationship to encourage delivery of the ETN.

Matters came to a head in February 2009 when BSC refused to commence the construction works as planned on Princes Street. Due to the importance of this thoroughfare to stakeholders the dispute over Princes Street eventually resulted in a proposal for a Supplemental Agreement (known as the PSSA) which would modify the Infraco Contract in a limited way for the 1km section of Princes Street. This allowed work on Princes Street to commence in late March 2009, the scope of works for the PSSA related specifically to civil engineering works.

However, although work was proceeding on Princes Street under the PSSA, the attempts to resolve other matters in dispute were largely proving fruitless. This resulted in an intensive week of informal mediation which was held in the week commencing 30 June 2009 covering a range of critical issues. On 8 July 2009, **tie Ltd** reported back to the Tram Project Board (TPB) that the mediation had not been successful and the **tie Ltd** Chief Executive outlined four options for consideration by the TPB as follows:

1. Seek a negotiated settlement
2. Formal contractual approach – Dispute Resolution Procedure (DRP) and applying other available contractual mechanisms
3. Reduce/re-phase BSC scope
4. Terminate the BSC contract

The TPB endorsed option 2.

A discrete number of disputed matters were initially selected for dispute resolution. The DRP strategy requires an increase in management time and additional advisor costs. In December 2009, tie concluded that the strategy was not delivering the desired outcomes. Whilst DRP had assisted in getting work started at some locations and significantly driving down the final value of contract changes, it had not achieved satisfactory breakthrough in the relationship. Indeed, in some cases the adjudicator had found in BSC's favour.

In early 2010 a further series of steps aimed at resolving the dispute, controlling project cost and regaining traction on the programme were recommended. These recommendations were approved and "Project Pitchfork" was launched.

Project Pitchfork
The fundamental options available to tie Ltd and CEC fall into three categories:

1. Termination of the Contract, potentially with project cancellation;
2. Continue with the current contract; or
3. Enforce adherence to the Contract and settlement of the disputed matters by agreement.

Option 1 includes the potential loss of the project, the waste of public investment and the likely risk of expensive litigation. Option 2 is the default position, which would continue in the absence of a change in approach by tie Ltd or BSC.

Option 3 is conceptually the most desirable approach, so long as the outcome is on acceptable and affordable terms. To achieve the most advantageous outcome, two broad lines of engagement were developed – a considerably more assertive approach to contract management by tie Ltd; and detailed examination of the causes of the current disputes and their possible solutions. The objective was to demonstrate to BSC that failure to deliver contractual obligations would place BSC in a very unattractive situation.

Project Pitchfork examined a range of potential outcomes and each of these was considered in detail. This has now evolved into two workstreams, named "Project Carlisle" and "Project Notice".

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Current Issues

Project Carlisle

The aim of Project Carlisle is to facilitate the negotiated exit of elements of the BSC consortium from the project. This would involve potentially reducing the scope of the delivery of the Infraco contract by BSC, with phased delivery of the project to match the affordability of funding. The current outline working assumption for Project Carlisle is:

- The consortium complete all infrastructure works to Haymarket;
- tie Ltd manage civil engineering delivery from Haymarket to Waverley Bridge (excluding civil engineering works already constructed on Princes Street) whilst Siemens remain in place to undertake systems work.
- Civil engineering works from Waverley Bridge to St Andrew Square is re-procured, with Siemens undertaking the systems work.
- Any further work on the ETN is separately procured on a phased basis.

The optimal outcome of Project Carlisle would be an operating tram service from the Airport to the city centre for the available funding of £545m. The remainder of the works would then be re-procured depending on the availability of further funding.

Latest advice from tie Ltd is that negotiations to conclude Project Carlisle have been difficult and agreement of a workable deal now appears doubtful.

Project Notice

One of the main difficulties for the project has been the ability of tie Ltd to force Infraco to comply with their obligations. This appears to be primarily due to the contract being insufficiently robust and precise in its terms.

