

Edinburgh Tram Project – Update Report DRAFT

The City of Edinburgh Council

24 June 2010

1 Purpose of report

1.1 The purpose of this report is to update the Council on the progress of the Edinburgh Tram Project and related issues including:

- current contractual difficulties with the Contractor, the Bilfinger Siemens CAF Consortium (“BSC”) (in particular regarding agreed scope and progress of the civil engineering and infrastructure installation works);
- the approach adopted by tie Limited (“tie”) to achieve acceptable resolution of the matters in dispute;
- budget, scope and programme implications;
- the Council’s funding strategy (including contingency planning);
- communications with stakeholders; and
- a summary of the current position on utilities diversion works completed on-street.

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1.1.2 The project governance arrangements have facilitated communication between tie and Council officers on key aspects of the project. Specifically, the Operating Agreement that is in place between the Council and Transport Edinburgh Limited (TEL) requires that the Council must be made aware when there is a reasonable expectation that the approved price, programme or scope of the project may change and this requirement is being fulfilled in terms of this report. TEL is not, however, seeking any additional budget for the project at this time.

1.2.1.3 In view of the importance of the project to the city and the ongoing difficulties being experienced, it is considered extremely important to place as much information in the public domain as commercial considerations and confidentiality undertakings allow.

2 Summary

2.1 A report was provided to the Council meeting of 20 August 2009 which resulted, *inter-alia*, in Council endorsement of the contractual processes on which tie had embarked to provide greater cost and programme certainty in the project. In the intervening period, tie has increasingly had to enforce contractual rights in its engagement with the BSC Consortium to attempt to

expedite progress on the tram infrastructure installation works and to compel action to resolve the dispute.

- 2.2 Although well behind the rate required by the contractual programme, there has been some degree of construction progress on the off-street sections of the works, particularly to the West of Murrayfield Stadium and at the tram depot at Gogar. The utility diversions (carried out under separate contract) are also now substantially complete, creating much-improved utility asset quality along some of the city's main thoroughfares as an adjunct to the unobstructed areas for tram installation. Substantial additional utilities work beyond that originally planned has had to be executed which has affected site access for BSC. The construction of the tram vehicles by CAF has proceeded to programme and the first vehicle has arrived on schedule in the city following successful testing at the Siemens facility in Germany.
- 2.3 There continue to be a number of serious contractual difficulties with BSC relating to design issues (including delay in design completion); impact of delay caused in part by utilities work and associated extension of time claims; and failure to progress by BSC despite client instruction. This report provides a comprehensive update on each of these issues and their respective implications.
- 2.4 The application by **tie** of the formal Dispute Resolution Procedure ("DRP") within the terms of the contractual agreement with ~~the Consortium~~ **BSC** ("the Agreement") has achieved resolution on some of the issues subjected to the process. However, the targeted improvement in infrastructure installation performance by BSC has not materialised.
- 2.5 Following Council endorsement at the end of 2009 and in the absence of acceptable construction progress, **tie** set out a number of areas where it was necessary to adopt a more contractually-led approach with BSC in order to protect stakeholders' interests. These included continued application of DRP, audit verification on a number of areas relating to BSC management of the contract and, for the purposes of dispute resolution and in preparation for litigation, (a) detailed legal investigation of the matters under dispute; and (b) Senior Counsel's opinion on the critical areas. A review of strategic delivery options for taking the project forward was performed, including assessment of the option of terminating the Agreement.
- 2.6 Although the formal adjudications under the DRP have produced mixed results, ~~the~~ detailed legal advice received has reinforced **tie's** interpretation of the contractual position on the main matters under dispute. Although there has been no breakthrough which has restored momentum to the project, negotiations continue with the benefit of the breadth of detailed commercial and legal support, including Senior Counsel's opinion, available to **tie**.
- 2.7 This report provides an update on the project budget, scope and the programme implications of developments since the last report to Council. It is now clear that the full Phase 1a tram system cannot be delivered within the available funding envelope of £545m and the overall outcome remains uncertain for so long as the intractable behaviour of BSC persists. **tie** ~~now~~ has recently received advice that a properly performing contractor could still have

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the trams open for revenue service by the end of 2012. However, while BSC remains in dispute with **tie** and construction progress is unsatisfactory, it is not possible to offer any certainty on the cost or programme outcomes.

