

Legally Privileged and FOISA Exempt

Commercial Due Diligence Report

TIE, Edinburgh Tram Network,

Initial Due Diligence

April 2011



TIE00096741_0001

Contents

| Subject | Page |
|---|------|
| 1.0 Introduction | 1 |
| 2.0 Contract Sum Breakdown | 2 |
| 3.0 Commentary on Tie Ltd Valuation of Work | 3 |
| 4.0 Termination Clause Commentary | 6 |
| 5.0 Next Steps | 7 |

Appendices

Appendix A Milestone Analysis – Projected Certified End Feb 2011

Appendix B Off Street Works – Estimated Value of Works Complete on site Based on Tie Ltd Percentages

| Author | Date | Version | Issued to : | Status |
|---------------|-----------|---------|--|-------------------|
| William Allan | 7 April11 | Draft | Alan Manuel, Dennis Murray, Steven Bell, Fiona Dunn | Draft for comment |
| | | | | |

I

1.0 Introduction

Cyril Sweett have been requested by Tie Ltd to carry out an independent commercial review of the Edinburgh Tram project. This initial report has been restricted due to the timescales involved and relates primarily to the following topics:

- Commentary on the current gross valuation of amounts certified to date
- Cyril Sweett's initial estimate for the current valuation of work done to date based upon milestones and using Tie's information
- Our initial estimate for the current valuation of work done to date based upon Cyril Sweett's pricing schedule for the off street works using Tie's percentages for completion and Tie's milestones for the on street works
- An initial review of the termination clause

To carry out this initial review Cyril Sweett has worked with Tie Ltd to derive a breakdown of the Contract Sum for the Edinburgh Tram project works.

It is the intention of the exercise to build upon this current report to provide Cyril Sweett's independent view of the commercial position of the project using our own assessments of the actual work carried out. This should allow further analysis of the project and consideration of an estimate of the cost to complete the works as well as a review of potential procurement routes, contract forms for adoption and timescales for carrying out any potential contingency procurement exercises.

Cyril Sweett would clarify that it is not the intention of this report to review the legal position of any disputes but instead to carry out commercial due diligence of the level of works carried out to date on behalf of Tie Ltd.

2.0 Contract Sum Breakdown

Within Appendix A is a developed Milestone Analysis schedule detailing Cyril Sweett's current understanding of the Contract Sum amount of £304,444,301 and how this is broken down between the following key headings:

- Mobilisation Payments upon Contract award
- Preliminaries Amounts including Network Rail Immunisation amounts
- Design Costs – entitled SDS Price
- Incentivisation Costs
- Section Construction Amounts – 1A, 1B, 1C, 1D, 2, 5A, 5B, 5C 6, 6A and 7
- Future Maintenance
- Value Engineering Amounts
- Defined Provisional Sums
- Undefined Provisional Sums

Our understanding of the Contract Sum breakdown has given our team greater clarity on the Section Construction Amounts and Provisional Sums, however we would expect to further analyse the following more complex areas :

- Mobilisation amounts of £22.6m for Bilfinger Berger and £22.6m for Siemens; typically we would expect mobilisation costs to be paid as the first milestone for tendering costs to date, procurement of insurances, bonds etc and site set up costs as well as any specific early purchase items.
- How the Value Engineering amounts of £9.965m and £2.670m have been allocated throughout the Section Construction amounts
- Confirm a detailed breakdown of the Preliminaries amount for the project which identifies sums for items such as Design Risk and Inflation (Escalation)

3.0 Commentary on Tie Ltd Valuation of Works

Cyril Sweett's initial estimate for the value of the works carried out to date has been carried out using two methodologies. The first valuation of the works relates to the milestones completed to date and reflects the updated and actual Certified Amounts. The second valuation of the works relates to the actual value of works completed on the project and uses the first valuation but amends the Off Street works amounts for Cyril Sweett's estimates (civil engineering works only) and applying Tie's percentage of completion. In addition we have also amended the preliminaries amounts by considering the value of Preliminaries carried out to date. This second valuation estimate requires the most consideration as it is potentially the most useful but makes an assumption around the amount to be paid for Preliminaries and Mobilisation which requires a greater level of detailed analysis to be carried out. We have included our Estimate of the Off Street Works amounts in Appendix B for further clarity.

Our Estimate for the Completed Milestone Valuation is £178,877,043 which compares to the Tie Ltd Valuation estimate of £182,005,004.