In the absence of a commercial agreement on Project Carlisle, and assuming that the status quo is unacceptable, the only way forward would appear to be termination of the Infraco contract (whether for BSC default, tie default or on an agreed basis).

The main objective of Project Notice is to identify areas of the project where BSC have potentially been in breach of contract. This would assist in either forcing them to work, using the mechanisms within the contract, or to help facilitate a value for money deal on Project Carlisle. This work is still ongoing and tie Ltd has recently issued a number of Remedial Termination Notice's (RTN)/Under Performance Warning Notices (UPWN) under the contract. If tie Ltd have a robust case on any area where an RTN has been issued, they could potentially terminate the contract on the basis that Infraco is in default. Detailed legal advice will be required on such matters.

In the event that a commercial resolution cannot be achieved, the earliest possible time that the contract could be terminated on the basis of an alleged default would be the second week in November. In the interim, negotiations seeking a commercial resolution continue.

In summary, the project has faced many challenges from the outset. The ambiguity that exists in the Infraco contract has enabled the consortium, or at least elements of it, to adopt an attitude of intransigence and non-delivery. The lack of a complete design at contract signing and the change mechanisms created to deal with this matter have been particularly difficult matters to deal with. It is unclear at the present time what, if any, breaches exist which would allow tie Ltd to terminate the contract and validly prove Infraco default.

Governance

The governance structure, illustrated in Appendix 1, has been developed using a phased approach. In order to maximise the benefits of an integrated transport operation Transport Edinburgh Limited (TEL) was set up to develop the strategy for the combined bus and tram operations. The first phase which saw the shares of tie Ltd transferred from CEC to TEL was completed in December 2009. The rationale for this action was to streamline board structure and to facilitate a smooth transition from tram construction to operations.

The second phase concerns the shares of Lothian Buses being transferred from CEC to TEL as part of the final arrangements for tram operations. As part of this, the appointment of the posts of Chief Executive Officer (CEO) and Chief Operations Officer (COO) for TEL require to be filled. This is subject of a report to Full Council on 24 October 2010. It is proposed that Richard Jeffrey, currently the Chief Executive of tie Ltd, will become the CEO and Iain Craig of Lothian Buses will become COO.

There is a significant amount of work required on contractual, legal and financial issues to close out Phase two and effect the transfer of Lothian Buses shares. This work is ongoing and the transfer is currently proposed to take effect in Spring 2011.

Future issues in 2011

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The project is at a very delicate stage. In the last few months there has been heightened press, political and public pressure. The issues with the project in terms of increasing costs, allied to continual programme slippage and the ongoing contractual dispute leave the project in a difficult position. In the event that a value for money solution cannot be agreed with BSC, this may lead to political calls to terminate the Infraco contract and/or cancel the project. There are many permutations which may result from contract termination, depending upon whether there is default on either side proven and also whether there is the funding and appetite for any re-procurement;

Each possible outcome carries with it different risks. In the extreme, cancellation without cause could result in the Council paying damages to BSC, paying the costs associated with making the various worksites safe, potentially refunding Transport Scotland the monies already spent (a significant revenue write off for CEC) and considerable reputational damage.

However, a commercial resolution to continue with BSC also risks continuing a relationship with a contractor with which there has been so much difficulty. There are also procurement risks inherent in any change to the current contract.

In the event of termination, several things will need to happen quickly and in parallel, and will need co-ordinating as they are inter related.

A dedicated commercial and legal team will need to bring closure to the Infraco contract. There are several prescribed activities that need to be undertaken. tie Ltd would seek to conclude a financial settlement with the consortium to avoid, if possible, the issue reaching the courts. We must however recognise that this issue may end up being resolved in the courts, which is expensive, lengthy and risky for all parties, and has no certainty of outcome.

A team must quickly establish what state of asset the Council have for example design and its status and what is actually built on the ground.

