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DLA PIPER SCOTLAND LLP

REVIEW OF POINTS ARISING FROM THE CHALLENGE MEETING
on
17 AUGUST 2009

relating to

DISPUTE RESOLUTION PROCEDURE: CASE 5a

The status of the **tie** change order 111
and any consequence entitlements to additional payment and extension of time

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1. INTRODUCTION

This review note follows from the challenge session on Case 5a, 17 August 2009 with Brandon Nolan. With reference to existing noted advice and a further review of the contract documents, this note addresses a question concerning the proper effect of insufficient design work on an alleged Notified Departure.

This question shows up as two separate questions in the daily progress update. These are: whether Infraco can be held responsible for SDS breaches; and the definition of "Infraco" in Schedule part 4. For the avoidance of doubt, we are dealing with these as two parts of a single question, namely:

"Can inadequate design form the basis of a Notified Departure?"

The simplest review method will be to gather the points in favour of **tie** (ie to answer "no" to the above question) and then examine the points against.

2. THE POINTS IN FAVOUR OF TIE

As discussed at the Challenge Meeting, the above question sits in an area not expressly covered by the Position Paper for Case 5a as the stated **tie** position rests entirely on a positive identification of each stated element of INTC 111 as being normal design evolution. This conclusion is reached notwithstanding it is also **tie's** position that the submission for an alleged Notified Departure is insufficient. It is acknowledged that this positive identification alongside the alleged deficiency is not the easiest position to take, but **tie** have a strong view underlying that positive conclusion. That view acknowledges that correction of insufficient design is not normal design development. If the **tie** positive conclusion is correct, it is agreed that the above question therefore does not arise.

Although therefore not stated in the Position Paper, it is **tie's** position that there is no overlap between normal design evolution, an Infraco Change, Infraco breach and departures from the Base Case Assumptions which would properly justify a Notified Departure. That position arises squarely from the definition of Notified Departure (which excludes Infraco breach and Infraco Change) and the exclusion of normal design development in Pricing Assumption 1.

Then, addressing directly the question of whether an alleged Notified Departure is automatically disqualified where it rests on inadequate design. There are two steps to this:

2.1 Insufficient design amounts to failure by the designer - outside of very unusual circumstances (discounted here) where the Employer's Requirements somehow manage to retain some design risk and specify an insufficient design which a competent design consultant would not be expected to have spotted and warned. We have considered the question raised at Challenge, that there might be insufficient design requiring correction (as opposed to development) which is nevertheless not a designer failure. Given that Infraco did price the BDDI, we feel that there is no room for that contention in this case. Clause 3 of the SDS Appointment sets out the standard of care required of the designer at length and includes the essential requirements of skill and care, all without qualification;

2.2 SDS failure is Infraco failure - this relies on Clause 11.3 of the Infraco Contract conditions which requires that Infraco shall procure that the SDS Provider shall carry out and complete the SDS Services in accordance with the SDS Agreement.

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Additionally, Clause 11.4 sets out an obligation on Infraco to manage the performance of the SDS Services and (more importantly) goes on to provide that Infraco shall be wholly liable for the performance of the SDS Services.

We note that there is support in Counsel's advice for this argument to translate SDS failure into Infraco breach for the purposes of Schedule Part 4.

More fundamentally we need to consider Infraco's own design obligations in relation to the Infraco Works. This was not raised at the challenge meeting but is (or should be) a simpler **tie** argument because it does not rely on the translation of SDS failure into Infraco failure as set out above. In short, if Infraco are responsible for design of the works to at least the equivalent professional standard as is the designer and regardless of the separate obligation to procure and manage the work of the designer, then insufficient design amounts to a direct Infraco breach (automatically in almost all circumstances in our view, see above) which immediately takes us outside of the definition of Notified Departure.

Infraco's obligation to carry out and complete the design of the Infraco Works is derived from a reading of several provisions together, beginning with the core Infraco acceptance of full responsibility and agreement to carry out and complete the Infraco Works fully in accordance with the terms of the contract, then the definition of the Infraco Works, taking us to the definition of the Edinburgh Tram Network and the process obligations in Clause 10 for presentation and development of the design Deliverables. Counsel's opinion to date has also touched on design obligations of Infraco and he agrees by these means and others that Infraco are responsible for the design of the Infraco Works.

We should note here that the question of Infraco design responsibility and its effect on Infraco entitlement to submit for a Notified Departure, have already been aired in exchanges of papers in early 2009. In those exchanges Infraco have not denied their responsibility for design of the whole of the works nor their liability for any failure in that regard but they do still maintain an entitlement to compensation arising from a Notified Departure in this circumstance, but on other grounds, which we shall deal with in the next section.

3. THE POINTS AGAINST TIE

Looking first at the points related to the "translation" argument (SDS breach to Infraco breach) some of which were raised in the challenge meeting:

- It was suggested that Infraco failure does not in this Schedule Part 4 mean to include SDS failure, notwithstanding Clauses 11.3 and 11.4 of the Contract Conditions. In response, it is accepted that the Schedule, and in particular the Pricing Assumptions, do refer to the SDS Provider separately from Infraco, also that the Pricing Assumptions includes (3) "that the Deliverables prepared by the SDS Provider prior to the date of this Agreement comply with the Infraco Proposals and the Employer's Requirements." which does make it more likely to be decided that the parties did not intend for the purposes of recognising a Notified Departure, to treat SDS Provider failure as automatic Infraco breach and defeating the definition of Notified Departure. That said, the document is practical in its nature and to fulfil its function it does have to differentiate between Infraco and SDS Provider. Having reviewed it, each of those instances of differentiation is necessary for it to have meaning. Whilst acknowledging that it sets up a plain conflict with the intention of Clause 11.3 (Infraco to procure due performance by SDS) we remain of the view that SDS failure

would (on a straight balance of probability) be considered Infraco breach for the purposes of Schedule Part 4.