It should be noted that in this estimate we have assumed that the Mobilisation and Preliminaries amounts are as per the Tie Ltd total. With regard to this estimate we would note that the overall preliminaries amount paid is circa 70% of the contract sum value which is higher than we would have expected at this stage and excludes any consideration of mobilisation costs.

Cyril Sweett's Non Milestone Valuation estimate is £139,818,680 which is £42,186,324 below the Tie Ltd Milestone Valuation amount. A breakdown of this figure is included within Appendix A of this report. It should be noted that within our Non Milestone estimate there are a number of assumptions which require explanation and further examination in future exercises. This will allow our team to develop a more accurate Valuation of the work carried out to date.

Within this estimate we have excluded any consideration of materials on site and have included amounts or made assumptions for preliminaries, inflation, mobilisation, SDS costs, tram supply contract and additional works as follows:

(i) Preliminaries costs:

Within the overall project total of £304,444,301 we have estimated that there is an approximate construction works total of £230,292,742 on which the Preliminaries amount can be calculated. The amount of £230,292,742 is exclusive of SDS Design costs (£3,308,815), Maintenance Mobilisation costs (£4,050,098), Tram Supply price (£55,781,634), Network Rail Immunisation costs (£3,000,000) and Undefined Provisional Sums (£8,011,012); amounts which would not normally attract Preliminaries costs.

Cyril Sweett would normally expect Preliminaries to be circa 18% for projects of this nature and this would be split as noted below. The application of this percentage against the approximate value of construction works amount of £41,453,000.

| Item | Description | Comments | % |
|---------------------------|--|---|-------------|
| 1. | Site management, plant and equipment, overheads and profit | Based upon similar scale of projects (range 9 – 12%) | 10 |
| 2. | Site Logistics | Large site to manage/double hutting/staffing etc | 1.5 |
| 3. | Design Risk | Dependant on the stage and level of design at award (can range between 1 – 10%) | 6 |
| 4. | Bonding/securities | Specialist requirements for Edinburgh Trams project | 0.5 |
| 5. | Maintenance | Excluded from this section of preliminaries | 0 |
| Overall Percentage | | | 18.0 |

(ii) Inflation

Another important factor in the estimation of the overall value of the works is the amount which would have been included by the Infracore within the tender amount for inflation (or escalation). At this stage Cyril Sweett have not included inflation within our estimates for construction works and have allowed a further allowance of 8% for this on the assumption that Tender Price Inflation can now be shown to approximately 8% per annum at the time of tender, 4th quarter 2007.

Our estimate of cost against the heading of inflation is therefore £18,423,000.

The overall amounts for Preliminaries, site set up costs and inflation is therefore estimated currently at a total of £59,876,000 with is the total of the sums identified in (i) and (ii) above.

Within our calculation of Preliminaries we have used an allowance of 38% of the overall Preliminaries total which is an average of the two values calculated below. This average value does however allow for the initial project set up costs which are one off items (insurance, site set up etc) and are not included within the average running costs calculation :

- the value of Cyril Sweett's measured works (£35,000,000) against the contract sum value of this amount (£118,000,000) – 30%
- the value of Cyril Sweett's measured works plus Tie Ltd's valuation of changes paid to date (£59,000,000) against the contract sum value plus the Provisional Sum values (£137,500,000) – 46%

(iii) Mobilisation Payments

More complex is the consideration of a mobilisation payment at the project commencement and what this value should be. It is accepted practice that on contract award of major projects of this nature (PFI/PPP) a mobilisation payment can be applied for at the commencement of the project to recover procurement costs, insurance costs etc. The purpose of our exercise is however to consider the correct value of works which have been carried out to date and to this end we would not expect the first mobilisation payment to have any major value which has not been identified in the measurement works to date.

(iv) SDS Price

We have assumed that the amounts included for the SDS design in the milestone payment is accurate for the work carried out to date and variations works. We would note our assumption that the amount included by Tie Ltd does not include for works associated with the utilities diversions project.

(v) Tram Supply Contract

Cyril Sweett have allowed the amount included by Tie Ltd for this item and will seek to check this at the next stage.

(vi) Additional Works

We have incorporated the most recent Tie Ltd assessments of the Additional Works however at this stage we have not been able to interrogate the breakdowns to confirm how these relate to work carried out to date and their actual value or if Preliminaries have been included within the estimates. This is an area of work which will require action for the next reporting stage.

(vii) Value Engineering

We have not included any amounts against this heading but we understand that Tie Ltd have carried out an exercise on this and we would seek to review this and incorporate any amounts in our next stage report.