- 2.8 In the period since the 20 August 2009 update report, Council officers have been analysing contingency funding options in the event that the estimated capital cost of the project does exceed the available funding of £545m. This work has identified options for consideration and this report provides detail on these options. The report also examines the Council's funding strategy and current budget commitment of £45m.
- 2.9 As a prudent contingency, **tie** has assessed the option to deliver Phase 1a of the tram project on an incremental basis. Details of this assessment are included in the main body of this report.
- 2.10 Since August 2009 there has been regular communication with key stakeholders, in particular to ensure that Transport Scotland has been kept up to date with the issues relating to the project. A series of meetings has taken place with Transport Scotland explaining the areas of dispute, negotiations with BSC and the potential budget and programme implications.
- 2.11 In summary, the current position remains highly unsatisfactory despite extensive and constructive attempts by **tie** to achieve reliable execution by BSC of its obligations in the Agreement. It is to be hoped that an acceptable outcome can be achieved and current negotiations are examining options which could provide such an outcome. However, in the event that this cannot be achieved, **tie** is taking the steps necessary to prepare for termination of the Agreement.

3 Main report

Underlying Case for Trams

- 3.1 The Final Business Case for Phase 1a of the Edinburgh Tram Network was approved in December 2008. The validity of the Business Plan approved at that time remains intact. Since 2008, when construction of tram infrastructure commenced in Edinburgh, a number of other cities in the UK have continued their commitment to tram networks. Manchester Metrolink is currently planning several extensions over a prolonged period of time, while Nottingham Express Transit has two further lines planned. The initial success of the Dublin Luas tram scheme, upon operation in 2004, led to a commitment to seven future lines or extensions over a ten year period in the Irish government's 2005 Transport 21 plan. The evidence from all of the UK networks and also from Dublin is that trams are well-liked by the travelling public, enjoy excellent patronage and enhance the image of the cities in which they operate.
- 3.2 The first tram vehicle has now arrived in the city and is on public display at the tram stop on Princes Street. During the first month on exhibit there were in excess of 30,000 visitors. Feedback so far has been largely positive with 91% of visitors surveyed stating that they were impressed or very impressed by the vehicle.

Current Contractual Difficulties

- 3.3 Against that backdrop, the ongoing difficulties experienced with BSC are particularly disappointing. The Agreement to construct the tram infrastructure and deliver the tram vehicles was signed in May 2008 after an 18 month procurement process. The essence of the Agreement was that it provided a lump sum, fixed price for agreed delivery specification and programme, with appropriate mechanisms to attribute the financial and time impact of any subsequent changes, all as set out in the Agreement. However, a number of problems have arisen in the application of the Agreement terms.
- 3.4 Certain design-related matters have been disputed as to their inclusion or otherwise in the contracted scope of work and therefore their inclusion or otherwise in the contractual price. **tie** has accepted that certain matters would require to be treated as legitimate additions to that price and has concluded agreement on some **£18m** of extra payments for changes such as soft ground treatment; additional demolition works; utilities diversions undertaken by BSC; and the draw down of provisional sums or revised specifications to address Council or third party requirements. There remains disagreement with BSC on other matters and the DRP process in the Agreement is being deployed to enable issues in dispute to be resolved either through negotiation or by the decision of the adjudicator. The application of this formal process does not prejudice either party's right subsequently to take an issue to court; however, both parties must first exhaust the process set out in the Agreement.
- 3.5 Fifteen matters have been processed through DRP. Overall, the application of DRP to disputed matters has reduced BSC's claims for additional payment from circa £18m to circa £7.5m in relation to those DRPs which have actually reached financial settlement (9 of the 15 DRPs) by c£11m. This includes the sum of nearly £4m saved through application of the DRP on two claims resolved near the end of May 2010. The majority of the claims submitted have been prepared by Bilfinger Berger. **tie** is satisfied that the overall balance of adjudication outcomes has more than justified its interrogation of the initial claims made by Bilfinger Berger. **tie's** firm legal advice (prepared in contemplation of litigation), including advice from Senior Counsel, is that **tie's** general argument on many of these matters is to be preferred to BSCs.
- 3.6 **tie** accepts that construction works have been impacted by a delay to the completion of some utility works and has already offered (as part of addressing impact of other client changes and compensation events) a reasonable extension of time and associated costs to BSC. The link between utility delays and other causes of delay in the construction works is complicated, though capable of resolution with the involvement of suitably qualified parties engaged by tie.
- 3.7 However, the issue which is having the biggest impact on progress and the programme budget is the adoption by BSC of an approach of not progressing works where there is a change, or an alleged change, to the contracted scope of works until the financial entitlements from change are definitively resolved. This is not consistent with the conventional terms of the Agreement which requires progress to be made on such matters while work is undertaken to assess the impact (if any) on programme and costs. Such mechanisms are normal in construction contracts to avoid delay to progress where a contractor adopts the approach adopted by BSC.