- It was also suggested that the parties in any event intended that insufficient design pre-contract and sitting within BDDI may form the basis of a Notified Departure, even if later SDS breach may not. It has to be acknowledged that the Infraco obligation in Clause 11.3 looks forward "the Infraco **shall** procure that the SDS Provider **shall** carry out and complete the SDS Services in accordance with the SDS Agreement". However the "deemed compliance" provision which completes Clause 11.3 is retrospective and the deemed compliance by Infraco in relation to its obligations in the Infraco Contract is limited only to the extent that SDS have carried out and completed their obligations under the SDS Agreement. Therefore, although there is here no express statement of liability for prior SDS failure, the limits on the Infraco "deemed compliance" provision indicates acceptance that there is such liability.

Moving to the second argument (direct Infraco failure in its design obligations), we note the last point above in relation to Infraco responsibility for the design of the whole of the works and not just for completing that design. We also note that Infraco's lawyers readily took the view that Infraco has such obligations in relation to design and that these obligations arise in respect of the whole of the works, whether or not carried out prior to the date of novation of the SDS Agreement. This is plainly stated in their paper although we have to note that they are entitled to change their position.

The stated position from Infraco is that liability for design is not to be confused with the cost and programme implications arising from a Notified Departure. They say that the issue of the quality/adequacy of the design is irrelevant to the question of whether or not there has been a Notified Departure, notwithstanding the definition of Notified Departure excludes Infraco breach. If we can follow the Infraco argument it seems to be that the occurrence of a Notified Departure is a question of fact (any of the Pricing Assumptions turning out not to be correct) giving rise to a Mandatory **tie** Change but this still does not address the fact that a Notified Departure is defined not only in terms of those differing facts and circumstances but expressly excluding Infraco breach (or change in law).

Having acknowledged that the Infraco obligations as to design extend to the period prior to novation, their paper states that, the risk of negligence by the SDS Provider, is a shared one and points to Compensation Events in clause 65 which also arise from SDS failure and which, they say, still provide relief to Infraco. This is a separate matter which we have looked at previously and have had Counsel's opinion on the DLA advice paper. Without digressing too much into other arguments, it is worthwhile summarising the position on Compensation Events in order to try to understand Infraco's statement on shared risk. We see a reading of the conditions which disallows relief for poor or (culpably) late design for the same reasons - that this amounts to breaches of Infraco direct design obligations and the obligation to procure SDS performance - and no relief can arise from Infraco breach. Counsel endorses that reading but we must acknowledge that it sets up a conflict with Compensation Events based on late and poor design. It is also different to the common understanding of the parties in final negotiations, (insofar as that could be understood in the very heavy negotiations on these points) which did anticipate that these Compensation Events would have meaning, as is also reflected in our contract reporting.

It likely remains Infraco's view that the risks of SDS failure are shared, either in full and immediate relief under clause 65 or, at the very least, as a second step to "top up"

compensation, following Infraco having sought recourse first from SDS and run up against the time and quality liability caps. These are arguments which will arise on other referrals but is useful that we try to understand Infraco's whole view of the philosophy relating to compensation and to acknowledge that, once expressed, it will be a respectable argument.

In any event, it is worth setting out the further paragraph from the Infraco paper in full:

> *"More fundamentally, however, the question of the Infraco's liabilities for failure to comply with its contractual obligations arises on breach. In other words, the question of any liability of the Infraco for defective design arises where the design itself is negligent and causes loss to* ***tie*** *or the design does not comply with the Employer's Requirements. This is of no relevance to the question of design, development and the evolution of design and the cost/program implications of Notified Departures (unless the underlying cause of the Notified Departure was the negligence of the Infraco in design of the Infraco Works). "*

We can only agree with these words. If there is a point in here, it may still be that the parties have agreed an express and exclusive remedy for **tie** in the event of SDS failure (direct recourse against SDS in the Collateral Warranty) as opposed to Infraco failure in design of the works. This argument operates outside of the assumption that SDS will provide the design the whole of the works. Infraco may be saying that, should they take over any of that function and carry out and complete the design (or some of it) by other means and if they fail in doing so then - and only then - would a Notified Departure be denied.

If this is the Infraco position on design inadequacies affecting Notified Departures, then we can expect it to be repeated, but, insofar as we can guess at it, it is a very narrow argument. Further, the exchange of papers was on general principles and Case 5a is about actual design work. There is no suggestion that SDS are not the sole designers of these works.

We have in this review covered the arguments surrounding the central question framed above, both as aired at the challenge meeting and in previous exchanges. We do not know whether any of these arguments will come into play in the resolution of Case 5A as they are not raised expressly as subsidiary questions in the dispute as framed and the **tie** position, as set out in its Position Paper remains wholly in terms of positive statements that the Infraco submission is in fact entirely based on normal design development. From the discussions at the challenge meeting, we expect that the stated **tie** position will remain that way rather than attempting to anticipate these arguments in the Position Paper. Subject to internal discussion of this paper and any further points raised at re-challenge, we concur with that approach.

DLA Piper
18 August 2009