The Council must decide if at this stage is wishes tie (and/or TEL) to continue to administer the project in the short term or seek alternatives.
Very quickly, and in parallel to the above, the Council must decide if it wishes to complete any part of the work that is currently underway, or immediately cease all works (apart from the minimum required to make safe).
In addition, the Council must decide if it still wishes to take delivery of the tram vehicles, or to cancel the vehicles as part of the contract termination and seek the return of all monies paid for the vehicles on the grounds of breach of contract by the consortium.
A team should be set up to assess the options for the way forward for the project (including cancellation of the project). These options will require to be presented to the Council. It is envisaged this work could take six months. Until this work is done there can be no certainty of future cost or timescales.

If the project is to proceed, there must be a formal lessons learned session to identify some of the underlying root causes of the current situation and ensure that they are not repeated.

Funding and Affordability
It is clear that the currently committed funding of £545m will not be able to deliver the full scope of Phase 1a. This has resulted in options being considered for incremental delivery of the project. The Council have also outlined contingency funding options to facilitate spending up to £600m on the project. However, given the increasing costs on the project and considering recent negotiations with the contractor, it would appear that even this level of contingency planning will not provide sufficient funding to complete the project.

Further Sources of Information

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It is difficult to fully summarise the background and issues with such a complex project in a short note. However, a full briefing on any specific aspect can be provided.

Highlight further sources of information including hyperlinks to committee reports or web pages…

e.g. '<u>Edinburgh Partnership Single Outcome Agreement: Annual Report on Progress</u>', The City of Edinburgh Council, 19 August 2010.

Senior Officer Responsible

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The following person(s) can be contacted for additional briefing information as required:

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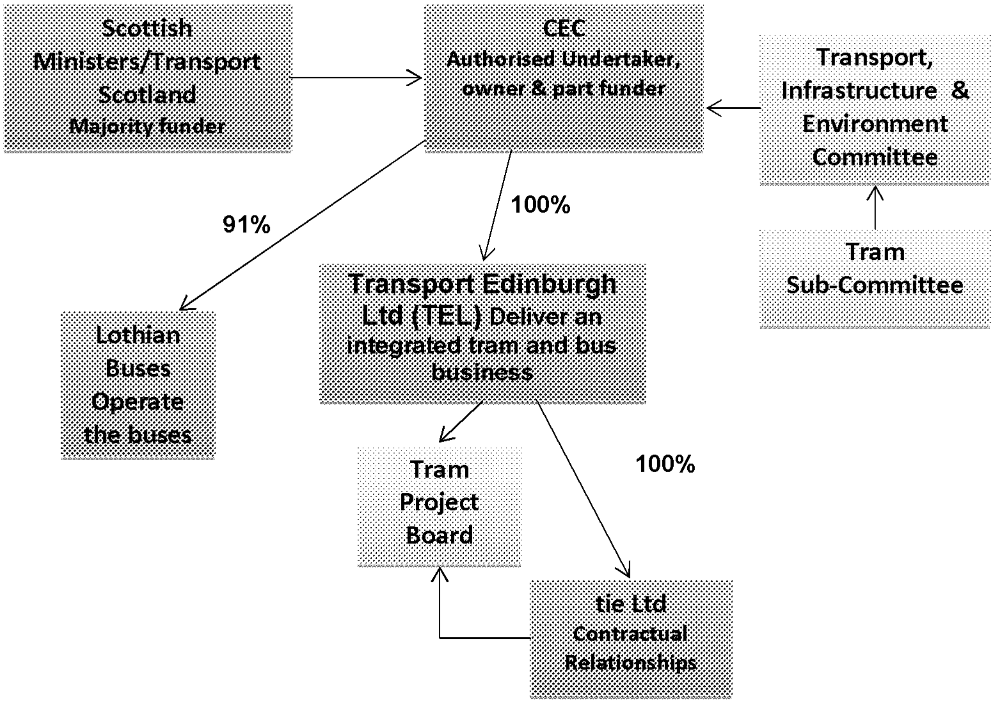
The Council's Planning Framework

Appendix 1



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