- 3.8 **tie** has issued a series of formal instructions to proceed with works within the terms of the Agreement, but BSC has not complied with these, asserting that the instructions are not valid. In anticipation, and for the purposes of legal proceedings, **tie** has taken Senior Counsel's opinion on this matter which has confirmed **tie's** interpretation. It is also noteworthy that many of the specific claims BSC assert require a competent estimate of the financial, programme and performance effects of the matter to be prepared by BSC, which in many cases has not been provided or has been delayed by very long periods, in some cases many months.
- 3.9 The disputes surrounding design-related changes, causes of programme delay and BSC's unwillingness to act on formal instructions from its client are the core reasons for lack of progress and increasing cost. **tie** and the Council have a duty to secure best value for public money and it would be entirely inappropriate for **tie** to accept unsupported or inaccurate claims for additional money made by BSC.
- 3.10 Whilst there have been disputes on design-related matters, as summarised above, it is normal in any large construction project for the scope of the project to change in marginal ways for a variety of technical and commercial reasons.
- 3.11 To ensure there is a robust validation of such changes, a formal change management process is set out within the Agreement. The justification for the formal treatment of such changes under the terms of the Agreement is carefully evaluated to ensure that public funds are protected and to enable examination of any options which would mitigate their cost implications. A large percentage of the changes proposed by BSC remain unresolved, mainly due to a lack of timeous, evidence-based technical justification.
- 3.12 To date there have been fifteen issues launched into DRP, eleven by **tie** and four by BSC. Once an issue is in the DRP process the argument ~~posted put forward~~ by BSC in 3.7 above is definitely removed.
- 3.13 Of the fifteen DRP issues, three were resolved by negotiation, three were resolved through external mediation, seven have been referred for external adjudication (of which six have been concluded) and two matters are at an early stage of the process. ~~The sum saved by tie through application of the DRP process to date represents cXX% of the final sum agreed as payable to BSC.~~ Taking into account matters which have been resolved under the DRP process and also changes put forward by BSC which were concluded outwith the DRP process, the sum saved by **tie's** negotiation of the claims submitted represents over **77.9XX%** of the sum finally agreed. It should be noted that the outcome of the DRPs in terms of legal principles is finely balanced and still subject to debate between the parties.
- 3.14 **tie** has been successful in achieving part of ~~its~~ the objective it aimed to achieve by setting DRP processes in motion: getting work started at some locations and significantly driving down the final value of claims submitted by BSC. This has generally been a success. However, the DRP process has not yet achieved the momentum that the project needs to ensure its completion within an acceptable extended programme.

Approach adopted by tie to achieve resolution

Comment [NS1]: RJ confirming figures

- 3.15 The development of the dispute with BSC has been regularly reported to the Council, including reports prepared for the April, August and December 2009 Council meetings [REFER TO PREVIOUS REPORTS RELEVANT TO THE DISPUTE]. In brief, following BSC's refusal to fulfil their contractual obligations in relation to works on Princes Street in early 2009, an alternative approach was agreed recognising the critical nature of the specific city centre work to the well-being of retailers and the travelling public. However, the period since early 2009 has been characterised by continued intransigence by BSC over performance of their contractual obligations. As a result, in the Summer of 2009, tie began to apply the DRP process with the results described above.
- 3.16 Towards the end of 2009, it became clear to tie and Council Officers that little real progress was being achieved in persuading BSC to progress the civil engineering and infrastructure installation works (for which Bilfinger Berger were responsible as BSC consortium member) according to the contractual programme. tie has therefore had to adopt a considerably more robust approach to enforcing its contractual rights.
- 3.17 To supplement tie's project team and principal advisers, tie has deployed additional expert resource in the areas of contract and dispute management, technical, commercial, forensic planning/delay analysis and litigation expertise. This has been done to enable a robust commercial approach to be taken with BSC and one which also sets the foundation, in due course, for a more formal entitlements enforcement process to be pursued through the courts, should that prove necessary. The cost of this additional resource has been covered many times over by the savings achieved through negotiation and the DRP.
- 3.18 The approach taken has included audits of BSC's performance in key areas such as design management and integration, programme management (including compliance with duty to mitigate delays) and sub-contractor arrangements. The evidence gathered from these audits has reinforced tie's concerns about the reasons for the commercial dispute with BSC ~~and poses serious questions about BSC's proper discharge of its obligations.~~