(viii) Work Not In Accordance with the Contract

Within our estimate we have excluded any amounts for work which may not be carried out in accordance with the contract or work which has deteriorated since the works have been suspended. This assumption will require review at the next stage.

4.0 Termination Clause Commentary

As part of this report Cyril Sweett has carried out a review of clause 90 of the contract to enable us to provide our opinion of payment requirements should Infraco's employment be terminated due to their default.

The clause categorises default in 3 ways the effect of termination under each of these headings alters the timetable for termination and the ongoing actions of Tie in relation to step in rights etc. It does not alter the payment rights.

The payment calculation methodology and timing is reasonably straightforward and clear, the main points to be noted are:

- (A) Infraco are not entitled to any compensation from Tie under the termination clause whether under contract, delict (including negligence), breach of (or compliance with) statutory duty, restitution or otherwise. (clause 90.11)
- (B) If Tie enters upon Infraco works and expels Infra Co in accordance with clause 90, Tie shall not be liable to pay Infraco any further monies until finalisation of the costs to complete – no later than 6 months from completion of works. (clause 90.13)
- (C) As soon as practicable after termination, the parties shall agree:
 - (i) The amounts, if any, which has been reasonably earned and not yet paid pursuant to this agreement by the Infraco in respect of work actually done by it (clause 90.12.1).

[The wording of this clause may given rise to dispute as the term “*reasonably earned*” in my opinion is not clear. Prior to any decision to terminate legal opinion should be taken on this point.]
 - (ii) The value of any unused or partially used goods and materials which are under the control of Tie or CEC for which Infra Co has not yet been paid (clause 90.12.2).
- (D) Within 6 months of completion of the works and services to be performed by Infraco as part of the Infraco works but excluding maintenance services. Tie's representative shall prepare:
 - (i) cost of completing the Infraco works and all other costs and expenses properly incurred by Tie less the sum that would have been due to Infraco if they had completed the works.
 - (ii) the amount Tie will spend on the maintenance services less the amount Tie would have paid to the Infraco for the maintenance services.
- (E) Once the 'additional' cost of completion is established any positive balance is then paid to Infraco and if the balance is a negative figure this would be pursued as a debt from Infraco.
- (F) A point to note is that any certificate for payment issued in relation to work done post termination must be copied to Infraco with “*such detailed explanation as may be necessary*” regarding the sum being paid.

5.0 Next Steps

This initial commercial report on the Edinburgh Trams project has identified that there is a potential gap between the value of Milestone payments made to date to Infraco and the potential value of work carried out due to a variety of reasons. It is also noted however that this contract is a relatively complex one and that further work is required to establish a more accurate amount for the Value of Work Carried out to Date and then estimate the cost of work to complete the project.

In summary the following areas require a greater level of scrutiny and analysis to establish an accurate commercial position for the Edinburgh Trams project:

- (i) Preliminaries This area of the project is of a high value and relates to the other aspects of the project including measured works, milestone payments, design and construction risk and inflation. It would be our intention to verify our initial estimates with further examination of the actual project requirements and available cost information from Tie Ltd.

- (ii) Measured Works To date we have used the Tie Ltd percentage completions to calculate the Off Street works value to date. We would expect to review the actual amounts for each measured item in each section to derive Cyril Sweett's independent assessment of the value for the off street works. In addition this exercise should provide cost information on the value of work which has been carried out but is not in accordance with the contract as well as work which is no longer in accordance with the contract as it has not been protected since work was suspended.

Cyril Sweett will also carry out their own estimate on the on street works carried out to date.

- (iii) SDS Price Cyril Sweett will review the level of design for the overall project and assess more accurately the likely fees required to complete the project to the satisfaction of Tie Ltd.

- (iv) Additional Works We would anticipate that an detailed review of each of the change items amounts be checked by Cyril Sweett to ensure that these all relate to works carried out to date and clarify if these amounts include further levels of Preliminaries amounts which would ensure that there is not double counting in our estimate of work carried out to date.

- (v) Value Engineering We would wish to assess scope and level of value engineering which could be applied to the values and estimate provided in this report.

- (vi) Tram Supply Contract Cyril Sweett will review the level of work carried out to date and ascertain our own assessment for the work which as been carried out to date.

Appendix A

Milestone Analysis – Projected Certified End Feb 2011

Appendix B

Off Street Works – Estimated Value of Works Complete on Site Based on TIE Percentages