Options Review

- 3.19 In December 2009, the Tram Project Board (TPB) concurred with tie's proposal that, in view of the lack of progress, a fundamental review should be conducted of the contractual position with BSC and that, if required, formal legal processes should be started to bring the major issues to a head and to enable the project to progress.
- 3.20 The analysis gathered from this work has enabled tie to evaluate a number of strategic options. A variety of options and sub-options has been examined and the preferred strategy was reported to the TPB on 10 March 2010.
- 3.21 Before setting out the approach approved, it is instructive to record a number of matters which are relevant to the actions now underway. Throughout the period of the dispute, progress on construction has been severely hampered by BSC's refusal to execute the works according to their contractual responsibilities, in an apparent attempt to coerce tie into agreeing to change the form of contract to a 'cost plus' arrangement. This has most recently been demonstrated by joint work to examine how to remove dispute over on street works, culminating in

BSC's proposal to fundamentally alter the balance of risk in the Agreement by seeking 'cost-plus' arrangements for the balance of the 'on-street' works across the city. Such an approach would not achieve best value and would also potentially put **tie** in breach of EU procurement law if applied across the whole scope of the works. Accordingly this proposal has been rejected.

- 3.22 Over the last year, **tie** has tried a number of approaches to overcome the difficulties in the relationship with BSC. These have included making a specific change in relation to the work on Princes Street (due to the importance of the thoroughfare to the commercial interests of Edinburgh's city centre retail businesses and the city's tourism economy and Festivals); attempting to resolve impasses through external mediation; meetings with different levels of senior management within BSC; and offering an extension of time for completion of the works programme despite the absence of a properly justified submission from BSC. Unfortunately, BSC remains wedded to the concept that **tie** must agree to the value of all changes before the relevant work begins, thereby all but paralysing the sequential works programme.
- 3.23 Against the backdrop of lack of progress and unwillingness on the part of BSC to adhere to its contractual responsibilities, **tie** has had to invest considerable time and public money to instruct external legal advice as well as commercial advice from independent experts. This advice has confirmed the validity of **tie's** contractual interpretation on a number of key issues. The advice reinforces **tie's** position, acknowledging that there will always be an inherent level of risk in seeking a determination through the courts.
- 3.24 The assessment of options by the TPB concluded that it was untenable to continue to seek a change in BSC's behaviour through informal commercial negotiation and that the investment of time and money in the reinforcement of **tie's** contractual position was a necessary next step.
- 3.25 Current dialogue with BSC is focussed on revision to the programme, the sequencing of work and the parties' responsibilities in a manner which will mitigate the range of disputed matters while maintaining a best value outcome. Although some degree of momentum has been achieved in recent weeks, the outcome remains very uncertain. This approach is currently believed to represent the first of two possible outcomes.
- 3.26 The second possible outcome is termination of the BSC Agreement. The options review addressed how the Agreement might be terminated and the consequences of such a termination. There is a contractually defined process in place to do this. BSC's failure to adhere to its contractual obligations, notably its direct failure to respond to instructions, supports the grounds for termination, should **tie** and the Council conclude that such an approach would be the best means of protecting public money. It is hoped that this outcome can be avoided but the grounds for such an approach have been extensively examined by **tie** and its advisors and preparatory work for litigation, should that prove to be necessary, is underway.

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~~3.28~~3.27 Amid the difficulties on the principal civil engineering works being carried out under management of Bilfinger Berger, it is important to recognise that the

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work carried out under the contract by the other Consortium partners, Siemens and CAF, has generally been conducted in a robust but constructive manner. The most tangible evidence of this is the recent successful testing on Siemens' facility in Germany of the first tram vehicle manufactured by CAF and the appearance of the tram vehicle in Princes Street. All 27 trams ordered have now been completed or are in the process of being constructed. While the Agreement rests between **tie** and BSC, not the individual members of the Consortium, it is unfortunate that Bilfinger Berger have not adopted the approach adopted by their Consortium partners.

3.293.28 Throughout the period of the dispute, the governance model established for the project has been operated rigorously. The levels of authority delegated to the parties with responsibilities for governance is fully documented and has been adhered to; the Tram Project Board, a formal committee of the TEL Board, has also met regularly to receive reports on progress and on the matters in dispute and their impact on the project. Despite many matters being commercially sensitive, there has been regular reporting from **tie** through the governance structure to Council officers and regular reports to Group Leaders.

3.303.29 In addition to communications between **tie** and Council officers through the project governance structure, other key stakeholders have been kept fully informed. There has been regular dialogue between **tie**, Council officers and senior representatives of Transport Scotland. Inquiries about the project from members of the public, MSPs, the media and other interested parties have been responded to as fully as possible, always subject to the need for confidentiality in order to protect public funds and to respect the terms of the Agreement.

3.313.30 In summary, the current position remains highly unsatisfactory despite extensive and constructive attempts by **tie** to achieve reliable execution of the obligations in the Agreement. **tie** has been required to adopt increasingly forceful tactics in relation to its rights and obligations under the Agreement and in the face of BSC's unwillingness to adhere to its obligations. Negotiations on the key matters continue and it is to be hoped that an acceptable outcome can be achieved. In the event that this cannot be achieved, **tie** is taking the steps necessary to prepare for termination of the Agreement.

Utilities

3.323.31 One of the most visible aspects of the project and one which has had most impact on Edinburgh's travelling public has been the diversion of extensive utility works along the route. The multi-utility framework strategy was a unique and innovative approach to the challenge of costly and disruptive diversion work and this diversion work is now substantially complete with only minor cabling works and commissioning of new assets currently being finished in the city centre.

3.333.32 As reported to the Tram Sub-Committee on 22 March 2010 the majority of the utilities diversion work was originally undertaken by Alfred McAlpine Infrastructure Services (AMIS) under the Multi-Utilities Diversion Framework Agreement (MUDFA). Work commenced under this contract in July 2007.

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- 3.343.33 Subsequently AMIS was subject to takeover by Carillion plc who progressed the MUDFA until the end of November 2009.
- 3.353.34 The remaining utilities works are being undertaken by two separate contractors, Clancy Docwra and Farrans.
- 3.363.35 The works undertaken represent significant betterment to the infrastructure in Edinburgh as many of the cables and pipes were in need of replacement which would have resulted in ongoing disruption to the city traffic over a number of years. This investment will be of long term benefit to the city and there will be a reduced requirement for maintenance and replacement of this infrastructure in the future.
- 3.373.36 The original scope of works covered 27,000m of pipes and cabling; this had to be significantly expanded once physical conditions underground became clear. The complexity of utilities along the tram route, congestion of pipes and cables in key locations and unforeseen obstructions has proven to be much more problematic than originally anticipated. In addition the records held by Scottish Utilities Companies and the Council were not comprehensive. The final scope of diverted utilities is estimated at c50,000m. Currently 48,000m of the expected volume has been completed.
- 3.383.37 The estimated cost for this part of the project has increased by approximately 25% to take account of the additional project scope and time. Of this increase 15% was anticipated and provided for in the original risk allowance. The net costs of utilities have been calculated after deducting a substantial credit from the Statutory Utilities Companies for betterment of their assets.
- 3.393.38 In summary, the MUDFA utilities works have required a net 10% increase in budget which is considered reasonable given the significant increase in volume of works encountered and the benefit of the enduring enhancement to the city's utility infrastructure along key traffic corridors.
- 3.403.39 The agreement of the final account with Carillion is subject to determination of additional amounts relating to claims by the contractor for alleged delay and disruption to the works they carried out. These claims will be subject to discussion with the Tram Monitoring Officer, in accordance with the Operating Agreement, before any settlement is made.

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Budget, Scope and Programme

- 3.413.40 The original project budget at contract award was £512m for the full scope of Phase 1a (plus an additional £3.2m should Phase 1b not be progressed) with an Open for Revenue Service (OFRS) date of July 2011.
- 3.423.41 The report to Council on 20 August 2009 highlighted that delivery of Phase 1a within the funding envelope of £545m would be very difficult to achieve and that the Council would undertake contingency planning in the event that the estimated capital cost of the project exceeded the available funding envelope.

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3.433.42 It is now anticipated the full scope of Phase 1a cannot be delivered for the approved funding of £545m. It is thought that, given the problems with BSC, it is prudent to plan for a contingency of 10% above the approved funding of £545m due to lack of clarity on programme and cost. **However, TEL is not seeking approval for an increased budget at this time.**

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3.443.43 Spend to date on the project, to the end of Financial Year 2009/10, is £347.8m. It should be noted that a construction project of this nature requires a significant amount of upfront costs, including land acquisition, design, procurement and legal costs. The contract with BSC accounts for £240m of the original budget of £512m and of this amount £135m relates to the civil engineering costs (substantially contracted to Bilfinger Berger) of the project. The table below shows each individual element of spend to date.

	Financial Close Budget £m	Current Spend £m
Infrastructure	250.5	117.1
Vehicles	58.2	42.2
Utilities	48.4	62.4
Design	26.9	31.2
Resources	68.3	63.4
Other (Including Land Acquisition Costs)	32.6	31.5
Risk + Phase 1b postponement and design costs (included in Current Spend in right hand column)	30.3	
	515.2	347.8

3.453.44 The original risk allowance within the budget of £515.2m has now been allocated to the individual budget headings.

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3.463.45 Of the expenditure to date, it should be noted that the components relating to Design and Utilities are almost complete. Therefore, exposure to additional costs in these areas is not significant.

3.473.46 The final anticipated cost related to Vehicles is £58m. With the exception of minor internal design changes related expenditure, this area of the project is on budget and ahead of schedule.

3.483.47 Other costs primarily relate to land acquisition costs. These costs were accrued earlier in the project and therefore the remaining cost exposure in this area is minimal although there are some residual risks related to future claims.

3.493.48 Resource costs for the project are currently running higher than previously envisaged. The primary driver for the additional cost is the

commercial and legal resource that has been required due to the ongoing disputes with BSC and a prospectively longer construction programme. There has also been an increase in costs related to Traffic Management arrangements and embargoes.

3.503.49 Therefore, the remaining uncertainty primarily surrounds the infrastructure costs and the current dispute with BSC.

3.50 One of the reasons for the increase in infrastructure costs has been the cost incurred for the Princes Street works ~~on Princes Street~~ which have now been substantially completed. Given the unique nature of Princes Street and the commercial impact on key city stakeholders, a customised approach to the completion of construction activity on Princes Street was required. An arrangement was reached whereby additional work, including the costs of programme acceleration, would be reimbursed on the basis of demonstrable costs by BSC.

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3.51 The final account for this section has now been substantially completed and shows a significant increase compared to the original sum of circa £2m included within the Infraco contract. Negotiations continue with BSC over a potential £11m of costs, with tie having already certified £8m of these. However, it should be noted that certain of these costs would have been additional to the original contract in any event (eg improvements to the track base, full-depth road reconstruction, use of setts on Princes Street and utility conflicts).

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3.52 Some of these potential additional costs can be justified given the unique nature of Princes Street and the achievement of a tight programme schedule in a critical area in the city. Nevertheless, it is clear that the experience with this arrangement to date demonstrates that this approach cannot be extended to all on-street works.

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3.52 In February 2009, BSC refused to commence the construction works as planned on Princes Street, despite the access and extensive traffic diversions arranged by tie and the Council.

3.53 Completion of the key works along Princes Street was especially critical. The Council and tie were very sensitive to both the unique nature of Princes Street and the needs of key stakeholders and commercial interests in the city centre. In addition it was vital that the 2009 Edinburgh Festival and the vitally important pre-Christmas and New Year shopping period could proceed with minimum disruption.

3.54 Accordingly, the potential for commercial harm to the city of major disruption during these periods required a customised approach to the completion of construction activity on Princes Street.

3.55 tie, therefore, agreed an arrangement whereby additional work, including the costs of programme acceleration, would be reimbursed on the basis of demonstrable costs by BSC.

3.56 The final account for this section has now been substantially completed and shows a significant increase compared to the original sum of circa £2m included within the Infraco contract. Negotiations with BSC continue to conclude the final account, although they have now certified £8m of costs relating to Princes Street. However it should be noted significant commercial matters require to be resolved with BSC.

3.57 It should be noted that there are a number of elements within these costs which would have been incurred over and above the original contractually agreed price in any event. These items include improvements to the track base, full-depth road reconstruction (which was not included in the original contract price), the use of setts in response to Princes Street's status as part of a world heritage site and additional work associated with utility conflicts.

3.58 These items total £3m and it should further be noted that there will be a substantial increase in the value of the Council's road asset due to full depth reconstruction which should reduce the need for further carriageway works on Princes Street in the future years.

3.59 In addition, costs of £2m were incurred relating to delay, disruption and subsequent acceleration to achieve the end of November 2009 embargo timescale.

3.60 The remaining premium cost of potentially £6m remains the subject of discussion with BSC. Some of these additional costs can be justified given the unique nature of Princes Street and the achievement of a tight programme schedule in a critical area in the city.

3.61 Nevertheless, it is clear that the experience with this arrangement to date demonstrates that this approach cannot be extended to all on-street works.

Council Funding Strategy, Contingency Planning and Incremental Delivery

3.623.53 The Council's funding strategy for its commitment of £45m was derived from a variety of sources, including capital receipts of land assets along the route of the tram line, developers' contributions and contributions from the Council's Capital Investment Programme. The original breakdown of the Council's funding and the contributions made to date is shown in the table below.

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CEC Contribution Breakdown	Planned Contribution	Achieved Contribution
Council Cash	£2.5m	£2.5m
Council Land	£6.2m	£6.2m
Developer Contributions – Cash	£25.4m	£4.5m
Developer Contributions – Land	£1.2m	£1.2m
Capital Receipts (Development Gains)	£2.8m	£0.0m
Capital Receipts	£6.9m	£2.0m
Total	£45.0m	£16.4m

3.633.54 When this strategy was originally devised, it was assumed that capital receipts and developers' contributions would be accrued over a time horizon of twenty years; therefore it was never assumed these funds would be in place during the construction phase of the tram project.

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3.643.55 There is no doubt that the rate of funding from developer led sources has been affected by the economic downturn. However, evidence in recent months ~~indicates that would suggest that the rate of contributions are still being generated has increased, £1m of the total developers contributions achieved of £4.5m, has been received since November 2009.~~

3.653.56 However, there remains a risk that the full level of contributions may not be achieved. The Council will continue to monitor the levels and progress of the developers' contributions and assess these within the wider contingency planning being carried out on the project.

3.663.57 As detailed earlier in the report, it is now envisaged the full scope of Phase 1a cannot be delivered within the approved funding envelope and within the originally envisaged timescales.

3.673.58 Whilst **TEL** is not seeking approval for an increased budget or formal change to the baseline programme date at this point in time, in terms of the Operating Agreements it is appropriate that Council is made aware of the current position. Any changes to cost, programme or scope which emerge from future negotiations with BSC will be formalised as a request for approval from the Council prior to any commitment.

3.683.59 In terms of balancing demands, the factors of scope, project cost and date of delivery need to be considered together. This work is ongoing as the Tram Project Board considers how best to balance the varying demands of the programme.

3.693.60 It should be noted that whilst there remains significant commercial uncertainty, it is not possible to provide a robust estimate for the full cost of ~~P~~phase 1a. However, based on the strategic options work which ~~tie~~ has

undertaken and as a result of all the other factors included in this report, it is now considered prudent for the Council to plan for a further 10% over the available funding of £545m, on the understanding that further potential risks have been identified beyond this level.

- | **3.703.61** Contingency plans up to a funding level of 10% above the approved project funding have therefore been examined. The contingency planning undertaken has primarily identified two potential sources of funding to allow the Council to borrow under the Prudential Framework.
- | **3.713.62** The Council has made allowance within the Council's Long Term Financial Plan of £2m per annum to cover infrastructure development costs. This provision would allow the Council to borrow £24m under the Prudential Framework; this would represent an opportunity cost for the Council but would have no impact on specific projects already in the capital programme. Headroom within the existing budget for loan charges may also allow future investment in infrastructure beyond this sum.
- | **3.723.63** Further borrowing, should it be necessary, can be financed from the future profits of Transport Edinburgh Limited (TEL). Based on the full scope of Phase 1a TEL's forecast cumulative net profit from 2013 – 2031 would allow the Council to prudently borrow additional funding up to the level of circa £600m.
- | **3.733.64** The Council's contingency planning is dependant on its ability to use the prudential borrowing framework. However, a risk has emerged recently around potential restrictions on the use of the prudential framework given the current economic difficulties at UK level. If this risk crystallised the Council would have to investigate alternative funding arrangements. Further contingency planning will be undertaken in this regard.
- | **3.743.65** Following recent meetings of the Tram Project Board, **tie** has been instructed to review the options for incremental delivery for Phase 1a as a further contingency plan. This review requires the input of colleagues at Lothian Buses to ensure the extent of Tram services delivered at any point in time can be integrated with appropriately adjusted bus services. This review will be undertaken as the outcome of current negotiations with BSC becomes clearer.
- | **3.753.66** The incremental delivery options review will address the imperative to manage the affordability risks of the project (in the context of the current commercial disputes with BSC) by means of flexible incremental delivery of the on street sections over a longer period of time and in a way which provides the Council greater control over the precise timing of the remaining on-street works. The approach will ensure the investment already made in the in the project is realised by the delivery of a viable tram service, integrated with bus services, whilst preserving for delivery the entirety of the scope of Phase 1a as detailed in the Final Business Case. The stages of Phase 1a service delivery under examination are;
 - Airport – Haymarket (core off-street street works under construction)
 - Airport - York Place (connects the Airport to the City Centre)

- Airport - Foot of the Walk (achieves integration with bus services on Leith Walk and interchange at FOW)
- Airport – Ocean Terminal (serves the core of the Leith Docks development)
- Airport – Newhaven (Full Scope of Phase 1a)

3.763.67 The capital costs of each of the options will allow future decisions to be taken within the overall context of the affordability of funding. The full assessment of these options and the overall funding strategy can only meaningfully be performed once there is clarity on the dispute with BSC.

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4 Financial Implications

- 4.1 It is now considered that the full scope of Phase 1a cannot be delivered within the approved funding envelope of £545m.
- 4.2 The contingency planning work that has been undertaken has identified funding options which could facilitate project costs up to £600m.
- 4.3 There are further risks that could impact on the costs of the project. As part of the work **tie** have undertaken on strategic options, potential incremental delivery of construction, based on affordability assessments may need to be considered in the future.

5 Environmental Impact

- 5.1 The Edinburgh Tram Project will make a positive contribution towards the vehicular emissions and air quality in the city centre and the transport corridor to the west of the city and the airport. This will have a positive impact on current pollution levels and provide a quieter mode of public transport.

6 Conclusions

6.1 Despite the huge increase in cabling works against that which was initially expected, there has only be a relatively small corresponding increase in cost in relation to the utilities works against budget.

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6.2 Despite the parties entering into an alternative arrangement for the delivery of the Princes Street works in good faith, this has proved not to be an appropriate approach to adopt across the rest of the route.

6.3 Whilst negotiations between **tie** and BSC continue to be finely balanced, it is clear that the Project cannot continue in this way. **tie** has taken robust legal advice as to its position and has been enforcing its contractual rights under the contract.

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6.4 Whilst there remains significant commercial uncertainty, it is not possible to provide a robust estimate for the full cost of Phase 1a. However, it is now clear that the full scope of Phase 1a of the tram system cannot be delivered within the available funding envelope of £545m.

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6.5 Notwithstanding the continuing difficulties, TEL is not seeking further funding approval at this time. Council officers are however looking at options for contingency funding and tie are examining the possibility of delivering Phase 1a on an incremental basis.

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6.6 The current position remains highly unsatisfactory. It is to be hoped that an acceptable outcome can still be achieved through negotiations. However, in the event that this cannot be achieved, tie is taking the steps necessary to prepare for termination of the Agreement.

6.16.7 Any changes to cost, programme or scope which emerge from the negotiations with BSC will be formalised as a request for approval from the Council prior to any commitment.

7 Recommendations

7.1 It is recommended that the Council;

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- a) notes the updated position with regard to the Project and requests tie to continue to seek an acceptable resolution with BSC if possible;
- b) notes that whilst no clear estimate of the cost of Phase 1a is available at this time due to uncertainty, Council officers and tie are examining all possible options for contingency funding and the possibility of incremental delivery;
- c) notes that in the event that an acceptable agreement cannot be reached, tie has carried out the necessary preparation should termination of the contract be the appropriate option; and
- d) notes that -changes to cost, programme or scope which emerge from the negotiations with BSC will be reported to Council prior to any commitment being made.

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a) _____

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Director of Finance

Appendices None

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Wards affected All

Single Outcome Agreement

Background Papers

Director's Name

Director of (Dept title but not using "Department")

Appendices 4

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Contact/tel/Email

Wards affected

Single Outcome Agreement

Background Papers

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